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Whitestone REIT
Form 10-Q
August 13, 2009
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, 2009

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)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

Accelerated filer

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Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of August 13, 2009, the registrant had outstanding 10,337,307 Common Shares of Beneficial Interest, \$0.001 par value per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	June 30, 2009 (unaudited)	December 31, 2008 (revised)
ASSETS		
Real estate assets, at cost:		
Property	\$ 191,139	\$ 180,397
Accumulated depreciation	(31,732)	(29,550)
Total real estate assets	159,407	150,847
Cash and cash equivalents	14,018	12,989
Escrows and acquisition deposits	3,036	4,076
Accrued rent and accounts receivable, net of allowance for doubtful accounts	5,617	4,880
Unamortized lease commissions and loan costs	4,299	4,338
Prepaid expenses and other assets	978	815
Total assets	\$ 187,355	\$ 177,945
LIABILITIES AND EQUITY		
Liabilities:		
Notes payable	\$ 109,409	\$ 100,003
Accounts payable and accrued expenses	6,652	7,422
Tenants' security deposits	1,659	1,629
Dividends and distributions payable	1,775	1,719
Total liabilities	119,495	110,773
Commitments and contingencies:		
Equity:		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding as of June 30, 2009 and December 31, 2008	-	-
Common shares, \$0.001 par value per share; 400,000,000 shares authorized; 10,337,307 and 9,707,307 issued and outstanding as of June 30, 2009 and December 31, 2008, respectively	10	10
Additional paid-in capital	69,566	69,188
Accumulated deficit	(25,490)	(23,307)
Total Whitestone REIT shareholders' equity	44,086	45,891
Noncontrolling interest in subsidiary	23,774	21,281
Total equity	67,860	67,172
Total liabilities and equity	\$ 187,355	\$ 177,945

See notes to Condensed Consolidated Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

(in thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2009	2008 (revised)	2009	2008 (revised)
Property Revenues				
Rental revenues	\$ 6,572	\$ 6,236	\$ 13,077	\$ 12,463
Tenants' reimbursements and other property revenues	1,631	1,514	3,170	3,043
Total property revenues	8,203	7,750	16,247	15,506
Property expenses				
Property operation and maintenance	2,205	2,188	4,583	4,311
Real estate taxes	1,063	925	2,112	1,933
Total property expenses	3,268	3,113	6,695	6,244
Other expenses (income)				
General and administrative	1,625	2,170	3,054	4,133
Depreciation and amortization	1,710	1,791	3,418	3,347
Interest expense	1,470	1,425	2,898	2,827
Interest income	(11)	(39)	(22)	(124)
Total other expenses	4,794	5,347	9,348	10,183
Income (loss) from continuing operations before loss on disposal of assets and income taxes	141	(710)	204	(921)
Provision for income taxes	(57)	(53)	(111)	(110)
Loss on disposal of assets	(12)	(68)	(53)	(100)
Income (loss) from continuing operations	72	(831)	40	(1,131)
Loss from discontinued operations	-	(378)	-	(188)
Gain on sale of properties from discontinued operations	-	3,619	-	3,619
Net income	72	2,410	40	2,300
Less: Net income attributable to noncontrolling interests	25	878	14	837
Net income attributable to Whitestone REIT	\$ 47	\$ 1,532	\$ 26	\$ 1,463

See notes to Condensed Consolidated Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

(in thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2009	2008 (revised)	2009	2008 (revised)
Earnings per share - basic				
Income (loss) from continuing operations attributable to Whitestone REIT				
excluding amounts attributable to unvested restricted shares	\$0.00	\$(0.05)	\$0.00	\$(0.07)
Income from discontinued operations attributable to Whitestone REIT	0.00	0.20	0.00	0.22
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.00	\$0.15	\$0.00	\$0.15
Earnings per share - diluted				
Income (loss) from continuing operations attributable to Whitestone REIT				
excluding amounts attributable to unvested restricted shares	\$0.00	\$(0.05)	\$0.00	\$(0.07)
Income from discontinued operations attributable to Whitestone REIT	0.00	0.20	0.00	0.22
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.00	\$0.15	\$0.00	\$0.15
Weighted average number of common shares outstanding:				
Basic	9,707	9,903	9,707	9,952
Diluted	9,899	9,903	9,910	9,952
Dividends declared per common share	\$0.1125	\$0.1500	\$0.2250	\$0.3000
Condensed Consolidated Statements of Comprehensive Income:				
Net income	\$72	\$2,410	\$40	\$2,300
Other comprehensive gain (loss)				
Unrealized gain (loss) on cash flow hedging activities	0	423	0	(169)
Comprehensive income	72	2,833	40	2,131
Less: Comprehensive income attributable to noncontrolling interests	25	1,033	14	770
Comprehensive income attributable to Whitestone REIT	\$47	\$1,800	\$26	\$1,361

See notes to Condensed Consolidated Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
 (in thousands)

	Common Shares	Additional Paid-in Capital	Accumulated Other Comprehensive Income Deficit	Accumulated Other Comprehensive Income Loss	Shareholders' Equity	Noncontrolling Interests Units	Dollars	Total Equity	
Balance, December 31, 2008 (revised)	9,707	\$10	\$69,188	\$(23,307)	\$-	\$45,891	4,740	\$21,281	\$67,172
OP units issued at \$5.15 per unit in connection with property acquisition	-	-	-	-	-	-	704	3,625	3,625
Share-based compensation	630	-	378	-	-	378	-	-	378
Dividends and distributions	-	-	-	(2,209)	-	(2,209)	-	(1,146)	(3,355)
Net income	-	-	-	26	-	26	-	14	40
Balance, June 30, 2009 (unaudited)	10,337	\$10	\$69,566	\$(25,490)	\$-	\$44,086	5,444	\$23,774	\$67,860

See notes to Condensed Consolidated Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(in thousands)	Six Months ended June 30,	
	2009	2008 (revised)
Cash flows from operating activities:		
Net income (loss) from continuing operations	\$ 26	\$ (720)
Net income from discontinued operations	-	2,183
Net income	26	1,463
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,418	3,347
Net income (loss) attributable to noncontrolling interest	14	(411)
Loss on sale or disposal of assets	53	100
Bad debt expense	464	222
Share-based compensation	497	-
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	1,185	291
Accrued rent and accounts receivable	(1,201)	320
Unamortized lease commissions and loan costs	(292)	(522)
Prepaid expenses and other assets	222	(107)
Accounts payable and accrued expenses	(1,199)	(1,303)
Tenants' security deposits	30	(17)
Net cash provided by operating activities	3,217	1,200
Net cash provided by operating activities of discontinued operations	-	8
Cash flows from investing activities:		
Acquisitions of real estate	(5,619)	-
Additions to real estate	(1,683)	(3,100)
Net cash used in investing activities	(7,302)	(3,100)
Net cash used in investing activities of discontinued operations	-	(8)
Cash flows from financing activities:		
Dividends paid on common shares and common share equivalents	(2,319)	(3,062)
Distributions paid to OP unit holders	(1,062)	(1,817)
Proceeds from notes payable	9,791	11,404
Repayments of notes payable	(1,008)	(6,377)
Payments of loan origination costs	(288)	(1,004)
Net cash provided by (used in) financing activities	5,114	(856)
Net increase (decrease) in cash and cash equivalents	1,029	(2,756)
Cash and cash equivalents at beginning of period	12,989	10,811
Cash and cash equivalents at end of period	\$ 14,018	\$ 8,055
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 2,668	\$ 2,819
Cash paid for taxes	\$ 223	\$ 224

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Non cash investing and financing activities:

Disposal of fully depreciated real estate	\$ 504	\$ 586
Financed insurance premiums	\$ 478	\$ 464
Disposal of real estate in settlement of lawsuit	\$ -	\$ 7,844
Acquisition of real estate asset in exchange for OP Units	\$ 3,625	\$ -

See notes to Condensed Consolidated Financial Statements

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009

(Unaudited)

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

1. Interim Financial Statements

The condensed consolidated financial statements included in this report are unaudited; however, amounts presented in the condensed consolidated balance sheet as of December 31, 2008 are derived from our audited consolidated financial statements at that date. The unaudited financial statements as of June 30, 2009 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information on a basis consistent with the annual audited consolidated financial statements and with the instructions to Form 10-Q, except for the adoptions in the first quarter of 2009 of Statement of Financial Accounting Standards (“SFAS”) No. 160, “Noncontrolling Interests in Consolidated Financial Statements” (“SFAS No. 160”); Financial Accounting Standards Board (“FASB”) Staff Position EITF No. 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities” (“FSP EITF No. 03-6-1”); SFAS No. 141(R), “Business Combinations” (“SFAS No. 141(R)”), which is applied prospectively to business combinations with acquisition dates on or after January 1, 2009; and SFAS No. 157, “Fair Value Measurements” (“SFAS No. 157”), for all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the condensed consolidated financial statement on a recurring basis. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

The impact of SFAS No. 160 is discussed in more detail in Note 2, Summary of Significant Accounting Policies. The impact of FSP EITF No. 03-6-1, is discussed in more detail in Note 8, Earnings Per Share.

The condensed 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, 2009 and the results of operations for the three and six month periods ended June 30, 2009 and 2008, the condensed consolidated statement of changes in equity for the six month period ended June 30, 2009 and cash flows for the six month periods ended June 30, 2009 and 2008. All of these adjustments are of a normal recurring nature. The results of operations for the interim period 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 which are included in our Annual Report on Form 10-K for the year ended December 31, 2008.

Business. Whitestone was formed as a real estate investment trust, 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 pursuant to a merger of Whitestone directly with and into a Maryland real estate investment trust formed for the sole purpose of effectuating the reorganization and the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity (the “Common Shares”). 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 power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of June 30, 2009 and December 31, 2008, we owned and operated 36 and 35 retail, warehouse and office 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, 2009 and

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009

(Unaudited)

December 31, 2008, we owned a majority of the partnership interests in the Operating Partnership. Consequently, the accompanying condensed consolidated financial statements include the accounts of the Operating Partnership. All significant inter-company balances have been eliminated. Noncontrolling interest in the accompanying condensed 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 year. Issuance of additional Common Shares and units of limited partnership interest in the Operating Partnership that are convertible into Common Shares on a one-for-one basis (the "OP Units") changes the ownership interests of both the noncontrolling interests and Whitestone.

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. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at 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, estimates supporting our impairment analysis for the carrying values of our real estate assets and the estimated fair value of interest rate swaps. Actual results could differ from those estimates.

Reclassifications. We have reclassified certain prior fiscal year amounts in the accompanying condensed consolidated financial statements in order to be consistent with the current fiscal year presentation, including changes resulting from the adoption of SFAS No. 160 on January 1, 2009, as discussed later in this Note 2. Other than the changes resulting from the implementation of SFAS No. 160, these reclassifications had no effect on net loss or equity.

Share-Based Compensation. From time to time the Company awards nonvested Common Shares or Common Share Units to trustees, executive officers and employees which may be converted into Common Shares under the 2008 Long-Term Equity Incentive Ownership Plan (the "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 using the fair market value of the shares as of the grant date, in accordance with SFAS No. 123R, "Share-Based Payments," as revised ("SFAS No. 123R"). For the three and six months ended June 30, 2009, the Company recognized approximately \$0.3 and \$0.5 million in share-based compensation expense. No share-based compensation expense was recognized prior to 2009 as no awards had been granted.

Noncontrolling Interests. In December 2007, the FASB issued SFAS No. 160 which is effective for fiscal years beginning on or after December 15, 2008. We adopted SFAS No. 160 effective January, 2009. 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 condensed consolidated balance sheets but separate from Whitestone's equity as prescribed by SFAS No. 160. On the consolidated statements of operations and comprehensive loss, 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 both quarterly and annual financial statements, including beginning balances, activity for the period and ending balances for shareholders' equity, noncontrolling interests and total equity.

See Whitestone's Annual Report on Form 10-K for the year ended December 31, 2008 for further discussion on significant accounting policies.

Recent Accounting Pronouncements. In September 2006, the FASB issued SFAS No. 157. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles and expands disclosures about fair value measurements. The statement

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009

(Unaudited)

does not require new fair value measurements but is applied to the extent other accounting pronouncements require or permit fair value measurements. The statement emphasizes fair value as a market-based measurement which should be determined based upon assumptions market participants would use in pricing an asset or a liability. In February 2008, FASB issued FSP 157-2, "Effective Date of FASB Statement 157" ("FSP 157-2") which deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities except for those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008. Adoption of SFAS No. 157 on January 1, 2009 did not have a material effect on the Company.

In December 2007, FASB issued SFAS No. 141(R) which replaces SFAS No. 141, "Business Combinations" which, among other things, establishes principles and requirements for how an acquiring entity recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed (including intangibles) and any noncontrolling interests in the acquired entity. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption of SFAS No. 141(R) on January 1, 2009 impacts our accounting for acquisitions and related transaction costs.

In December 2007, FASB issued SFAS No. 160. SFAS No. 160 amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also amends certain of ARB 51's consolidation procedures for consistency with the requirements of SFAS No. 141(R). SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We adopted SFAS No. 160 on January 1, 2009.

In March 2008, FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Currently, we do not have any derivative instrument or hedging activities.

In June 2008, the FASB issued FSP EITF No. 03-6-1, "Determining Whether Instruments Granted in Share-based Payment Transactions are Participating Securities" ("FSP EITF No. 03-6-1"). FSP EITF No. 03-6-1 affects entities which accrue non-returnable cash dividends on share-based payment awards during the awards' service period. FASB concluded unvested share-based payment awards which are entitled to cash dividends, whether paid or unpaid, are participating securities any time the common shareholders receive dividends. Because the awards are considered participating securities, the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share, as prescribed by EITF No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128.". FSP EITF No. 03-6-1 is effective for fiscal years beginning after December 15, 2008, and early adoption is not permitted. Adoption on January 1, 2009 impacts our earnings per share ("EPS") calculation, as specified in Note 8.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity

should recognize events or transactions occurring after the balance sheet date in its financial statements, and disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 is effective for financial periods ending after June 15, 2009. The Company is adhering to the requirements of SFAS 165 starting in the second

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009

(Unaudited)

quarter of 2009.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," ("SFAS 167"), which changes the approach to determining the primary beneficiary of a variable interest entity and requires companies to more frequently assess whether they must consolidate a VIE. This new standard is effective on the first annual reporting period that begins after November 15, 2009. We are currently assessing the potential impacts, if any, on our consolidated financial statements.

3. Derivatives and Hedging

On September 28, 2007, we entered into an interest rate swap transaction which we designated as a cash flow hedge. The effective date of the swap transaction was October 1, 2007, had a total notional amount of \$70 million, and fixed the swap rate at 4.77% plus the LIBOR margin through October 1, 2008. The purpose of this swap was to mitigate the risk of future fluctuations in interest rates on our variable rate debt. We determined that this swap was highly effective in offsetting future variable interest cash flows on variable rate debt. This interest rate swap matured on October 1, 2008 and was not renewed by us.

Whitestone elected to implement SFAS No. 157 with the one-year deferral permitted by FASB Staff Position No. FAS 157-2. FSP No. 157-2, which was issued February 2008, defers the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities measured at fair value, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis.

SFAS No. 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

- Level 1 – Observable inputs such as quoted prices in active markets at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 – Other inputs that are observable directly or indirectly, such as quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.
 - Level 3 – Unobservable inputs for which there is little or no market data and which the Company makes its own assumptions about how market participants would price the assets and liabilities.

All of our derivative instruments which are included in the fair value requirements fall under the Level 2 criteria. Interest rate swaps are valued by a third-party consultant using modeling techniques that include market inputs such as interest rate yield curves.

4. Real Estate

As of June 30, 2009, we owned 36 commercial properties in the Houston, Dallas, San Antonio, Phoenix and Chicago areas comprising approximately 3.0 million square feet of total area.

WHITESTONE REIT AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 JUNE 30, 2009

(Unaudited)

5. Accrued Rent and Accounts Receivable, net

Accrued rent and accounts receivable, net, consists of amounts accrued, billed and due from tenants, amounts due from insurance claims, allowance for doubtful accounts and other receivables as follows (in thousands):

	June 30, 2009	December 31, 2008
Tenant receivables	\$ 2,543	\$ 2,733
Accrued rent	3,755	3,644
Insurance receivable	1,068	-
Allowance for doubtful accounts	(1,759)	(1,497)
Other receivables	10	-
Totals	\$ 5,617	\$ 4,880

During the quarter ended June 30, 2009, we settled six of our sixteen insurance claims related to damages to our properties from Hurricane Ike for \$1.7 million, of which we have received \$0.6 million, \$0.2 million of which is held in escrow pending completion of the repairs.

We expect to settle the reimbursement amounts for the remaining ten properties during the third quarter of 2009.

6. Unamortized Leasing Commissions and Loan Costs

Costs which have been deferred consist of the following (in thousands):

	June 30, 2009	December 31, 2008
Leasing commissions	\$ 4,387	\$ 4,412
Deferred financing costs	2,224	1,921
Total cost	6,611	6,333
Less: accumulated amortization leasing commissions	(1,933)	(1,842)
Less: accumulated amortization deferred financing costs	(379)	(153)
Total cost, net of accumulated amortization	\$ 4,299	\$ 4,338

WHITESTONE REIT AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 JUNE 30, 2009

(Unaudited)

7. Debt

Mortgages and other notes payable consist of the following (in thousands):

Description	June 30, 2009	December 31, 2008
Fixed rate notes		
\$10.0 million 6.04% Note, due 2014	\$ 9,715	\$ 9,782
\$11.2 million 6.52% Note, due 2015	11,107	11,159
\$21.4 million 6.53% Note, due 2013	20,996	21,263
\$24.5 million 6.56% Note, due 2013	24,500	24,500
\$ 9.9 million 6.63% Note, due 2014	9,881	-
\$ 0.5 million 5.05% Note, due 2009	306	40
Floating rate notes		
\$ 6.4 million LIBOR + 2.00% Note, due 2009	6,400	6,400
\$26.9 million LIBOR + 2.60% Note, due 2013	26,504	26,859
	\$ 109,409	\$ 100,003

Floating Rate Notes. On January 25, 2008, we entered into a \$6.4 million term loan agreement with KeyBank. The term loan was secured by a pledge of the partnership interests in Whitestone REIT Operating Partnership III, L.P. ("WROP III"), and Whitestone Pima Norte LLC ("WPN"), a wholly owned subsidiary of the Operating Partnership that was formed to hold title to our Pima Norte property purchased in October 2007. At June 30, 2009 and December 31, 2008, WROP III owned 13 and 17 properties, respectively, and WPN owned 1 property.

This loan contains certain financial covenants, some of which we were not in compliance with as of June 30, 2009, including the secured debt to fair market value ratio covenant. This loan was paid in full on July 25, 2009.

Our loans are subject to customary financial covenants. As of June 30, 2009, we are in compliance with all loan covenants other than the \$6.4 million term loan described above, which was paid in full on its maturity date July 25, 2009.

Annual maturities of notes payable as of June 30, 2009, are due as set forth below (in thousands):

Year	Principal
2009	\$ 7,671
2010	2,276
2011	2,402
2012	2,534
2013	66,457
	28,069

2014 and
thereafter

Total	\$ 109,409
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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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(Unaudited)

8. Earnings Per Share

Basic earnings per share for Whitestone's common shareholders is calculated by dividing income (loss) from continuing operations excluding amounts attributable to unvested restricted shares, income from discontinued operations, and the net income (loss) attributable to non-controlling interests by Whitestone's weighted-average common shares outstanding during the period. Diluted earnings per share is computed by dividing the net income (loss) attributable to common shareholders excluding amounts attributable to unvested restricted shares, income from discontinued operations, and the net income (loss) attributable to non-controlling interests by the weighted-average number of common shares including any dilutive unvested restricted shares.

On January 1, 2009, Whitestone adopted FSP EITF No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities," ("FSP EITF No. 03-6-1"), which addresses whether share-based payment transaction instruments are considered participating securities prior to vesting, and in which all unvested stock awards which contain non-forfeitable rights to dividends, whether paid or unpaid, are to be included in the number of shares outstanding in Whitestone's basic and diluted earnings per share ("EPS") calculations.

Certain of Whitestone's performance restricted common shares are considered participating securities which require the use of the two-class method for the computation of basic and diluted earnings per share. For the three and six months ended June 30, 2009, basic EPS was not impacted by the two-class method because the Company's participating securities are not obligated to participate in net operating losses, and diluted EPS was not impacted because the inclusion of these securities would have had an anti-dilutive effect on diluted EPS. During the three months ended June 30, 2009 and 2008, 5,443,797 and 5,452,187 OP Units, respectively, were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive. During the six months ended June 30, 2009 and 2008, 5,443,797 and 5,630,261 OP Units, respectively, were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive.

For the three months and six months ended June 30, 2009, distributions of \$71,000 and \$135,000 respectively, were made to the holders of certain restricted share units, \$64,000 and \$121,000 of which, respectively, were charged against earnings. No distributions were made on the performance restricted shares prior to 2009. See Note 14 for information related to restricted shares under the long-term equity incentive share plan.

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009

(Unaudited)

(in thousands)	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
Numerator:				
Income (loss) from continuing operations	\$72	\$(831)	\$40	\$(1,131)
Less: Net loss (income) attributable to noncontrolling interests	(25)	302	(14)	411
Dividends paid on unvested restricted shares	(7)	-	(14)	-
Undistributed earnings attributable to unvested restricted shares	-	-	-	-
Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	40	(529)	12	(720)
Income from discontinued operations attributable to Whitestone REIT	-	3,241	-	3,431
Less: Net income attributable to noncontrolling interests	-	(1,180)	-	(1,248)
Income from discontinued operations attributable to Whitestone REIT	-	2,061	-	2,183
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$40	\$1,532	\$12	\$1,463
Denominator				
Weighted average number of common shares - basic	9,707	9,903	9,707	9,952
Effect of dilutive securities:				
Unvested restricted shares	192	-	203	-
Weighted average number of common shares - dilutive	9,899	9,903	9,910	9,952
Basic earnings per common share:				
Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	\$-	\$(0.05)	\$-	\$(0.07)
Income from discontinued operations attributable to Whitestone REIT	-	0.20	-	0.22
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$-	\$0.15	\$-	\$0.15
Diluted earnings per common share:				
Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	\$-	\$(0.05)	\$-	\$(0.07)
Less: Net income attributable to noncontrolling interests	-	0.20	-	0.22
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$-	\$0.15	\$-	\$0.15

9. Income Taxes

Federal income taxes are not assessed against us because we intend to and believe we qualify as a real estate investment trust ("REIT") under the provisions of the Internal Revenue Code of 1986, as amended. 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, share-based compensation and rental revenue.

In May 2006, the State of Texas adopted the Texas Margin Tax effective with franchise tax reports filed on or after January 1, 2008. The Texas Margin Tax is computed by applying the applicable tax rate (1% for us) to the profit margin, which generally will be determined for us as total revenue less a 30% standard deduction. Although House Bill 3 states that the Texas Margin Tax is not an income tax, SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109") applies to the Texas Margin Tax. We have recorded a margin tax provision of approximately \$57,000 and \$111,000 for the three and six months ended June 30, 2009, respectively. Additionally, we recorded a margin tax provision of approximately

WHITESTONE REIT AND SUBSIDIARIES
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(Unaudited)

\$53,000 and \$110,000 for the three and six months ended June 30, 2008, respectively.

10. Equity

Dividends and distributions. The following tables summarize the cash dividends/distributions paid to holders of Common Shares and holders of OP Units for the four quarters of 2008 and the first two quarters of 2009.

Dividend per Common Share	Whitestone Shareholders Quarter Dividend Paid	Total Amount Paid (in thousands)
\$ 0.1500	Qtr. ended 03/31/08	\$ 1,500
0.1500	Qtr. ended 06/30/08	1,529
0.1500	Qtr. ended 09/30/08	1,456
0.1125	Qtr. ended 12/31/08	1,093
0.1125	Qtr. ended 03/31/09	1,156
0.1125	Qtr. ended 06/30/09	1,163

Distribution per OP Unit	OP Unit Holders Including Noncontrolling Unit Holders Quarter Distribution Paid	Total Amount Paid (in thousands)
\$ 0.1500	Qtr. ended 03/31/08	\$ 2,317
0.1500	Qtr. ended 06/30/08	2,423
0.1500	Qtr. ended 09/30/08	2,113
0.1125	Qtr. ended 12/31/08	1,585
0.1125	Qtr. ended 03/31/09	1,687
0.1125	Qtr. ended 06/30/09	1,694

WHITESTONE REIT AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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11. Commitments and Contingencies

We are subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, management believes the final outcome of such matters will not have a material adverse effect on our condensed consolidated financial statements.

Hurricane Ike. Our 31 properties in Houston had minor to moderate harm, ranging from broken signage to uprooted landscaping; other properties had more significant issues, such as damaged roofing and exterior siding. We maintain casualty and business interruption insurance at levels that we believe are adequate and have determined that 16 of these properties will have an insurance claim. During the quarter ended June 30, 2009, insurance reimbursements were determined on 6 of the 16 properties. We expect to settle the insurance claims for the remaining 10 properties during the third quarter of 2009.

12. Property Dispositions

On May 30, 2008, as part of our settlement with Hartman Management L.P. and Allen R. Hartman ("Hartman"), we exchanged two retail properties, Garden Oaks, a 95,046 square foot retail property located in Houston, Texas and Northeast Square, a 40,525 square foot retail property located in Houston, Texas, for \$11.4 million. The \$11.4 million purchase price was paid by Hartman in the form of 293,961.54 Common Shares and 1,068,451.271 OP Units.

The following is a summary of income (loss) from discontinued operations for the three and six months ended June 30, 2009 and 2008:

	Three Months ended June 30,		Six Months ended June 30,	
	2009	2008	2009	2008
Property Revenues				
Rental revenues	\$ -	\$ 59	\$ -	\$ 333
Other revenues	-	133	-	225
Total property revenues	-	192	-	558
Property Expenses				
Property operation and maintenance	-	109	-	170
Real estate taxes	-	87	-	133
Total property expenses	-	196	-	303
Other expense				
General and administrative	-	221	-	221
Depreciation and amortization	-	151	-	218
Total other expense	-	372	-	439
Loss before loss on disposal of assets and income taxes				
	-	(376)	-	(184)

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Gain on sale of properties	-	3,619	-	3,619
Provision for income taxes	-	(2)	-	(4)
Income from discontinued operations	\$ -	\$ 3,241	\$ -	\$ 3,431

13. Acquisitions

On January 16, 2009, we acquired a 41,396 square foot garden style mixed use property in Buffalo Grove, Illinois for approximately \$9.4 million, including cash of \$5.5 million, issuance of

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(Unaudited)

703,912 OP Units worth \$3.6 million and credit for net prorations of \$0.3 million. The property, Spoerlein Commons, is a two story complex of retail, medical and professional office tenants. James C. Mastandrea, our Chairman, President and Chief Executive Officer, was the controlling limited partner of Midwest Development Venture IV, the seller of Spoerlein Commons, and had an ownership interest in the property and was entitled to a portion of the proceeds from the sale of the property to the Operating Partnership. Because of Mr. Mastandrea's relationship with the seller, a special committee of the independent members of the Board of Trustees, including Donald F. Keating, Jack L. Mahaffey, and Chris A. Minton, negotiated the terms of the transaction, which included the use of an independent appraiser to value the property. This purchase was accounted for using the acquisition method as prescribed under SFAS No. 141(R). The assets acquired and liabilities accrued in this transaction were recorded at their estimated fair value at the time of purchase.

14. Incentive Share Plan

On July 29, 2008, our shareholders approved the 2008 Long-Term Equity Incentive Ownership Plan (the "Plan"). The Plan provides that awards may be made with respect to Common Shares or OP Units, which may be converted into Common Shares of Whitestone. The Plan authorizes awards in respect of an aggregate of 2,063,885 Common Shares. The maximum aggregate number of Common Shares that may be issued under the Plan will be increased upon each issuance of Common Shares by Whitestone (including issuances pursuant to the Plan) so that at any time the maximum number of shares that may be issued under the Plan shall equal 12.5% of the aggregate number of Common Shares of Whitestone and OP Units issued and outstanding (other than treasury shares and/or units issued to or held by Whitestone).

The Compensation Committee of Whitestone's Board of Trustees administers the Plan, except with respect to awards to non-employee trustees, for which the Plan is administered by Whitestone's Board of Trustees. The Committee is authorized to grant stock options, including both incentive stock options and non-qualified stock options, as well as stock appreciation rights, either with or without a related option. The Committee is also authorized to grant restricted common shares, restricted common share units, performance awards and other share-based awards.

On January 6, 2009, the Compensation Committee, pursuant to the Plan, granted to certain of its officers restricted common share awards (the "Restricted Shares") and restricted common share unit awards (the "Restricted Units") subject to certain restrictions. The Restricted Shares and Restricted Units will vest based on certain performance goals (as specified in the award agreement). The grantee is the record owner of the Restricted Shares and has all rights of a shareholder with respect to the Restricted Shares, including the right to vote the Restricted Shares and to receive dividends and distributions with respect to the Restricted Shares. The grantee has no rights of a shareholder with respect to the Restricted Units, including no right to vote the Restricted Units and no right to receive current dividends and distributions with respect to the Restricted Units until the units are fully vested and convertible to Common Shares of Whitestone.

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A summary of the stock-based incentive plan activity as of and for the six months ended June 30, 2009 is as follows:

	Shares		Weight-Average Grant Date Fair Value
Non-vested at January 1, 2009	-	\$	-
Granted	1,786,187		4.13
Vested	-		-
Forfeited	(9,000)	3.71
Non-vested at June 30, 2009	1,777,187	\$	4.13

Total compensation recognized in earnings for share-based payments for the three and six months ended June 30, 2009 was \$0.3 and \$0.5 million, respectively. There was no share-based compensation expense prior to 2009. As of June 30, 2009, there was \$0.4 million of total unrecognized compensation cost related to outstanding nonvested shares issued under the Plan, which is expected to be recognized over a weighted-average period of six months. The fair value of the shares granted during the six months ended June 30, 2009 was determined based on observable market transactions occurring near the date of the grants.

15. Grants to Trustees

On March 25, 2009, each of our five independent trustees was granted 5,000 restricted common shares which vest in equal installments in 2010, 2011, and 2012. These shares were granted pursuant to individual grant agreements and were not pursuant to our 2008 Long-Term Equity Incentive Ownership Plan. The 25,000 shares had a weighted average grant date fair value of \$4.94 per share, resulting in total unrecognized compensation cost of \$0.1 million, which is expected to be recognized over a weighted-average period of approximately three years. The fair value of the shares granted during the six months ended June 30, 2009 was determined based on observable market transactions occurring near the date of the grants.

16. Segment Information

Historically, our management has not differentiated results of operations by property type or location and therefore does not present segment information.

17. Related Party Transactions

Spoerlein Commons Acquisition

On January 16, 2009, Whitestone, operating through the Operating Partnership, acquired Spoerlein Commons, a mixed use-garden style complex of retail, medical, and professional office tenants located in Buffalo Grove, Illinois. The Operating Partnership acquired Spoerlein Commons pursuant to the terms and conditions of the purchase, sale and contribution agreement dated December 18, 2008 (the "Agreement") between the Operating Partnership and Bank One, Chicago, NA, as trustee under a trust agreement dated January 29, 1986 ("Seller"). Midwest Development Venture IV, an Illinois limited partnership ("Midwest"), is the sole beneficiary of the Seller under the trust agreement.

Spoerlein Commons represents an acquisition for Whitestone, and a substantial equity investment on behalf of the Seller. In exchange for Spoerlein Commons, the Operating Partnership paid the Seller \$5,500,000, received credit for net prorations of \$275,854 and issued 703,912 OP Units, valued at \$5.15 per Unit, for a total purchase price of \$9,401,000.

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WHITESTONE REIT AND SUBSIDIARIES
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Midwest, the sole beneficiary of the Seller, is entitled to all earnings and proceeds from the sale of Spoerlein Commons. James C. Mastandrea, our Chairman, President and Chief Executive Officer, is the controlling limited partner in Midwest and as such, had an ownership interest in Spoerlein Commons and is entitled to a portion of the proceeds from the sale of Spoerlein Commons to the Operating Partnership. Because of Mr. Mastandrea's relationship with the Seller, a special committee of the independent members of the Board of Trustees including Donald F. Keating, Jack L. Mahaffey, and Chris A. Minton determined the terms of the transaction, which included the use of an independent appraiser to value Spoerlein Commons.

No brokerage commission was paid by Whitestone for this acquisition, and in relation to Mr. Mastandrea's investment, there was no front-end-load, meaning that 100% of the amount paid is working for the benefit of Whitestone's shareholders.

In connection with the closing of Spoerlein Commons and the investment on behalf of the Seller, the Operating Partnership issued 703,912 OP Units to Midwest for its contribution of Spoerlein Commons to the Operating Partnership. The OP Units were issued in reliance on the exemption from registration provided by Section 4(2) under the Securities Act of 1933, as amended. The issuance was not effected using any form of general advertising or general solicitation and the issuance was made to a qualified investor.

The OP Units are convertible on a one-for-one basis into Common Shares at any time after July 1, 2009 in accordance with the terms of the Operating Partnership's Limited Partnership Agreement, as amended (the "Limited Partnership Agreement"). The Seller is not entitled to any distributions with respect to the OP Units prior to June 30, 2009.

18. Subsequent Events

We have disclosed the following subsequent events in accordance with SFAS 165. Subsequent events have been evaluated through August 13, 2009, the date the financial statements were filed.

On July 25, 2009, the stated maturity date, we paid the \$6.4 million term loan with KeyBank.

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 condensed consolidated financial statements and the notes thereto included in this quarterly report on Form 10-Q (the "Report"). For more detailed information regarding the basis of presentation for the following information, you should read the notes to the condensed consolidated financial statements included in this Report.

This 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 terms and 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 Report. 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 Report include:

- the imposition of federal taxes if we fail to qualify as a REIT in any taxable year or foregone opportunity to ensure REIT status;
- uncertainties related to the national economy, the real estate industry in general and in our specific markets;
 - legislative or regulatory changes, including changes to laws governing REITs;
 - construction costs that may exceed estimates or construction delays;
 - increases in interest rates;
 - availability of credit equity or significant disruption in the credit or equity markets;
 - litigation risks;
 - lease-up risks;
 - inability to obtain new tenants upon the expiration of existing leases;
- inability to generate sufficient cash flows due to market conditions, competition, uninsured losses, changes in tax or other applicable laws; 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 Annual Report on Form 10-K for the year ended December 31, 2008, as previously filed with the Securities and Exchange Commission (the “SEC”).

Executive Overview

We are a self-administered real estate investment trust (“REIT”) engaged in owning and operating income-producing real properties. Our investments include retail, office and warehouse properties located in the Houston, Dallas, San Antonio, Chicago and Phoenix metropolitan areas. Whitestone serves as the general partner of Whitestone REIT Operating Partnership, L.P. (the “Operating Partnership,” or “WROP” or “OP”), 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 power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of June 30, 2009, we owned and operated 36 commercial properties consisting of:

- Seventeen retail properties containing approximately 1.1 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$61.0 million.
- Eight office properties containing approximately 0.7 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$55.6 million.
- Eleven office/warehouse properties containing approximately 1.2 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$42.8 million.

Our primary source of income and cash is rents associated with commercial leases. Our business objective is to increase shareholder value by employing a value-added investment strategy. This strategy is focused on owning and renovating commercial real estate assets in markets with positive demographic trends, achieving diversification by property type and location, and acquiring properties within our targeted returns.

As of June 30, 2009, we had 694 total tenants. We have a diversified tenant base with our largest tenant comprising only 2.7% of our total revenues for the three and six months ended June 30, 2009. Lease terms for our properties range from less than one year for smaller tenants to over 15 years for larger tenants. Our leases generally include minimum monthly lease payments and tenant reimbursements for payment of taxes, insurance and maintenance.

We employ 55 full-time employees as of June 30, 2009. 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.

We believe that one of the key measures of our performance is property occupancy. Occupancy for the total portfolio was 82% at June 30, 2009, compared to 85% as of June 30, 2008. We executed 127 new and renewal leases during the six months ended June 30, 2009, totaling approximately 300,000 square feet and \$11.4 million in total lease value.

In the fourth quarter of 2006, our Board approved our five-year business plan. The key elements of the plan are as follows:

- Maximize value in current properties through operational focus and redevelopment;
- Grow through strategic acquisitions of commercial properties in high potential markets, including properties outside of Texas;
- Dispose of non-core properties and reinvest the capital in redevelopment of existing properties or acquisition of core properties in high potential markets;
- Raise capital using a combination of the private and public equity and debt markets, as well as joint ventures; and
 - Bring liquidity to our stock by listing on a national stock exchange.

A summary of our progress on the execution of this five year plan is described in the following sections on redevelopment, acquisitions and dispositions.

Redevelopment

We completed the redevelopment of the Westchase Plaza Retail and Office Center located in Houston, Texas during the three months ended March 31, 2009. The total redevelopment of this center cost approximately \$1.7 million, and it added approximately 6,600 square feet of leasable office space.

Acquisitions

On January 16, 2009, we acquired a 41,396 square foot garden style mixed use property in Buffalo Grove, Illinois for approximately \$9.4 million. The property, Spoerlein Commons, is a two story complex of retail, medical and professional office tenants. James C. Mastandrea, our Chairman, President and Chief Executive Officer, was the controlling limited partner of Midwest Development Venture IV, the seller of Spoerlein Commons, and had an ownership interest in the property and was entitled to a portion of the proceeds from the sale of the property to the Operating Partnership. Because of Mr. Mastandrea's relationship with the seller, a special committee of the independent members of the Board of Trustees, including Donald F. Keating, Jack L. Mahaffey, and Chris A. Minton, negotiated the terms of the transaction, which included the use of an independent appraiser to value the property.

Dispositions (discontinued operations)

On May 30, 2008, as part of our settlement with Hartman Management L.P. and Allen R. Hartman ("Hartman"), we exchanged two retail properties, Garden Oaks, a 95,046 square foot retail property located in Houston, Texas and Northeast Square, a 40,525 square foot retail property located in Houston, Texas, for \$11.4 million. The \$11.4 million purchase price was paid by Hartman in the form of 293,961.54 Whitestone Common Shares (the "Common Shares") and 1,068,451.271 units of ownership interest in our Operating Partnership (the "OP Units").

Critical Accounting Policies

In preparing the condensed consolidated financial statements, we have made estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. Actual results may differ from these estimates. A summary of our critical accounting policies is included in our Form 10-K for the year ended December 31, 2008, under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no significant changes to these policies during the first six months of 2009 except for the adoptions in the first quarter of 2009 of Statement of Financial Accounting Standards ("SFAS") No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"); Financial Accounting Standards Board ("FASB") Staff Position EITF No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities" ("FSP EITF No. 03-6-1"); SFAS 141(R), "Business Combinations," which is applied prospectively to business combinations with acquisition dates on or after January 1, 2009; and SFAS No. 157, "Fair Value Measurements" (SFAS No. 157), for all nonfinancial assets and nonfinancial liabilities. For disclosure regarding recent accounting pronouncements and the anticipated impact they will have on our operations, please refer to Note 2 of the condensed consolidated financial statements.

Results of Operations

Comparison of the Three Month Periods Ended June 30, 2009 and 2008

The following tables provide a general comparison of our results of operations for the three months ended June 30, 2009 and 2008 (in thousands, except for aggregate gross leasable area):

	June 30, 2009	June 30, 2008
Number of properties owned and operated	36	35
Aggregate gross leasable area (sq. ft.)	3,039,300	2,957,492
Ending occupancy rate	82 %	85 %
Total property revenues	\$ 8,203	\$ 7,750
Total property expenses	3,268	3,113
Total other expenses	4,794	5,347
Provision for income taxes	57	53
Loss on disposal of assets	12	68
Income (loss) from continuing operations	72	(831)
Loss from discontinued operations	-	(378)
Gain on sale of properties from discontinued operations	-	3,619
Net income	72	2,410
Less: Net income attributable to noncontrolling interests	25	878
Net income attributable to Whitestone REIT	\$ 47	\$ 1,532
Funds from operations (1)	\$ 1,633	\$ 426
Dividends and distributions paid on common shares and OP Units	1,694	2,303
Per common share and OP unit	\$ 0.1125	\$ 0.1500
Dividends paid as a % of funds from operations	104 %	541 %

(1) For a reconciliation of funds from operations to net income, see Funds From Operations below.

Property revenues. Substantially all of our revenue is derived from rents received from the use of our properties. We had rental income and tenant reimbursements of approximately \$8.2 million for the three months ended June 30, 2009 as compared to \$7.8 million for the three months ended June 30, 2008, an increase of \$0.4 million, or 5%. The increase is primarily attributable to the addition of our Spoerlein Commons property during January 2009.

Property expenses. Our total property expenses were \$3.3 million for the three months ended June 30, 2009, as compared to \$3.1 million for the three months ended June 30, 2008, an increase of \$0.2 million, or 6%. The primary components of operating expense are detailed in the table below (in thousands):

	Three Months Ended June 30,	
	2009	2008
Real estate taxes	\$ 1,063	\$ 925
Utilities	608	662
Contract services	548	536
Repairs and maintenance	383	659
Bad debt	246	31
Hurricane Ike repairs, net of insurance reimbursements	(51)	-
Labor and other	471	300
Total property expenses	\$ 3,268	\$ 3,113

Increases during 2009 in real estate taxes and bad debt expense increased property expenses a total of approximately \$350,000. The increase of \$138,000 in real estate taxes is the result of increased assessed values on our properties and the addition of the Spoerlein Commons property during January 2009. Bad debt for the three months ended June 30, 2009 was \$215,000 more than the same period in 2008. The increase in bad debt is driven by slower paying tenants and abandonments. We vigorously pursue past due accounts, but expect for collection of rents to continue to be challenging for the foreseeable future. Hurricane Ike repairs, net of insurance reimbursements includes the known insurance reimbursements for six of the sixteen properties we filed claims on. We expect to settle the reimbursement amounts for the remaining ten properties during the third quarter of 2009.

Other expenses. Our other expenses were \$4.8 million for the three months ended June 30, 2009, as compared to \$5.3 million for the three months ended June 30, 2008, a decrease of \$0.5 million, or 10%. The primary components of other expense, net are detailed in the table below (in thousands):

	Three Months Ended June 30,	
	2009	2008
General and administrative	\$ 1,625	\$ 2,170
Depreciation and amortization	1,710	1,791
Interest expense	1,470	1,425
Interest income	(11)	(39)
Total other expenses	\$ 4,794	\$ 5,347

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General and administrative. The decrease of \$0.5 million in general and administrative expense is primarily due to decreased legal fees as a result of the settlement of the litigation with Mr. Hartman and Hartman Management, L.P. in May 2008, offset by share-based compensation that was incurred in 2009 but not 2008. Legal fees were \$103,000 for the three months ended June 30, 2009, as compared to \$997,000 for the same period in 2008. Share-based compensation was \$256,000 and \$0 for the three months ended June 30, 2009 and 2008, respectively. The share-based compensation is tied to performance measures, and we expect quarterly share-based compensation expense to remain at current levels for the rest of 2009.

Depreciation and amortization. Depreciation and amortization decreased \$81,000 for the three months ended June 30, 2009, as compared to the three months ended June 30, 2008.

Interest expense, net. Interest expense for the three months ended June 30, 2009 was \$1.5 million, an increase of \$45,000 over the same period in 2008. An increase in the average outstanding note payable balance of \$21.2 million accounted for approximately \$341,000 in increased interest expense during 2009, while a lower effective interest rate of 1.1% per annum (excluding amortized loan fees) accounted for approximately \$296,000 in decreased interest expense during 2009. The decrease in interest income of approximately \$28,000 is primarily due to lower interest rates of return on our deposits.

Discontinued Operations. Discontinued operations are comprised of the two properties known as Garden Oaks and Northeast Square. The two properties were transferred to Mr. Hartman and Hartman Management, L.P. as part of a legal settlement on May 30, 2008. Below is a recap of income from discontinued operations (in thousands):

	Three Months ended June 30,	
	2009	2008
Property Revenues		
Rental revenues	\$ -	\$ 59
Other revenues	-	133
Total property revenues	-	192
Property Expenses		
Property operation and maintenance	-	109
Real estate taxes	-	87
Total property expenses	-	196
Other expense		
General and administrative	-	221
Depreciation and amortization	-	151
Total other expense	-	372
Loss before loss on disposal of assets and income taxes		
	-	(376)
Gain on sale of properties	-	3,619
Provision for income taxes	-	(2)
Income from discontinued operations	\$ -	\$ 3,241

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Comparison of the Six Month Periods Ended June 30, 2009 and 2008

The following tables provide a general comparison of our results of operations for the six months ended June 30, 2009 and 2008 (in thousands, except for aggregate gross leasable area):

	June 30, 2009	June 30, 2008
Number of properties owned and operated	36	35
Aggregate gross leasable area (sq. ft.)	3,039,300	2,957,492
Ending occupancy rate	82 %	85 %
Total property revenues	\$ 16,247	\$ 15,506
Total property expenses	6,695	6,244
Total other expenses	9,348	10,183
Provision for income taxes	111	110
Loss on disposal of assets	53	100
Income (loss) from continuing operations	40	(1,131)
Loss from discontinued operations	-	(188)
Gain on sale of properties from discontinued operations	-	3,619
Net income	40	2,300
Less: Net income attributable to noncontrolling interests	14	837
Net income attributable to Whitestone REIT	\$ 26	\$ 1,463
Funds from operations (1)	\$ 3,189	\$ 1,799
Dividends and distributions paid on common shares and OP Units	3,381	4,675
Per common share and OP unit	\$ 0.2250	\$ 0.3000
Dividends paid as a % of funds from operations	106 %	260 %

(1) For a reconciliation of funds from operations to net income, see Funds From Operations below.

Property revenues. We had rental income and tenant reimbursements of approximately \$16.2 million for the six months ended June 30, 2009 as compared to \$15.5 million for the six months ended June 30, 2008, an increase of \$0.7 million, or 5%. The increase is primarily attributable to the addition of our Spoerlien Commons property during January 2009.

Property expenses. Our total property expenses were \$6.7 million for the six months ended June 30, 2009, as compared to \$6.2 million for the six months ended June 30, 2008, an increase of \$0.5 million, or 8%. The primary components of operating expense are detailed in the table below (in thousands):

	Six Months Ended June 30, 2009	2008
Real estate taxes	\$ 2,112	\$ 1,933
Utilities	1,226	1,357
Contract services	1,091	1,061
Repairs and maintenance	751	972
Bad debt	464	222
Hurricane Ike repairs, net of insurance reimbursements	190	-
Labor and other	861	699
Total property expenses	\$ 6,695	\$ 6,244

Increases during 2009 in real estate taxes, bad debt expense and repairs attributable to Hurricane Ike increased property expenses by a total of approximately \$600,000. The increase of \$179,000 in real estate taxes is the result of increased assessed values on our properties and the addition of the Spoerlein Commons property during January 2009. Bad debt for the six months ended June 30, 2009 was \$242,000 more than the same period in 2008. The increase in bad debt is driven by slower paying tenants and abandonments. We vigorously pursue past due accounts, but expect for collection of rents to continue to be challenging for the foreseeable future. Hurricane Ike repairs, net of insurance reimbursements includes the known insurance reimbursements for six of the sixteen properties we filed claims on. We expect to settle the reimbursement amounts for the remaining ten properties during the third quarter of 2009.

Other expense. Our other expenses were \$9.3 million for the six months ended June 30, 2009, as compared to \$10.2 million for the six months ended June 30, 2008, a decrease of \$0.9 million, or 9%. The primary components of other expense, net are detailed in the table below (in thousands):

	Six Months Ended June 30,	
	2009	2008
General and administrative	\$ 3,054	\$ 4,133
Depreciation and amortization	3,418	3,347
Interest expense	2,898	2,827
Interest income	(22)	(124)
Total other expenses	\$ 9,348	\$ 10,183

General and administrative. The decrease of \$1.1 million in general and administrative expense is primarily due to decreased legal fees as a result of the settlement of the litigation with Mr. Hartman and Hartman Management, L.P. in May 2008, offset by share-based compensation that was incurred in 2009 but not 2008. Legal fees were \$166,000 for the six months ended June 30, 2009, as compared to \$1,660,000 for the same period in 2008. Share-based compensation was \$497,000 and \$0 for the six months ended June 30, 2009 and 2008, respectively.

Depreciation and amortization. Depreciation and amortization increased \$71,000 for the six months ended June 30, 2009, as compared to the six months ended June 30, 2008.

Interest expense, net. Interest expense for the six months ended June 30, 2009 was \$2,898,000, an increase of \$71,000 over the same period in 2008. An increase in the average outstanding note payable balance of \$19.6 million accounted for approximately \$640,000 in increased interest expense during 2009, while a lower effective interest rate of 1.1% per annum (excluding amortized loan fees) accounted for approximately \$569,000 in decreased interest expense during 2009. The decrease in interest income of approximately \$102,000 is primarily due to lower interest rates of return on our deposits.

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Discontinued Operations. Discontinued operations are comprised of the two properties known as Garden Oaks and Northeast Square. The two properties were transferred to Mr. Hartman and Hartman Management, L.P. as part of a legal settlement on May 30, 2008. Below is a recap of income from discontinued operations (in thousands):

	Six Months ended June	
	2009	2008
Property Revenues		
Rental revenues	\$ -	\$ 333
Other revenues	-	225
Total property revenues	-	558
Property Expenses		
Property operation and maintenance	-	170
Real estate taxes	-	133
Total property expenses		