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Whitestone REIT
Form 10-Q
August 09, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from _____ to _____

Commission file number 000-50256

WHITESTONE REIT

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or Other Jurisdiction of
Incorporation or Organization)

76-0594970

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

2600 South Gessner, Suite 500

Houston, Texas

(Address of Principal Executive Offices)

77063

(Zip Code)

(713) 827-9595

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

The issuer had the following numbers of shares outstanding, as of the latest practicable date:

Class	Outstanding as of August 2, 2012
Common Shares, \$0.001 par value	12,007,302 Shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Whitestone REIT and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Real estate assets, at cost		
Property	\$304,517	\$292,360
Accumulated depreciation	(48,999) (45,472
Total real estate assets	255,518	246,888
Cash and cash equivalents	3,863	5,695
Marketable securities	2,786	5,131
Escrows and acquisition deposits	3,767	4,996
Accrued rents and accounts receivable, net of allowance for doubtful accounts	6,727	6,053
Unamortized lease commissions and loan costs	4,495	3,755
Prepaid expenses and other assets	1,481	975
Total assets	\$278,637	\$273,493
LIABILITIES AND EQUITY		
Liabilities:		
Notes payable	\$140,051	\$127,890
Accounts payable and accrued expenses	7,034	9,017
Tenants' security deposits	2,393	2,232
Dividends and distributions payable	3,655	3,647
Total liabilities	153,133	142,786
Commitments and contingencies:	—	—
Equity:		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at June 30, 2012 and December 31, 2011, respectively	—	—
Class A common shares, \$0.001 par value per share; 50,000,000 shares authorized; 0 and 2,603,292 issued and outstanding as of June 30, 2012 and December 31, 2011, respectively	—	2
Class B common shares, \$0.001 par value per share; 350,000,000 shares authorized; 12,024,821 and 8,834,563 issued and outstanding as of June 30, 2012 and December 31, 2011, respectively	10	8
Additional paid-in capital	164,231	158,127
Accumulated other comprehensive loss	(497) (1,119
Accumulated deficit	(46,639) (41,060
Total Whitestone REIT shareholders' equity	117,105	115,958
Noncontrolling interest in subsidiary	8,399	14,749
Total equity	125,504	130,707
Total liabilities and equity	\$278,637	\$273,493

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Property revenues				
Rental revenues	\$8,523	\$6,705	\$16,651	\$13,376
Other revenues	2,464	1,365	4,762	2,780
Total property revenues	10,987	8,070	21,413	16,156
Property expenses				
Property operation and maintenance	2,759	1,998	5,111	3,952
Real estate taxes	1,503	1,108	2,813	2,128
Total property expenses	4,262	3,106	7,924	6,080
Other expenses (income)				
General and administrative	1,863	1,778	3,504	3,242
Depreciation and amortization	2,663	1,976	5,207	3,965
Interest expense	1,734	1,445	3,446	2,847
Interest, dividend and other investment income	(83)	(55)	(153)	(115)
Total other expense	6,177	5,144	12,004	9,939
Income (loss) before loss on disposal of assets and income taxes	548	(180)	1,485	137
Provision for income taxes	(70)	(58)	(135)	(111)
Loss on sale or disposal of assets	(16)	—	(28)	(18)
Net income (loss)	462	(238)	1,322	8
Less: Net income (loss) attributable to noncontrolling interests	31	(42)	98	1
Net income (loss) attributable to Whitestone REIT	\$431	\$(196)	\$1,224	\$7

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Basic and Diluted Earnings (Loss) Per Share:				
Net income (loss) attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.04	\$(0.02)	\$0.10	\$—
Weighted average number of common shares outstanding:				
Basic	11,746	8,520	11,685	7,008
Diluted	11,754	8,520	11,696	7,008
Distributions declared per common share / OP unit	\$0.2850	\$0.2850	\$0.5700	\$0.5700
Consolidated Statements of Comprehensive Income (Loss)				
Net income (loss)	\$462	\$(238)	\$1,322	\$8
Other comprehensive gain (loss)				
Unrealized gain (loss) on available-for-sale marketable securities	33	(209)	799	(209)
Comprehensive income (loss)	495	(447)	2,121	(201)
Less: Comprehensive income (loss) attributable to noncontrolling interests	30	(78)	157	(41)
Comprehensive income (loss) attributable to Whitestone REIT	\$465	\$(369)	\$1,964	\$(160)

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(Unaudited)
(in thousands)

	Class A Common Shares	Class B Common Shares	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity	Noncontrolling Interests	Total Equity			
	Shares	Amount	Shares	Amount	Capital	Deficit	Loss	Equity	Units	Dollars	Equity
Balance, December 31, 2011	2,603	\$2	8,835	\$8	\$158,127	\$(41,060)	\$(1,119)	\$115,958	1,361	\$14,749	\$130,707
Exchange of noncontrolling interest OP units and Class A common shares for Class B common shares	(2,605)	(2)	3,180	2	6,224	—	(118)	6,106	(575)	(6,106)	—
Exchange offer costs	—	—	—	—	(334)	—	—	(334)	—	—	(334)
Dividend reinvestment plan	—	—	3	—	45	—	—	45	—	—	45
Share-based compensation	2	—	7	—	169	—	—	169	—	—	169
Distributions	—	—	—	—	—	(6,803)	—	(6,803)	—	(401)	(7,204)
Unrealized gain on change in fair value of available-for-sale marketable securities	—	—	—	—	—	—	740	740	—	59	799
Net income	—	—	—	—	—	1,224	—	1,224	—	98	1,322
Balance June 30, 2012	—	\$—	12,025	\$10	\$164,231	\$(46,639)	\$(497)	\$117,105	786	\$8,399	\$125,504

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$1,322	\$8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,573	3,736
Amortization of deferred loan costs	634	229
Gain on sale of marketable securities	(32)	(38)
Loss on sale or disposal of assets	28	18
Bad debt expense	358	214
Share-based compensation	266	155
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	1,229	1,986
Accrued rents and accounts receivable	(1,064)	(544)
Unamortized lease commissions	(600)	(402)
Prepaid expenses and other assets	298	495
Accounts payable and accrued expenses	(1,917)	(1,758)
Tenants' security deposits	161	49
Net cash provided by operating activities	5,256	4,148
Cash flows from investing activities:		
Acquisitions of real estate	(6,400)	(8,650)
Additions to real estate	(6,465)	(2,066)
Investments in marketable securities	(750)	(10,461)
Proceeds from sales of marketable securities	3,926	909
Net cash used in investing activities	(9,689)	(20,268)
Cash flows from financing activities:		
Distributions paid to common shareholders	(6,684)	(3,737)
Distributions paid to OP unit holders	(559)	(1,030)
Proceeds from issuance of common shares	—	60,066
Payments of exchange offer costs	(306)	—
Proceeds from notes payable	13,156	2,905
Repayments of notes payable	(1,819)	(1,540)
Payments of loan origination costs	(1,187)	(359)
Net cash provided by financing activities	2,601	56,305
Net increase (decrease) in cash and cash equivalents	(1,832)	40,185
Cash and cash equivalents at beginning of period	5,695	17,591
Cash and cash equivalents at end of period	\$3,863	\$57,776

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)
 (in thousands)

	Six Months Ended June 30,	
	2012	2011
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$3,375	\$2,838
Cash paid for taxes	\$225	\$215
Non cash investing and financing activities:		
Disposal of fully depreciated real estate	\$523	\$21
Financed insurance premiums	780	649
Value of shares issued under dividend reinvestment plan	45	—
Accrued offering costs	28	305
Value of Class B shares exchanged for OP units	6,224	—
Change in fair value of available-for-sale securities	799	(209)

See accompanying notes to Consolidated Financial Statements

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2012
(Unaudited)

The use of the words “we,” “us,” “our,” “Company” or “Whitestone” refers to Whitestone REIT and our consolidated subsidiaries, except where the context otherwise requires.

1. INTERIM FINANCIAL STATEMENTS

The consolidated financial statements included in this report are unaudited; however, amounts presented in the consolidated balance sheet as of December 31, 2011 are derived from our audited consolidated financial statements as of that date. The unaudited financial statements as of June 30, 2012 have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information on a basis consistent with the annual audited consolidated financial statements and with the instructions to Form 10-Q.

The consolidated financial statements presented herein reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position of Whitestone and our subsidiaries as of June 30, 2012, and the results of operations for the three and six month periods ended June 30, 2012 and 2011, the consolidated statements of changes in equity for the six month period ended June 30, 2012 and cash flows for the six month periods ended June 30, 2012 and 2011. All of these adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of the results expected for a full year. The statements should be read in conjunction with the audited consolidated financial statements and the notes thereto which are included in our Annual Report on Form 10-K for the year ended December 31, 2011.

Business. Whitestone was formed as a real estate investment trust (“REIT”), pursuant to the Texas Real Estate Investment Trust Act on August 20, 1998. In July 2004, Whitestone changed its state of organization from Texas to Maryland. Whitestone serves as the general partner of Whitestone REIT Operating Partnership, L.P. (the “Operating Partnership”), which was formed on December 31, 1998 as a Delaware limited partnership. Whitestone currently conducts substantially all of its operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, Whitestone has the exclusive authority to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of June 30, 2012 and December 31, 2011, Whitestone owned and operated 46 and 45 commercial properties, respectively in and around Houston, Dallas, San Antonio, Chicago and Phoenix.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation. We are the sole general partner of the Operating Partnership and possess full legal control and authority over the operations of the Operating Partnership. As of June 30, 2012 and December 31, 2011, we owned a majority of the partnership interests in the Operating Partnership. Consequently, the accompanying consolidated financial statements include the accounts of the Operating Partnership. All significant inter-company balances have been eliminated. Noncontrolling interest in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income or loss is allocated to noncontrolling interests based on the weighted-average percentage ownership of the Operating Partnership during the period. Issuances of additional common shares of beneficial interest, par value \$0.001 per share, in Whitestone (the “common shares”) and units of limited partnership interest in the Operating Partnership that are convertible into cash or, at our option, common shares on a one-for-one basis (the “OP units”) changes the ownership interests of both the noncontrolling interests and Whitestone.

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Basis of Accounting. Our financial records are maintained on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when incurred.

Use of Estimates. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that we use include the estimated fair values of properties acquired, the estimated useful lives for depreciable and amortizable assets and costs, the estimated allowance for doubtful accounts and estimates supporting our impairment analysis for the carrying values of our real estate assets. Actual results could differ from those estimates.

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WHITESTONE REIT AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

(Unaudited)

Reclassifications. We have reclassified certain prior period amounts in the accompanying consolidated financial statements in order to be consistent with the current period presentation. These reclassifications had no effect on net income, total assets, total liabilities or equity.

Marketable Securities. We classify our existing marketable equity securities as available-for-sale in accordance with the Financial Accounting Standards Board's ("FASB") Investments-Debt and Equity Securities guidance. These securities are carried at fair value with unrealized gains and losses reported in equity as a component of accumulated other comprehensive income or loss. The fair value of the marketable securities is determined using Level 1 inputs under FASB Accounting Standards Codification ("ASC") 820, "Fair Value Measurements and Disclosures." Level 1 inputs represent quoted prices available in an active market for identical investments as of the reporting date. Gains and losses on securities sold are based on the specific identification method, and are reported as a component of interest, dividend and other investment income. We recognized gains on the sale of marketable securities of approximately \$31,000 and \$0 for the three months ended June 30, 2012 and 2011, respectively, and \$32,000 and \$38,000 for the six months ended June 30, 2012 and 2011, respectively. As of June 30, 2012, our investment in available-for-sale marketable securities was approximately \$2,786,000, which includes an aggregate unrealized loss of approximately \$530,000.

Development Properties. Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges and development costs. Carrying charges, primarily interest, real estate taxes and loan acquisition costs, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases when the property, or any completed portion, becomes available for occupancy. For the three months ended June 30, 2012, approximately \$44,000 and \$31,000 in interest expense and real estate taxes, respectively, were capitalized, and for the six months ended June 30, 2012, approximately \$88,000 and \$63,000 in interest expense and real estate taxes, respectively, were capitalized. No interest expense or real estate taxes were capitalized during the three or six months ended June 30, 2011.

Share-Based Compensation. From time to time, we award nonvested restricted common share awards or restricted common share unit awards, which may be converted into common shares, to executive officers and employees under our 2008 Long-Term Equity Incentive Ownership Plan (the "2008 Plan"). The vast majority of the awarded shares and units vest when certain performance conditions are met. We recognize compensation expense when achievement of the performance conditions is probable based on management's most recent estimates using the fair value of the shares as of the grant date. We recognized \$188,000 and \$77,000 in share-based compensation for the three months ended June 30, 2012 and 2011, respectively, and we recognized \$266,000 and \$155,000 in share-based compensation for the six months ended June 30, 2012 and 2011, respectively.

Noncontrolling Interests. Noncontrolling interests is the portion of equity in a subsidiary not attributable to a parent. The ownership interests not held by the parent are considered noncontrolling interests. Accordingly, we have reported noncontrolling interests in equity on the consolidated balance sheets but separate from Whitestone's equity. On the consolidated statements of operations, subsidiaries are reported at the consolidated amount, including both the amount attributable to Whitestone and noncontrolling interests. Consolidated statements of changes in equity are included for quarterly financial statements, including beginning balances, activity for the period and ending balances for shareholders' equity, noncontrolling interests and total equity.

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See our Annual Report on Form 10-K for the year ended December 31, 2011 for further discussion on significant accounting policies.

Recent Accounting Pronouncements. There are no new unimplemented accounting pronouncements that are expected to have a material impact on our results of operations, financial position or cash flows.

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WHITESTONE REIT AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

(Unaudited)

3. MARKETABLE SECURITIES

All of our marketable securities were classified as available-for-sale securities as of June 30, 2012 and December 31, 2011. Available-for-sale securities consisted of the following (in thousands):

	June 30, 2012	Gains in Accumulated Other Comprehensive Income	Losses in Accumulated Other Comprehensive Income	Estimated Fair Value
	Amortized Cost			
Real estate common stock	\$ 3,316	\$9,407		

Note 9 -**Federal Income Taxes**

Federal income taxes are not provided because we intend to and believe we qualify as a REIT under the provisions of the Internal Revenue Code. Our shareholders include their proportionate taxable income in their individual tax returns. As a REIT, we must distribute at least 90% of our ordinary taxable income to our shareholders and meet certain income sources and investment restriction requirements. In addition, REITs are subject to a number of organizational and operational requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate tax rates.

Taxable income differs from net income for financial reporting purposes principally due to differences in the timing of recognition of interest, real estate taxes, depreciation and rental revenue.

Note 10 -**Related-Party Transactions**

Prior to October 2006, our day-to-day operations and portfolio of properties were managed by Hartman Management through property management and advisory agreements. Mr. Hartman, our former President, Secretary, Chief Executive Officer, and Chairman of the Board, is the sole limited partner of Hartman Management, as well as the president, secretary, sole trustee and sole shareholder of the general partner of Hartman Management.

WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 10 - Related-Party Transactions (Continued)

Mr. Hartman was removed by our Board as our President, Secretary, and Chief Executive Officer on October 2, 2006, and he resigned from our Board on October 27, 2006.

In October 2006, our Board terminated for cause our property management agreement with Hartman Management. Hartman Management turned over all property management functions to us on November 14, 2006.

In addition, our Board elected not to renew our advisory agreement, dated August 31, 2004, with Hartman Management. This agreement had been extended on a month-to-month basis and ultimately expired on September 30, 2006.

Transactions between us, Hartman Management, and Mr. Hartman are considered related party transactions and are discussed in the following paragraphs.

In January 1999, we entered into a property management agreement with Hartman Management. Effective September 1, 2004, this agreement was amended and restated. Prior to September 1, 2004, in consideration for supervising the management and performing various day-to-day affairs, we paid Hartman Management a management fee of 5% and a partnership management fee of 1% based on effective gross revenues from the properties, as defined in the agreement. After September 1, 2004, we paid Hartman Management property management fees in an amount not to exceed the fees customarily charged in arm's length transactions by others rendering similar services in the same geographic area, as determined by a survey of brokers and agents in that area. These fees have ranged between approximately 2% and 4% of gross revenues (as defined in the amended and restated agreement) for the management of office buildings and approximately 5% of gross revenues for the management of retail and warehouse properties.

Effective September 1, 2004, we entered into an advisory agreement with Hartman Management which provided that we pay Hartman Management a quarterly fee of one-fourth of .25% of gross asset value (as defined in the advisory agreement) for asset management services. In addition, the advisory agreement provided for the payment of a deferred performance fee, payable in certain events, including termination of the advisory agreement, based upon appreciation in the value of certain of our real estate assets. The advisory agreement expired by its terms on September 30, 2006.

We incurred total management, partnership and asset management fees of \$0.4 million and \$0.8 million, under the advisory and management agreements for the three and six months ended June 30, 2006. We incurred no such fee for the three months ended June 30, 2007. No management fees were payable at June 30, 2007 or December 31, 2006. We have not accrued any deferred performance fees, as we believe the amount of these fees, if any are owing, cannot be determined with reasonable certainty at this time.

The aggregate fees and reimbursements payable to Hartman Management under the advisory agreement was not intended to be significantly different from the fees that would have been payable under our previous agreement with Hartman Management. The asset management fee under the advisory agreement, however, was significantly higher. Hartman Management waived the excess of the fee for the period September 1, 2004 through March 31, 2006 in perpetuity. The asset management fee under the advisory agreement was charged by Hartman Management in the second and third quarters of 2006 and was reflected in our consolidated financial statements as of December 31, 2006. No such fee was charged for the three months or six months ended June 30, 2007.

During July 2004, we amended certain terms of our declaration of trust. Under the amended terms, Hartman Management was required to reimburse us for operating expenses exceeding certain limitations determined at the end

of each fiscal quarter. Reimbursements, if any, from Hartman Management were recorded on a quarterly basis as a reduction in property management fees.

WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 10 - Related-Party Transactions (Continued)

Under the provisions of the management agreement, costs incurred by Hartman Management for the management and maintenance of the properties were reimbursable to Hartman Management. No such amounts were payable at June 30, 2007 and December 31, 2006.

In consideration of leasing the properties, we historically paid Hartman Management leasing commissions for leases originated by Hartman Management and for expansions and renewals of existing leases. We incurred total leasing commissions to Hartman Management of \$0.2 million and \$0.6 million for the three and six months ended June 30, 2006. No such fees were incurred for the three and six months ended June 30, 2007. No such amounts were payable at June 30, 2007 and December 31, 2006.

In connection with our public offering described in Note 11, we have reimbursed Hartman Management up to 2.5% of the gross selling price of all common shares sold for organization and offering expenses (excluding selling commissions and a dealer manager fee) incurred by Hartman Management on our behalf. We have paid our dealer manager, through Hartman Management by agreement between them, a fee of up to 2.5% of the gross selling price of all common shares sold in the offering. We incurred total fees of \$0.1 million and \$0.3 million for the three and six months ended June 30, 2006. No such fees were incurred for the three or six months ended June 30, 2007. These fees have been treated as offering costs and netted against the proceeds from the sale of common shares. On October 2, 2006, our Board elected to terminate the public offering described in Note 11.

Also in connection with our public offering described in Note 11, Hartman Management has historically received an acquisition fee equal to 2% of the gross selling price of all common shares sold for services in connection with the selection, purchase, development or construction of properties for us. The advisory agreement expired by its terms on September 30, 2006. On September 30, 2006, \$0.2 million of acquisition fees paid to Hartman Management had been capitalized and not yet allocated to the purchase price of a property. In accordance with advisory agreement, Hartman Management is obligated to reimburse us for any acquisition fee that has not been allocated to the purchase price of our properties as provided for in our declaration of trust. A letter demanding payment was sent to Hartman Management on December 21, 2006, and \$0.2 million is included in other receivables on our consolidated balance sheet at June 30, 2007 as reclassified from December 31, 2006 as described in Note 1 - *Reclassification*.

We incurred total acquisition fees to Hartman Management of \$0.1 million for both the three and six months ended June 30, 2006. No such fees were incurred for the three and six months ended June 30, 2007. No such amounts were payable at June 30, 2007 and December 31, 2006.

Hartman Management was billed \$0.03 million and \$0.02 million for office space for the three months ended June 30, 2007 and 2006, respectively, and \$0.06 million and \$0.05 for the six months ended June 30, 2007 and 2006, respectively. These amounts are included in rental income in our consolidated statements of operations.

Substantially all of our business is conducted through the Operating Partnership. We are the sole general partner of the Operating Partnership. As of June 30, 2007, we owned a 62.4% interest in the Operating Partnership.

Mr. Hartman our former President, Secretary, Chief Executive Officer, and Chairman was owed \$0.04 million in dividends payable on his common shares at June 30, 2007 and December 31, 2006. Mr. Hartman owned 2.9% of our issued and outstanding common shares as of June 30, 2007 and December 31, 2006.

We were a party to various other transactions with related parties which are reflected in due to/from affiliates in the accompanying consolidated balance sheets and also disclosed in Notes 7 and 11.

WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 11 -

Shareholders' Equity

Under our declaration of trust, we have authority to issue 400 million common shares of beneficial interest, \$0.001 par value per share, and 50 million preferred shares of beneficial interest, \$0.001 par value per share.

On September 15, 2004, our Registration Statement on Form S-11, with respect to our public offering of up to 10 million common shares of beneficial interest offered at a price of \$10 per share was declared effective under the Securities Act of 1933. The Registration Statement also covered up to 1 million shares available pursuant to our dividend reinvestment plan offered at a price of \$9.50 per share. The shares were offered to investors on a best efforts basis. Post-Effective Amendments No. 1, 2 and 3 to the Registration Statement were declared effective by the SEC on June 27, 2005, March 9, 2006 and May 3, 2006, respectively.

On October 2, 2006, our Board terminated the public offering. On March 27, 2007, we gave the required ten day notice to participants informing them that we intend to terminate our dividend reinvestment plan. As a result, our dividend reinvestment plan terminated on April 6, 2007.

As of June 30, 2007, 2.8 million shares had been issued pursuant to our public offering with net offering proceeds received of \$24.6 million. An additional 165,000 shares had been issued pursuant to the dividend reinvestment plan in lieu of dividends totaling \$1.6 million. Shareholders that received shares pursuant to our dividend reinvestment plan on or after October 2, 2006 may have rescission rights.

At June 30, 2007 and December 31, 2006, Mr. Hartman owned 2.9% of our outstanding shares. At June 30, 2007 and December 31, 2006, our Board collectively owned 2.6% of our outstanding shares.

All net proceeds of our public offering were contributed to the Operating Partnership in exchange for OP Units. The Operating Partnership used the proceeds to acquire additional properties and for general working capital purposes. In accordance with the Operating Partnership's Agreement of Limited Partnership, in exchange for the contribution of net proceeds from sales of stock, we received an equivalent number of OP Units as shares of stock that are sold.

Operating Partnership Units

Limited partners in the Operating Partnership holding OP Units have the right to convert their OP Units into common shares at a ratio of one OP Unit for one common share. Distributions to OP Unit holders are paid at the same rate per unit as dividends per share of Whitestone. Subject to certain restrictions, OP Units are not convertible into common shares until the later of one year after acquisition or an initial public offering of the common shares. As of June 30, 2007 and December 31, 2006, there were 15,448,118 and 15,421,212 OP Units outstanding, respectively. We owned 9,639,781 and 9,612,875 OP Units as of June 30, 2007 and December 31, 2006, respectively. The balance of the OP Units is owned by third parties, including Mr. Hartman and certain trustees. Our weighted-average share ownership in the Operating Partnership was approximately 62.40%, and 61.41% for the three months ended June 30, 2007 and 2006, respectively, and 62.39% and 60.90% for the six months ended June 30, 2007 and 2006, respectively. At June 30, 2007 and December 31, 2006, Mr. Hartman owned 6.9% of the Operating Partnership's outstanding units. At June 30, 2007 and December 31, 2006, our Board collectively owned 0.4% of the Operating Partnership's outstanding units.

WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 11 -

Shareholders' Equity (Continued)

Dividends and distributions

The following tables summarize the cash dividends/distributions paid or payable to holders of common shares and holders of OP Units (after giving effect to the recapitalization) during the year ended December 31, 2006 and the quarters ended March 31, 2007, June 30, 2007 and September 30, 2007.

Whitestone Shareholders

Dividend per Common Share	Date Dividend Paid	Total Amount Paid (in thousands)
\$ 0.1768	Qtr ended 03/31/06	\$ 1,526
\$ 0.1768	Qtr ended 06/30/06	\$ 1,632
\$ 0.1500	Qtr ended 09/30/06	\$ 1,443
\$ 0.1500	Qtr ended 12/31/06	\$ 1,477
\$ 0.1500	Qtr ended 03/31/07	\$ 1,495
\$ 0.1500	Qtr ended 06/30/07	\$ 1,487
\$ 0.1500	Qtr ended 09/30/07	\$ 1,500

OP Unit Holders Including Minority Unit Holders

Distribution per OP Unit	Date Distribution Paid	Total Amount Paid (in thousands)
\$ 0.1768	Qtr ended 03/31/06	\$ 2,488
\$ 0.1768	Qtr ended 06/30/06	\$ 2,594
\$ 0.1500	Qtr ended 09/30/06	\$ 2,260
\$ 0.1500	Qtr ended 12/31/06	\$ 2,294
\$ 0.1500	Qtr ended 03/31/07	\$ 2,314
\$ 0.1500	Qtr ended 06/30/07	\$ 2,316
\$ 0.1500	Qtr ended 09/30/07	\$ 2,317

WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 12 - Commitments and Contingencies

The nature of our business exposes us to the risk of lawsuits for damages or penalties relating to, among other things, breach of contract and employment disputes. We are currently involved in the following litigation.

Hartman Commercial Properties REIT and Hartman REIT Operating Partnership, L.P. v. Allen R. Hartman and Hartman Management, L.P., in the 333rd Judicial District Court of Harris County, Texas

In October 2006, we initiated this action against our former Chief Executive Officer, Allen R. Hartman, and our former manager and advisor Hartman Management, L.P. We are seeking damages for breach of contract, fraudulent inducement and breach of fiduciary duties.

In November 2006, Mr. Hartman and Hartman Management filed a counterclaim against us, the members of our Board, and our Chief Operating Officer, John J. Dee. The counterclaim has since been amended to drop the claims against the individual defendants with the exception our current interim Chief Executive Officer, James C. Mastandrea, and Mr. Dee. The amended counterclaim asserts claims against us for alleged breach of contract and alleges that we owe Mr. Hartman and Hartman Management fees for the termination of an advisory agreement. The amended counterclaim asserts claims against Messrs. Mastandrea and Dee for tortious interference with the advisory agreement and a management agreement and conspiracy to seize control of us for their own financial gains. We have indemnified Messrs. Mastandrea and Dee to the extent allowed by our governing documents and Maryland law. The amended counterclaim also asserts claims against our prior outside law firm and one of its partners. Recently, Hartman has nonsuited without prejudice our prior outside law firm and its partner. Limited discovery has been conducted in this case as of the date of this report

It is too early to express an opinion respecting the likelihood of an adverse outcome on the counterclaim, although we intend to vigorously defend against those claims and vigorously prosecute our affirmative claims.

Hartman Commercial Properties REIT v. Allen R. Hartman, et al; in the United States District Court for the Southern District of Texas

In December 2006, we initiated this action complaining of the attempt by Mr. Hartman and Hartman Management to solicit written consents from shareholders to replace our Board.

Mr. Hartman and Hartman Management filed a counterclaim claiming that certain changes to our bylaws and declaration of trust are invalid and that their enactment is a breach of fiduciary duty. They were seeking a declaration that the changes to our bylaws and declaration of trust are invalid and an injunction barring their enforcement. These changes, among other things, stagger the terms of our Board members over three years, require two-thirds vote of the outstanding common shares to remove a Board member and provide that our secretary may call a special meeting of shareholders only on the written request of a majority of outstanding common shares. A group of shareholders filed a request to intervene in this action seeking to assert claims similar to those of Mr. Hartman and Hartman Management. We opposed the intervention.

Both parties have filed Motions for Temporary Injunction. The REIT sought to prevent Mr. Hartman's continued attempts to solicit written consents to replace our Board and Hartman sought to prohibit the changes in the REIT's bylaws described above. On April 6, 2007, the trial Court granted our Motion for Temporary Injunction and denied the Motion for Temporary Injunction filed by Hartman. The Court found that the changes to the bylaws and declaration of trust were valid. The Court granted our Motion to Dismiss, dismissing many of Hartman and Hartman

Management's claims. After the ruling, the group of shareholders who were seeking to intervene dismissed their intervention.

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WHITESTONE REIT AND SUBSIDIARY
Notes to Consolidated Financial Statements
June 30, 2007

Note 12 - Commitments and Contingencies (Continued)

Hartman and Hartman Management have appealed the Court's ruling on an expedited basis and Oral Argument for this appeal was on August 8, 2007. As of the date of this report the court has not yet issued a decision.

The discovery conducted in this case has been limited to issues relevant to the change in the REIT's bylaws. Documents were produced and interrogatory responses exchanged. We produced the members of our Board and Mr. Dee for deposition and also took the deposition of Mr. Hartman.

Because of the pending Appeal, it is too early to express an opinion concerning the likelihood of an adverse outcome on the counterclaim, although we intend to vigorously defend against those claims and vigorously prosecute our affirmative claim.

Other

We are a participant in various other legal proceedings and claims that arise in the ordinary course of our business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, we believe that the final outcome of these matters will not have a material effect on our financial position, results of operations, or cash flows.

Note 13 - Segment Information

Our management historically has not differentiated results of operations by property type nor location and therefore does not present segment information.

Unless the context otherwise requires, all references in this report to “Whitestone,” “we,” “us” or “our” are to Whitestone REIT and our subsidiary.

Forward-Looking Statements

This quarterly report contains forward-looking statements, including discussion and analysis of our financial condition, anticipated capital expenditures required to complete projects, amounts of anticipated cash distributions to our shareholders in the future and other matters. These forward-looking statements are not historical facts but are the intent, belief or current expectations of our management based on its knowledge and understanding of our business and industry. Forward-looking statements are typically identified by the use of terms such as “may,” “will,” “should,” “potential,” “predicts,” “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates” or the negative of such variations of these words and similar expressions. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. You are cautioned to not place undue reliance on forward-looking statements, which reflect our management’s view only as of the date of this Form 10-Q. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. Factors that could cause actual results to differ materially from any forward-looking statements made in this Form 10-Q include:

- changes in general economic conditions;
 - changes in real estate conditions;
- construction costs that may exceed estimates;
 - construction delays;
 - increases in interest rates;
 - litigation risks;
 - lease-up risks;
- inability to obtain new tenants upon the expiration of existing leases; and
- the potential need to fund tenant improvements or other capital expenditures out of operating cash flow.

The forward-looking statements should be read in light of these factors and the factors identified in the “Risk Factors” sections of our Form 10-K and our Registration Statement on Form S-11, as amended, as previously filed with the Securities and Exchange Commission.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion of our financial condition and results of operations in conjunction with our financial statements and the notes thereto included in this report. For more detailed information regarding the basis of presentation for the following information, you should read the notes to the consolidated financial statements included in this report.

Overview and Outlook

We own 36 commercial properties, consisting of 19 retail centers, 11 warehouse properties and 6 office buildings. All of our properties are located in the Houston, Dallas and San Antonio, Texas metropolitan areas. As of June 30, 2007, we had 706 total tenants. No individual lease or tenant is material to our business. Revenues from our largest lease constituted 1.58% and 2.19% of our total revenues for the three and six months ended June 30, 2007. Lease terms for our properties range from one year for our smaller tenants to over ten years for larger tenants. Our leases generally include minimum monthly lease payments and tenant reimbursements for payment of taxes, insurance and maintenance.

Since November 14, 2006, we have operated as a self-managed and self-administered REIT. As of June 30, 2007, we had 50 full-time employees. We believe that our current staffing level is sufficient to effectively manage our property portfolio for the foreseeable future. As a self-managed REIT, we bear our own expenses of operations, including the salaries, benefits and other compensation of our employees, office expenses, legal, accounting and investor relations expenses and other overhead. In the short term, we believe expenses will be higher than normal due to legal expenses associated with the litigation with Mr. Hartman and Hartman Management, LP. In the future, we believe that our operations will be more effective and efficient than they were when we were externally managed and our operating margins will improve as a result.

Prior to November 14, 2006, our properties and day-to-day operations were managed by Hartman Management, our former advisor and manager under an advisory agreement and a management agreement. Our advisory agreement expired at the end of September 2006 and our Board terminated our property management agreement for cause in October 2006. Hartman Management turned over all property management functions to us on November 14, 2006.

Under our management agreement in effect until November 14, 2006, we paid Hartman Management the following:

- Property management fees in an amount not to exceed the fees customarily charged in arm's length transactions by others rendering similar services in the same geographic area for similar properties as determined by a survey of brokers and agents in that area. Generally, these fees were between approximately two percent (2.0%) and four percent (4.0%) of gross revenues for the management of office buildings and approximately five percent (5.0%) of gross revenues for the management of retail and warehouse properties.
- For the leasing of the properties, a separate fee for the leases of new tenants and renewals of leases with existing tenants in an amount not to exceed the fee customarily charged in arm's length transactions by others rendering similar services in the same geographic area for similar properties as determined by a survey of brokers and agents in that area (with these fees, being equal to 6% of the effective gross revenues from leases originated by Hartman Management and 4% of the effective gross revenues from expansions or renewals).
- Except as otherwise specifically provided, all costs and expenses incurred by Hartman Management in fulfilling its duties for the account of and on behalf of us. These costs and expenses were to include the wages and salaries and other employee-related expenses of all on-site and off-site employees of Hartman Management who were engaged in the operation, management, maintenance and leasing or access control of our properties, including taxes, insurance and benefits relating to these employees, and legal, travel and other out-of-pocket expenses that are

directly related to the management of specific properties.

Gross revenues were defined as all amounts actually collected as rents or other charges for the use and occupancy of our properties, but excluded interest and other investment income and proceeds received for a sale, exchange, condemnation, eminent domain taking, casualty or other disposition of assets.

Under our advisory agreement in effect until September 30, 2006, we paid Hartman Management a quarterly fee for asset management services in an amount equal to one-fourth of 0.25% of the gross asset value calculated on the last day of each preceding quarter. Gross asset value is defined as the amount equal to the aggregate book value of our assets (other than investments in bank accounts, money market funds or other current assets), before depreciation, bad debts or other similar non-cash reserves and without reduction for any debt relating to our assets, at the date of measurement, except that during these periods in which we are obtaining regular independent valuations of the current value of our net assets for purposes of enabling fiduciaries of employee benefit plans to comply with applicable Department of Labor reporting requirements, gross asset value was the greater of (i) the amount determined pursuant to the foregoing or (ii) our assets' aggregate valuation established by the most recent valuation report without reduction for depreciation, bad debts or other similar non-cash reserves and without reduction for any debt relating to our assets.

The aggregate fees and reimbursements payable to Hartman Management under our advisory agreement was not intended to be significantly different from the fees and reimbursements that would have been payable under our previous agreement with Hartman Management. The asset management fee under our advisory agreement, however, was significantly higher. Hartman Management waived the excess of the fee for the period September 1, 2004 through March 31, 2006 in perpetuity. The asset management fee payable under our advisory agreement was charged by Hartman Management in the second and third quarters of 2006 and was reflected in our consolidated financial statements as of December 31, 2006. The asset management fee was not charged after the third quarter of 2006 as the advisory agreement expired on September 30, 2006.

The advisory agreement provided for the payment of a deferred performance fee, payable upon certain events, including termination of the agreement. This fee is based upon appreciation in the value of certain of our real estate assets. We have not accrued any deferred performance fees, as we believe the amount of these fees, if any are owing, cannot be determined with reasonable certainty at this time. Hartman Management has asserted that approximately \$17 to \$25 million is owed in deferred performance fees plus \$8 million in attorney's fees is due under our advisory agreement. We believe that there is no reasonable basis for this assertion. Although we currently estimate that no deferred performance fee is owed, there can be no assurance that our view will ultimately prevail. If Hartman Management is awarded a deferred performance fee it may have a material adverse effect on our financial condition and results of operations.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements. We prepared these financial statements in conformity with U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements required us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances. Our results may differ from these estimates. Currently, we believe that our accounting policies do not require us to make estimates using assumptions about matters that are highly uncertain. You should read Note 1, Summary of Significant Accounting Policies, to our consolidated financial statements in conjunction with this *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

We have described below the critical accounting policies that we believe could impact our consolidated financial statements most significantly.

Basis of Consolidation. We are the sole general partner of the Operating Partnership and possess full legal control and authority over its operations. As of June 30, 2007, we owned a majority of the partnership interests in the Operating Partnership. Consequently, our consolidated financial statements include the accounts of the Operating Partnership. All significant inter-company balances have been eliminated. Minority interest in the accompanying consolidated

financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income (loss) is allocated to minority interests based on the weighted-average percentage ownership of the Operating Partnership during the year. Issuance of additional common shares and Operating Partnership units changes our ownership interests as well as those of minority interests.

Real Estate Valuation. We record real estate properties at cost, net of accumulated depreciation. We capitalize improvements, major renovations and certain costs directly related to the acquisition, improvement and leasing of real estate. We charge expenditures for repairs and maintenance to operations as they are incurred. We calculate depreciation using the straight-line method over the estimated useful lives of 5 to 39 years of our buildings and improvements. We depreciate tenant improvements using the straight-line method over the life of the lease.

We review our properties for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through our operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, we record a loss for the amount by which the carrying value of the property exceeds its fair value. We currently are reviewing our properties and therefore have made no adjustment for any potential impairment in the carrying value of our real estate assets as of June 30, 2007.

Real Estate Acquisitions. We account for real estate acquisitions pursuant to Statement of Financial Accounting Standards No. 141 “*Business Combinations.*” Accordingly, we allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, and legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.

Revenue Recognition. All leases on properties we hold are classified as operating leases, and we recognize the related rental income on a straight-line basis over the terms of the related leases. We capitalize or charge to accrued rent receivable, as applicable, differences between rental income earned and amounts due per the respective lease agreements. Percentage rents are recognized as rental income when the thresholds upon which they are based have been met. Recoveries from tenants for taxes, insurance, and other operating expenses are recognized as revenues in the period the corresponding costs are incurred. We provide an allowance for doubtful accounts against the portion of tenant accounts receivable which we estimate to be uncollectible.

Liquidity and Capital Resources

General. We generally lease our properties on a triple-net basis or on a basis that provides for tenants to pay for increases in operating expenses over a base year or set amount. During the six months ended June 30, 2007, our cash used in operating activities was \$0.4 million and our total distributions were \$4.7 million. Therefore we had a cash flow shortage of approximately \$5.1 million. We funded this shortage from cash by borrowing from our KeyBank credit facility and our Windsor Park Centre mortgage loan. During the first six months of 2007, we incurred approximately \$1.2 million in legal costs as a result of the termination of the management and advisory agreements, the termination of Mr. Hartman as President, Secretary and Chief Executive Officer and the litigation with Mr. Hartman and Hartman Management. We do not know when this litigation will be fully resolved, although we are very pleased with the recent favorable ruling by the Federal Court. The continued legal cost associated with this litigation may have a significant impact on our cash flow. We anticipate that cash flows from operating activities and our borrowing capacity will provide adequate capital for our working capital requirements, anticipated capital expenditures, litigation costs and scheduled debt payments during the next twelve months. We also believe that cash flows from operating activities and our borrowing capacity will allow us to make all distributions required for us to continue to qualify to be taxed as a REIT.

Cash and Cash Equivalents. We had cash and cash equivalents of \$11.7 million at June 30, 2007, as compared to \$8.3 million on December 31, 2006. The increase was primarily the result of the following:

- Proceeds of approximately \$4.0 million from our KeyBank Credit facility.
- Net proceeds of approximately \$4.7 million from the refinancing of our Windsor Park Centre property.
 - Cash used for dividend and distribution payments of \$4.7 million
 - Improvements to real estate of \$0.7 million

We place all cash in short-term, highly liquid investments that we believe provide appropriate safety of principal.

Our Debt for Borrowed Money. As of June 30, 2007 we had two active loans which are described below:

Revolving Credit Facility

We have a revolving credit facility with a consortium of banks. The credit facility is secured by a pledge of the partnership interests in WROP III, a wholly owned subsidiary of the Operating Partnership that was formed to hold title to the properties comprising the borrowing base pool for the facility. At June 30, 2007, 35 properties are owned by WROP III.

In 2006, the credit facility was increased to \$75 million from \$50 million, and may be increased to \$100 million as the borrowing base pool expands. We entered into this credit facility to refinance our then existing debt, to finance property acquisitions and for general corporate purposes.

As of June 30, 2007 and December 31, 2006, the balance outstanding under the credit facility was \$65.2 million and \$61.2 million, respectively, and the availability for additional borrowings was \$9.8 million and \$13.8 million, respectively.

Outstanding amounts under the credit facility accrue interest computed (at our option) at either the LIBOR or the Alternative Base Rate on the basis of a 360 day year, plus the applicable margin as determined from the following table:

Total Leverage Ratio	LIBOR Margin	Alternative Base Rate Margin
Less than 60% but greater than or equal to 50%	2.40%	1.150%
Less than 50% but greater than or equal to 45%	2.15%	1.025%
Less than 45%	1.90%	1.000%

The Alternative Base Rate is a floating rate equal to the higher of the bank's base rate or the Federal Funds Rate plus 0.5%. LIBOR Rate loans are available in one, two, three or nine month periods, with a maximum of nine contracts at any time. The effective interest rate as of June 30, 2007 was 7.28% per annum.

Interest only is payable monthly under the loan with the total amount of principal due at maturity on March 11, 2008. The loan may be prepaid at any time in part or in whole, provided that the credit facility is not in default. If LIBOR pricing is elected, there is a prepayment penalty based on a “make-whole” calculation for all costs associated with prepaying a LIBOR borrowing.

As of March 31, 2007, we are in violation of a loan covenant which provides that the ratio of declared dividends to funds from operations (as defined in the loan agreement) shall not be greater than 95%. We have requested a waiver from the consortium of banks. We received approval from the bank group in May and are in the process of formalizing this agreement.

On January 8, 2007, we requested that legal fees incurred in connection with the litigation with Mr. Hartman and Hartman Management be excluded from the definition of funds from operations in testing the covenant requiring the ratio of declared and paid dividends to funds from operations not be in excess of 95%. On January 23, 2007, the lenders granted the exclusion as requested. On March 26, 2007, we formalized this agreement in Amendment No. 3 to our Revolving Credit Agreement which was filed with our 2006 Form 10-K

In October 2006, our Board (i) elected not to renew our advisory agreement with Hartman Management, (ii) terminated our property management agreement with Hartman Management; and (iii) removed Mr. Hartman from his positions as our President, Secretary and Chief Executive Officer. These actions violated certain covenants in the loan agreement and were events of default thereunder. These events of default have been waived by the lenders.

The revolving credit facility is supported by a pool of eligible properties referred to as the borrowing base pool. The borrowing base pool must meet the following criteria:

- We will provide a negative pledge on the borrowing base pool and may not provide a negative pledge of the borrowing base pool to any other lender.
 - The properties will be free of all liens, unless otherwise permitted.
- All eligible properties will be retail, office-warehouse, or office properties, will be free and clear of material environmental concerns and will be in good repair.
 - The aggregate physical occupancy of the borrowing base pool will remain above 80% at all times.
 - No property may comprise more than 15% of the value of the borrowing base pool with the exception of Corporate Park Northwest, which is allowed into the borrowing base pool.
 - The borrowing base pool will at all times be comprised of at least 10 properties.
 - The borrowing base pool properties may not contain development or redevelopment projects.

Properties can be added to and removed from the borrowing base pool at any time provided no defaults would occur as a result of a removal. If a property does not meet the criteria of an eligible property and we want to include it in the borrowing base pool, a majority vote of the bank consortium is required.

Covenants, tested quarterly, relative to the borrowing base pool are as follows:

- We will not permit any liens on the properties in the borrowing base pool unless otherwise permitted.
- The ratio of aggregate net operating income from the borrowing base pool to debt service shall at all times exceed 1.5 to 1.0. For any quarter, debt service shall be equal to the average loan balance for the past quarter times an interest rate which is the greater of (a) the then current annual yield on 10 year United States Treasury notes over 25 years plus 2%; (b) a 6.5% constant; or (c) the actual interest rate for the facility.
- The ratio of the value of the borrowing base pool to total funded loan balance must always exceed 1.67 to 1.00. The value of the borrowing base pool is defined as aggregate net operating income for the preceding four quarters, less a \$0.15 per square foot per annum capital expenditure reserve, divided by a 9.25% capitalization rate.

Covenants, tested quarterly, relative to us are as follows:

- We will not permit our total indebtedness to exceed 60% of the fair market value of our real estate assets at the end of any quarter. Total indebtedness is defined as all our liabilities, including this facility and all other secured and unsecured debt, including letters of credit and guarantees. Fair market value of real estate assets is defined as aggregate net operating income for the preceding four quarters, less a \$0.15 per square foot per annum capital expenditure reserve, divided by a 9.25% capitalization rate.

- The ratio of consolidated rolling four-quarter earnings before interest, income tax, depreciation and amortization expenses to total interest expense, including capitalized interest, shall not be less than 2.0 to 1.0.
- The ratio of consolidated earnings before interest, income tax, depreciation and amortization expenses to total interest, including capitalized interest, principal amortization, capital expenditures and preferred stock dividends shall not be less than 1.5 to 1.0. Capital expenditures shall be deemed to be \$0.15 per square foot per annum.
 - The ratio of secured debt to fair market value of real estate assets shall not be greater than 40%.
 - The ratio of declared dividends to funds from operations shall not be greater than 95%.
- The ratio of development assets to fair market value of real estate assets shall not be greater than 20%.
 - We must maintain our status as a REIT for income tax purposes.
- Total other investments shall not exceed 30% of total asset value. Other investments shall include investments in joint ventures, unimproved land, marketable securities and mortgage notes receivable. Additionally, the preceding investment categories shall not comprise greater than 30%, 15%, 10% and 20%, respectively, of total other investments.

Within six months of closing, we were required to hedge all variable rate debt above \$40 million until the point at which the ratio of variable rate debt to fixed rate debt is 50% of total debt. Thereafter, we must maintain this type of hedge during any period in which variable rate debt exceeds 50% of total debt. On March 27, 2006, we executed an interest rate swap dated as of March 16, 2006, for the purpose of hedging variable interest rate exposure, in compliance with the requirements of the loan agreement. The lenders waived the default for not executing the hedge within six months of closing, as required by the loan agreement.

On June 30, 2006, we borrowed \$34.8 million on the revolving credit facility to extinguish the then existing debt and to pay related legal and banking fees.

Mortgage Loan on Windsor Park Centre

In connection with the purchase of the Windsor Park Centre property in December 2003, we assumed a note payable in the amount of \$6.6 million, secured by the property. The balance at December 31, 2006, was \$5.1 million. The note was payable in equal monthly installments of principal and interest of \$80,445, with interest at the rate of 8.34% per annum. The balance of the note was payable in full on December 1, 2006. We obtained an extension through March 2, 2007 and paid off this note in full with the proceeds from a \$10 million loan described in the following paragraph.

On March 1, 2007, we obtained a \$10 million loan to pay off the loan obtained upon the acquisition of the Windsor Park Centre property and to provide funds for future acquisitions and improvements to existing properties. The mortgage loan is secured by Windsor Park Centre, which is owned by WROC IV, a wholly owned subsidiary of the Operating Partnership that was formed to hold title to Windsor Park Centre. On March 1, 2007, we conveyed ownership of Windsor Park Centre from the Operating Partnership to WROC IV in order to secure the \$10 million loan. The note is payable in equal monthly installments of principal and interest of \$60,212, with interest at the rate of 6.04% per annum. The balance of the note is payable in full on March 1, 2014. The balance of this note is approximately \$10 million at June 30, 2007.

Capital Expenditures. Currently, we are evaluating all of our properties to determine a strategy for each property. We may determine it is best to invest capital in properties we believe have potential for increasing value. We also may have unexpected capital expenditures or improvements for our existing assets. Additionally, we intend to invest in

similar properties outside of Texas in cities with exceptional demographics to diversify market risk, and we may incur significant capital expenditures or make improvements in connection with any properties we may acquire.

Total Contractual Cash Obligations. A summary of our contractual cash obligations, as of June 30, 2007, is as follows (in thousands):

Contractual Obligations	Total	Payment due by period			
		Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
Long-Term Debt Obligations	\$ 75,519	\$ 65,559	\$ -	\$ -	\$ 9,960
Capital Lease Obligations	-	-	-	-	-
Operating Lease Obligations	-	-	-	-	-
Purchase Obligations	-	-	-	-	-
Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP	-	-	-	-	-
Total	\$ 75,519	\$ 65,559	\$ -	\$ -	\$ 9,960

We have no commercial commitments such as lines of credit or guarantees that might result from a contingent event that would require our performance pursuant to a funding commitment.

Property Acquisitions. During the first six months of 2007 and the year ended December 31, 2006, we have acquired no properties.

During 2005, we acquired from unrelated parties three multi-tenant office buildings comprising approximately 486,024 square feet of gross leasable area. The properties were acquired for cash for approximately \$30.4 million.

Common Share Dividends. We declared the following dividends to our shareholders with respect to the first quarter of 2006 through the third quarter of 2007, payable in three monthly installments after the end of each respective quarter:

Quarter Paid	Total Amount of Dividends Paid (in thousands)	Dividends per Share
03/31/2006	\$ 1,526	\$ 0.1768
06/30/2006	\$ 1,632	\$ 0.1768
09/30/2006	\$ 1,443	\$ 0.1500
12/31/2006	\$ 1,477	\$ 0.1500
03/31/2007	\$ 1,495	\$ 0.1500
06/30/2007	\$ 1,487	\$ 0.1500
09/30/2007	\$ 1,500	\$ 0.1500
Average Per Quarter		\$ 0.1577

OP Unit Distributions. The Operating Partnership declared the following distributions to holders of its OP Units, including the Company, with respect to the first quarter of 2006 through the third quarter of 2007, payable in three monthly installments after the end of each respective quarter:

Quarter Paid	Total Amount of Dividends Paid (in thousands)	Dividends per Share
03/31/2006	\$ 2,488	\$ 0.1768
06/30/2006	\$ 2,594	\$ 0.1768
09/30/2006	\$ 2,260	\$ 0.1500
12/31/2006	\$ 2,294	\$ 0.1500
03/31/2007	\$ 2,314	\$ 0.1500
06/30/2007	\$ 2,316	\$ 0.1500
09/30/2007	\$ 2,317	\$ 0.1500
Average Per Quarter		\$ 0.1577

Results of Operations**Comparison of the Three Month Periods Ended June 30, 2007 and 2006***General.*

The following tables provide a general comparison of our results of operations for the three months ended June 30, 2007 and 2006:

	Three Months ended June 30,	
	2007	2006
		(As Restated)
Number of properties owned and operated	36	37
Aggregate gross leasable area (sq. ft.)	3,093,063	3,121,037
Average occupancy rate	82%	83%
	(in thousands, except per share data)	
Total revenues	\$ 7,568	\$ 7,494
Total operating expenses	6,188	4,971
Operating income	1,380	2,523
Other income (expense), net	(1,166)	(1,120)
Income before minority interests	214	1,403
Minority interests in the Operating Partnership	(81)	(545)
Net income	\$ 133	\$ 858
Funds from operations ⁽¹⁾	\$ 1,770	\$ 2,758
Adjusted funds from operations ⁽¹⁾	1,182	2,116
Dividends paid on common shares and OP Units	2,332	2,659
Per common share and OP unit	\$ 0.15	\$ 0.17
Dividends paid as a % of AFFO	197%	126%

(1) In accordance with Regulation G, "reconciliation of non-GAAP measures" see "Funds From Operations and Adjusted Funds From Operations" below.

Revenues. Substantially all of our revenue is derived from rents received for the use of our properties. We had rental income and tenant reimbursements of approximately \$7.6 million for the three months ended June 30, 2007, as compared to \$7.5 million for the three months ended June 30, 2006, an increase of \$0.1 million or 1%. Our average occupancy rate was 82% and 83% for the three months ended June 30, 2007 and 2006, respectively. Our average annualized revenue was \$10.03 and \$9.97 per square foot for the three months ended June 30, 2007 and 2006, respectively. This increase in average annualized revenue was offset by a decrease in average leasable square footage of approximately 28,000 square feet.

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Operating Expenses. Our total operating expenses were \$6.2 million for the three months ended June 30, 2007, as compared to \$5.0 million for the three months ended June 30, 2006, an increase of \$1.2 million, or 24%. The primary components of operating expense are detailed in the table below (in thousands):

	Three months ended June 30,	
	2007	2006
		(As Restated)
Property operations and maintenance	\$ 1,127	\$ 1,058
Real estate taxes and insurance	1,177	1,117
Electricity, water and gas utilities	618	601
Property management and asset management fees to an affiliate	-	391
G & A - professional fees and other	811	288
G & A - employee compensation	639	-
Depreciation	1,250	1,181
Amortization	367	208
Bad Debt	199	127
Total Operating Expenses	\$ 6,188	\$ 4,971

Property operations and maintenance. The increase in property operations and maintenance expenses for the three months ended June 30, 2007, as compared to the three months ended June 30, 2006, is primarily the result of increased repair and maintenance costs for our properties. The majority of these costs relate to work that had been deferred by the prior management company. While these costs decreased our earnings for the three months ended June 30, 2007, we believe that they will ultimately result in higher tenant satisfaction, lower tenant attrition and higher occupancy levels.

Property management and asset management fees paid to an affiliate. On September 30, 2006, our advisory agreement with Hartman Management expired. On November 14, 2006, all property management functions were transferred to us from Hartman Management. As such, no fees were charged by Hartman Management after November 13, 2006.

G & A Fees - Previous to termination of the property management agreement and expiration of the advisory agreement, both of which were with Hartman Management, LP, general and administrative expenses for the REIT primarily consisted of fees paid to Hartman Management, LP and professional fees for accounting and legal services. The accounting for various general and administrative expenses is now different than when the REIT was managed by a third party advisor. As an example, previously the fees charged for acquisition of real estate, acquisition of capital, construction management and leasing were capitalized and recorded on the balance sheet. Fees for acquisition of real estate, construction and leasing were then amortized through the statement of operations generally over 3 years to 39 years. Fees for acquisition of capital were recorded as a reduction in the capital raised and thus never reflected on the statement of operations.

As a self-managed REIT we expense salaries, benefits and related expenses for individuals performing the functions described above. Commissions paid to internal and external leasing agents are capitalized and amortized over the life of the tenant lease.

Fees capitalized and thus not reflected in G & A costs were \$0.3 million and \$0.4 million for the three months ended June 30, 2007 and 2006, respectively.

G & A - professional fees and other. The increase in our professional fees of \$0.5 million is primarily due to an increase in legal fees resulting from the termination of the management and advisory agreements, the termination of Mr. Hartman as our President, Secretary and Chief Executive Officer and the litigation with Mr. Hartman and Hartman Management.

G & A - employee compensation. The increase in employee compensation of \$0.6 million is a result of our becoming a self-managed REIT in the fourth quarter of 2006. As of June 30, 2007 we had 50 employees to perform the functions previously outsourced to Hartman Management.

Operating Income. Operating income was \$1.4 million for the three months ended June 30, 2007, as compared to \$2.3 million for the three months ended June 30, 2006, a decrease of \$0.9 million or 39%. The primary reasons for the decrease are detailed above in *Revenues* and *Operating Expenses*.

Net Income. Income before minority interests was \$0.2 million and \$1.4 million for the three months ended June 30, 2007 and 2006, respectively. Net income of \$0.1 million and \$0.9 million for the three months ended June 30, 2007 and 2006, respectively. The decrease in net income was the result of the items discussed above in expenses and revenue.

Comparison of the Six Month Periods Ended June 30, 2007 and 2006

General.

The following tables provide a general comparison of our results of operations for the six months ended June 30, 2007 and 2006:

	Six Months Ended June 30,	
	2007	2006
		(As Restated)
Number of properties owned and operated	36	37
Aggregate gross leasable area (sq. ft.)	3,093,063	3,121,037
Average occupancy rate	83%	83%
	(in thousands, except per share data)	
Total revenues	\$ 15,113	\$ 14,908
Total operating expenses	12,796	10,237
Operating income	2,317	4,671
Other income (expense), net	(2,325)	(2,331)
Income before minority interests	(8)	2,340
Minority interests in the Operating Partnership	3	(917)
Net income	\$ (5)	\$ 1,423
Funds from operations ⁽¹⁾	\$ 3,101	\$ 5,546
Adjusted funds from operations ⁽¹⁾	2,272	4,263
Dividends paid on common shares and OP Units	4,742	5,211
Per common share and OP unit	\$ 0.30	\$ 0.34
Dividends paid as a % of AFFO	209%	122%

⁽¹⁾ In accordance with Regulation G, "reconciliation of non-GAAP measures" see "Funds From Operations and Adjusted Funds From Operations" below.

Revenues. Substantially all of our revenue is derived from rents received for the use of our properties. We had rental income and tenant reimbursements of approximately \$15.1 million for the six months ended June 30, 2007, as compared to \$14.9 million for the six months ended June 30, 2006, an increase of \$0.2 million or 1%. Our average occupancy rate was 83% for the six months ended June 30, 2007 and 2006. Our average annualized revenue was \$9.97 per square foot for the three months ended June 30, 2007, as compared to our average annualized revenue of \$9.80 per square foot for the three months ended June 30, 2006. This increase in average annualized revenue was offset by a decrease in average leasable square footage of approximately 28,000 square feet.

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Operating Expenses. Our total operating expenses were \$12.8 million for the six months ended June 30, 2007, as compared to \$10.2 million for the six months ended June 30, 2006, an increase of \$2.6 million, or 25%. The primary components of operating expense are detailed in the table below (in thousands):

	Six months ended June 30,	
	2007	2006
		(As Restated)
Property operations and maintenance	\$ 2,406	\$ 2,075
Real estate taxes and insurance	2,211	2,115
Electricity, water and gas utilities	1,098	1,113
Property management and asset management fees to an affiliate	-	804
G & A - professional fees and other	2,180	738
G & A - employee compensation	1,304	-
Depreciation	2,614	2,539
Amortization	615	735
Bad Debt	368	118
Total Operating Expenses	\$ 12,796	\$ 10,237

Property operations and maintenance. The increase in property operations and maintenance expenses for the six months ended June 30, 2007, as compared to the six months ended June 30, 2006, is primarily the result of increased repair and maintenance costs for our properties. The majority of these costs relate to work that had been deferred by the prior management company. While these costs decreased our earnings for the six months ended June 30, 2007, we believe that they will ultimately result in higher tenant satisfaction, lower tenant attrition and higher occupancy levels.

Property management and asset management fees paid to an affiliate. On September 30, 2006, our advisory agreement with Hartman Management expired. On November 14, 2006, all property management functions were transferred to us from Hartman Management. As such, no fees were charged by Hartman Management after November 13, 2006.

G & A Fees - Previous to termination of the property management agreement and expiration of the advisory agreement, both of which were with Hartman Management, LP, general and administrative expenses for the REIT primarily consisted of fees paid to Hartman Management, LP and professional fees for accounting and legal services. The accounting for various general and administrative expenses is now different than when the REIT was managed by a third party advisor. As an example, previously the fees charged for acquisition of real estate, acquisition of capital, construction management and leasing were capitalized and recorded on the balance sheet. Fees for acquisition of real estate, construction and leasing were then amortized through the statement of operations generally over 3 years to 39 years. Fees for acquisition of capital were recorded as a reduction in the capital raised and thus never reflected on the statement of operations.

As a self-managed REIT we expense salaries, benefits and related expenses for individuals performing the functions described above. Commissions paid to internal and external leasing agents are capitalized and amortized over the life of the tenant lease.

Fees capitalized and thus not reflected in G & A costs were \$0.6 million and \$1.1 million for the six months ended June 30, 2007 and 2006, respectively.

G & A - professional fees and other. The increase in our professional fees of \$1.4 million is primarily due to an increase in legal fees resulting from the termination of the management and advisory agreements, the termination of Mr. Hartman as our President, Secretary and Chief Executive Officer and the litigation with Mr. Hartman and Hartman Management.

G & A - employee compensation. The increase in employee compensation of \$1.3 million is a result of our becoming a self-managed REIT in the fourth quarter of 2006. As of June 30, 2007 we had 50 employees to perform the functions previously outsourced to Hartman Management.

Bad Debt. The increase in bad debt of \$0.3 million is primarily a result of additional bad debt reserves recorded due to an increase in the accounts receivable balance of \$0.5 million at June 30, 2007, as compared to the balance at June 30, 2006.

Operating Income. Operating income was \$2.3 million for the six months ended June 30, 2007, as compared to \$4.7 million for the six months ended June 30, 2006, a decrease of \$2.4 million or 51%. The primary reasons for the decrease are detailed above in *Revenues* and *Operating Expenses*.

Net Income (Loss). Income (loss) before minority interests was a loss of \$(0.08) million and income of \$2.3 million for the six months ended June 30, 2007 and 2006, respectively. Net loss of \$(0.05) million and income of \$1.4 million for the six months ended June 30, 2007 and 2006, respectively. The decrease in net income was the result of the items discussed above in expenses and revenue.

Funds From Operations and Adjusted Funds From Operations

We believe that Funds From Operations (“FFO”) and Adjusted Funds From Operations (“AFFO”) are appropriate supplemental measures of operating performance because these measures help investors compare our operating performance relative to other REITs. The National Association of Real Estate Trusts (“NAREIT”) defines FFO as net income (loss) available to common shareholders computed in accordance with GAAP, excluding gains or losses from sales of operating properties and extraordinary items, plus depreciation and amortization of real estate assets, including our share of unconsolidated partnerships and joint ventures. We calculate FFO in a manner consistent with the NAREIT definition.

We calculate AFFO by subtracting from FFO both (1) normalized recurring expenditures that are capitalized by the REIT and then amortized, but which are necessary to maintain a REIT's properties and its revenue stream (e.g., leasing expenses and tenant improvement expenditures) and (2) "straight-lining" of rents. This calculation also is called Cash Available for Distribution (CAD) or Funds Available for Distribution (FAD). AFFO is primarily a measure of a real estate company's funds generated by operations.

There can be no assurance that FFO or AFFO as presented by us are comparable to similarly titled measures of other REITs. We consider FFO and AFFO to be an alternative to net income or other measurements under GAAP as an indicator of our operating performance or to cash flows from operating, investing, or financing activities as a measure of liquidity. These measures do not reflect working capital changes, cash expenditures for capital improvements or principal payments on indebtedness. Below is the calculation of FFO and AFFO and the reconciliation to net income, which we believe is the most comparable GAAP financial measure (in thousands):

Reconciliation of Non-GAAP Financial Measures

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
				(As Restated)
Net income (loss)	\$ 133	\$ 858	\$ (5)	\$ 1,423
Minority interest in (income) loss of operating partnership	81	545	(3)	917
Depreciation and amortization of real estate assets	1,556	1,355	3,109	3,206
FFO	1,770	2,758	3,101	5,546
Tenant improvements	(108)	(234)	(239)	(398)
Leasing commissions	(376)	(231)	(559)	(617)
Change in fair value of derivatives	(36)	(196)	(15)	(196)
Straight-line rents	(88)	(5)	(55)	(104)
Above (below) market lease value	20	24	39	32
AFFO	\$ 1,182	\$ 2,116	\$ 2,272	\$ 4,263

Taxes

We elected to be taxed as a REIT under the Internal Revenue Code beginning with our taxable year ended December 31, 1999. As a REIT, we generally are not subject to federal income tax on income that we distribute to our shareholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate rates. We believe that we are organized and operate in such a manner as to qualify to be taxed as a REIT, and we intend to operate so as to remain qualified as a REIT for federal income tax purposes.

Inflation

We anticipate that our leases will continue to be triple-net leases or otherwise provide that tenants pay for increases in operating expenses and will contain provisions that we believe will mitigate the effect of inflation. In addition, many of our leases are for terms of less than five years, which allows us to adjust rental rates to reflect inflation and other changing market conditions when the leases expire. Consequently, increases due to inflation, as well as ad valorem tax rate increases, generally do not have a significant adverse effect upon our operating results.

Environmental Matters

Our properties are subject to environmental laws and regulations adopted by various governmental authorities in the jurisdictions in which our operations are conducted. From our inception, we have incurred no significant environmental costs, accrued liabilities or expenditures to mitigate or eliminate future environmental contamination.

Off-Balance Sheet Arrangements

We have no significant off-balance sheet arrangements as of June 30, 2007 and December 31, 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices. The principal market risk to which we are exposed is the risk related to interest rate fluctuations. Based upon the nature of our operations, we are not subject to foreign exchange or commodity risk. We will be exposed to changes in interest rates as a result of our credit facilities which have floating interest rates. As of June 30, 2007, we had approximately \$65.2 million of indebtedness outstanding under these facilities, of which approximately \$35.2 million was not hedged to protect against rising interest rates. The impact of a 1% increase in interest rates on our debt would result in an increase in interest expense and a decrease in income before minority interests of approximately \$0.3 million.

Item 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed pursuant to Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures which, by their nature, can provide only reasonable assurance regarding management's control objectives.

As reported in our annual report on Form 10-K for the year ended December 31, 2006, our independent registered public accounting firm, in the course of the audit of our financial statements, brought to management's attention two

material weaknesses in our internal controls: (1) inadequate controls and procedures in place to effectively monitor and record non-routine transactions and (2) inadequate controls and procedures in place to effectively manage certain spreadsheets that support the financial reporting process. Controls over completeness, accuracy, validity, and review of certain spreadsheet information that supports the financial reporting process either were not designed appropriately or did not operate as designed. As a result of these deficiencies, our accounting personnel may not process and record transactions or compile data appropriately that requires recognition in our financial accounting records. Accordingly, errors in our accounting for certain revenues and other profit and loss items may occur and may not be detected. A material weakness (within the meaning of the Public Accounting Oversight Board Accounting Standard No. 2) is a control deficiency, or aggregation of control deficiencies, that result in more than a remote risk that a material misstatement in the Company's annual or interim financial statements will not be prevented or detected.

We are in the process of remediating the material weakness through the following action plan:

- Engagement of external consultant to assist in documenting and establishing processes and controls that support financial reporting
- Elimination of several spreadsheets which support financial reporting processes through implementation of a fixed asset software and further utilization of our accounting and billing software.

We began our work with the external consultant in the 2nd quarter of 2007. We have made significant progress on the material weakness action plan and believe the weakness will be remediated by the end of 2007.

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to the Exchange Act. Based upon that evaluation, the material weakness described above, and the progress made on remediation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are not effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) that is required to be included in the Company's Exchange Act filings.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The nature of our business exposes us to the risk of lawsuits for damages or penalties relating to, among other things, breach of contract and employment disputes. We are currently involved in the following litigation:

Hartman Commercial Properties REIT and Hartman REIT Operating Partnership, L.P. v. Allen R. Hartman and Hartman Management, L.P., in the 333rd Judicial District Court of Harris County, Texas

On October 2, 2006, we initiated this action against our former Chief Executive Officer, Allen R. Hartman, and our former manager and advisor, Hartman Management, L.P. We are seeking damages for breach of contract, fraudulent inducement and breach of fiduciary duties.

In November 2006, Mr. Hartman and Hartman Management filed a counterclaim against us, the members of our Board and our Chief Operating Officer, John J. Dee. The counterclaim has since been amended to drop the claims against the individual defendants with the exception of our current interim Chief Executive Officer, James C. Mastandrea, and Mr. Dee. The amended counterclaim asserts claims against us for alleged breach of contract and alleges that we owe Mr. Hartman and Hartman Management fees for the termination of an advisory agreement. The amended counterclaim asserts claims against Messrs. Mastandrea and Dee for tortious interference with the advisory agreement and a management agreement and conspiracy to seize control of us for their own financial gains. We have indemnified Messrs. Mastandrea and Dee to the extent allowed by our governing documents and Maryland law. The amended counterclaim also asserts claims against our prior outside law firm and one of its partners. Recently, Hartman has nonsuited without prejudice our prior outside law firm and its partner. Limited discovery has been conducted in this case as of the date of this report.

It is too early to express an opinion concerning the likelihood of an adverse outcome on the counterclaim, although we intend to vigorously defend against those claims and vigorously prosecute our affirmative claims.

Hartman Commercial Properties REIT v. Allen R. Hartman, et al; in the United States District Court for the Southern District of Texas

On December 8, 2006, we initiated this action complaining of the attempt by Mr. Hartman and Hartman Management to solicit written consents from shareholders to replace our Board.

Mr. Hartman and Hartman Management filed a counterclaim claiming that certain changes to our bylaws and declaration of trust are invalid and that their enactment is a breach of fiduciary duty. They were seeking a declaration that the changes to our bylaws and declaration of trust are invalid and an injunction barring their enforcement. These changes, among other things, stagger the terms of our Board members over three years, require two-thirds vote of the outstanding common shares to remove a Board member and provide that our secretary may call a special meeting of shareholders only on the written request of a majority of outstanding common shares. A group of shareholders filed a request to intervene in this action seeking to assert claims similar to those of Mr. Hartman and Hartman Management. We opposed the intervention.

Both parties have filed Motions for Temporary Injunction. The REIT sought to prevent Mr. Hartman's continued attempts to solicit written consents to replace our Board and Hartman sought to prohibit the changes in the REIT's bylaws described above. On April 6, 2007, the trial Court granted our Motion for Temporary Injunction and denied the Motion for Temporary Injunction filed by Hartman. The Court found that the changes to the bylaws and declaration of trust were valid. The Court granted our Motion to Dismiss, dismissing many of Hartman and Hartman Management's claims. After the ruling, the group of shareholders who were seeking to intervene dismissed their

intervention.

Hartman and Hartman Management have appealed the Court's ruling on an expedited basis and Oral Argument for this appeal was on August 8, 2007. As of the date of this report the court has not yet issued a decision.

The discovery conducted in this case has been limited to issues relevant to the change in the REIT's bylaws. Documents were produced and interrogatory responses exchanged. We produced the members of our Board and Mr. Dee for deposition and also took the deposition of Mr. Hartman

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Because of the pending Appeal, it is too early to express an opinion concerning the likelihood of an adverse outcome on the counterclaim, although we intend to vigorously defend against those claims and vigorously prosecute our affirmative claim.

Other

We are a participant in various other legal proceedings and claims that arise in the ordinary course of our business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, we believe that the final outcome of these matters will not have a material effect on our financial position, results of operations or cash flows.

Item 1A. Risk Factors

As of June 30, 2007, there have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Market Information

There is no established trading market for our common shares of beneficial interest. As of July 30, 2007, we had 10,001,269 common shares of beneficial interest outstanding held by a total of approximately 1,428 shareholders.

Public Offering Proceeds

On September 15, 2004, our Registration Statement on Form S-11, with respect to our public offering of up to 10,000,000 common shares of beneficial interest to be offered at a price of \$10 per share was declared effective under the Securities Act of 1933. The Registration Statement also covered up to 1,000,000 shares available pursuant to our dividend reinvestment plan to be offered at a price of \$9.50 per share. The shares were offered to investors on a best efforts basis. Post-Effective Amendments No. 1, 2 and 3 to the Registration Statement were declared effective by the SEC on June 27, 2005, March 9, 2006 and May 3, 2006, respectively.

On October 2, 2006, our Board terminated the public offering. On March 27, 2007, we gave the required ten day notice to plan participants informing them that we intend to terminate our dividend reinvestment plan. As a result, our dividend reinvestment plan terminated on April 6, 2007.

No shares were offered to investors during the 2nd quarter of 2007.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

The Company held its annual shareholders meeting May 31, 2007 at the Westchase Marriott, 2900 Briarpark Drive, Houston, Texas 77042. The purpose of the meeting was to elect one trustee to serve on the Board of Trustees until our 2010 annual meeting of shareholders.

At the meeting the shareholders elected Chris A. Minton to serve on our board of trustees until the 2010 annual meeting of shareholders. The shareholders elected Mr. Minton as follows:

Name	Votes for	Votes Against	Votes Withheld
Chris A. Minton	4,891,018	0	1,241,257

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit No. Description

- 3.1 Declaration of Trust of Whitestone REIT (formerly Hartman Commercial Properties REIT), a Maryland real estate investment trust (previously filed as and incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-11/A, Commission File No. 333-111674, filed on May 24, 2004)
- 3.2 Articles of Amendment and Restatement of Declaration of Trust of Whitestone REIT (formerly Hartman Commercial Properties REIT) (previously filed as and incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11/A, Commission File No. 333-111674, filed on July 29, 2004)
- 3.3 Articles Supplementary (previously filed as and incorporated by reference to Exhibit 3(i).1 to the Registrant's Current Report on Form 8-K, Commission File No. 000-50256, filed on December 6, 2006)
- 3.4 Bylaws (previously filed as and incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11, Commission File No. 333-111674, filed on December 31, 2003)
- 3.5 First Amendment to Bylaws (previously filed as and incorporated by reference to Exhibit 3(ii).1 to the Registrant's Current Report on Form 8-K, Commission File No. 000-50256, filed on December 6, 2006)
- 4.1 Specimen certificate for common shares of beneficial interest, par value \$.001 (previously filed as and incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-11, Commission File No. 333-111674, filed on December 31, 2003)
- 10.24 Amendment No. 2, dated May 19, 2006, between Hartman REIT Operating Partnership, L.P., Hartman REIT Operating Partnership III, L.P., and KeyBank National Association, as agent for the consortium of lenders (previously filed and incorporated by reference to Exhibit 10.24 to the Registrant's Annual Report of Form 10-K for the year ended December 31, 2006, filed on March 30, 2007)
- 10.25 Promissory Note between HCP REIT Operating Company IV LLC and MidFirst Bank, dated March 1, 2007 (previously filed and incorporated by reference to Exhibit 10.25 to the Registrant's Annual Report of Form 10-K for the year ended December 31, 2006, filed on March 30, 2007)
- 10.26 Amendment No. 3, dated March 26, 2007, between Hartman REIT Operating Partnership, L.P., Hartman REIT Operating Partnership III, L.P., and KeyBank National Association, as agent for the consortium of lenders (previously filed and incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report of Form 10-K for the year ended December 31, 2006, filed on March 30, 2007)
- 31.1*

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Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)

31.2* Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

32.1* Certificate pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)

32.2* Certificate pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)

* Filed herewith.

+ Denotes management contract or compensatory plan or arrangement.

SIGNATURE

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.

Whitestone REIT

Date: August 14, 2007 /s/ James C. Mastandrea
James C. Mastandrea
Chief Executive Officer
(Principal Executive Officer)

Dated August 14, 2007 /s/ David K. Holeman
David K. Holeman
Chief Financial Officer
(Principal Financial Officer)