Whitestone REIT
Form 10-Q
November 07, 2011
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

	(Mark One)
[x]	QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

OR

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

For the transition period from ____________ to ____________

Commission file number 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	77063
(Address of Principal Executive Offices)	(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. ýYes ¨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).
ýYes ¨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 ¨
Non-accelerated filer (Do not check if a smaller reporting company) ý 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 ý No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding as of November 4, 2011
Class A Common Stock, $0.001 par value	2,603,294 Shares
Class B Common Stock, $0.001 par value	8,833,318 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)

	September 30, 2011 (unaudited)	December 31, 2010
ASSETS		
Real estate assets, at cost:		
Property	$241,488	$203,223
Accumulated depreciation	(43,761)	(38,989)
Net operating real estate assets	197,727	164,234
Real estate assets held-for-sale, net	—	1,164
Total real estate assets	197,727	165,398
Cash and cash equivalents	32,660	17,591
Marketable securities	4,579	—
Escrows and acquisition deposits	4,092	4,385
Accrued rents and accounts receivable, net of allowance for doubtful accounts	5,309	4,691
Unamortized lease commissions and loan costs	3,618	3,574
Prepaid expenses and other assets	705	746
Other assets - discontinued operations	—	60
Total assets	$248,690	$196,445
LIABILITIES AND EQUITY		
Liabilities:		
Notes payable	$102,234	$100,941
Accounts payable and accrued expenses	7,800	7,208
Tenants' security deposits	1,956	1,768
Dividends and distributions payable	3,647	2,133
Other liabilities - discontinued operations	—	112
Total liabilities	115,637	112,162
Commitments and contingencies:		
Equity:		
Preferred shares, $0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at September 30, 2011 and December 31, 2010	—	—
Class A common shares, $0.001 par value per share; 50,000,000 shares authorized; 3,471,090 and 3,471,187 issued and outstanding as of September 30, 2011 and December 31, 2010, respectively	3	3
Class B common shares, $0.001 par value per share; 350,000,000 shares authorized; 7,511,269 and 2,200,000 issued and outstanding as of September 30, 2011 and December 31, 2010, respectively	7	2
Additional paid-in capital	153,105	93,357
Accumulated other comprehensive loss	(1,545)	—
Accumulated deficit	(38,413)	(30,654)
Total Whitestone REIT shareholders' equity	113,157	62,708
Noncontrolling interests in subsidiary	19,896	21,575
Total equity	133,053	84,283
Total liabilities and equity	$248,690	$196,445

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 September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Property revenues				
Rental revenues	$7,075	$6,446	$20,354	$19,167
Other revenues	1,704	1,410	4,415	4,069
Total property revenues	8,779	7,856	24,769	23,236
Property expenses				
Property operation and maintenance	2,355	2,090	6,238	5,952
Real estate taxes	1,259	948	3,367	2,978
Total property expenses	3,614	3,038	9,605	8,930
Other expenses (income)				
General and administrative	1,495	1,263	4,737	3,735
Depreciation and amortization	2,162	1,816	6,098	5,281
Interest expense	1,430	1,401	4,277	4,210
Interest, dividend and other investment income	(264)	(7)	(379)	(19)
Total other expense	4,823	4,473	14,733	13,207
Income from continuing operations before gain (loss) on disposal of assets and income taxes	342	345	431	1,099
Provision for income taxes	(54)	(56)	(164)	(211)
Gain (loss) on sale or disposal of assets	1	(72)	(17)	(113)
Income from continuing operations	289	217	250	775
Income (loss) from discontinued operations	(11)	17	36	49
Gain on sale of property from discontinued operations	397	—	397	—
Net income	675	234	683	824
Less: Net income attributable to noncontrolling interests	97	57	122	264
Net income attributable to Whitestone REIT	$578	$177	$561	$560

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 September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Earnings per share - basic				
Income from continuing operations attributable to Whitestone REIT excluding amount attributable to unvested restricted shares	$0.02	$0.04	$0.02	$0.14
Income from discontinued operations attributable to Whitestone REIT	0.03	—	0.05	0.01
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	$0.05	$0.04	$0.07	$0.15
Earnings per share - diluted				
Income from continuing operations attributable to Whitestone REIT excluding amount attributable to unvested restricted shares	$0.02	$0.04	$0.02	$0.14
Income from discontinued operations attributable to Whitestone REIT	0.03	—	0.05	0.01
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	$0.05	$0.04	$0.07	$0.15
Weighted average number of common shares outstanding:				
Basic	10,797	4,020	8,285	3,517
Diluted	10,809	4,040	8,300	3,548
Dividends declared per Class A common share	$0.2850	$0.2850	$0.8550	$0.9075
Dividends declared per Class B common share (1)	0.2850	0.2850	0.8550	0.3810
Consolidated Statements of Comprehensive Income (Loss)				
Net income	$675	$234	$683	$824
Other comprehensive loss:				
Unrealized loss on available-for-sale marketable securities	(1,672)	—	(1,881)	—
Comprehensive income (loss)	(997)	234	(1,198)	824
Less: Comprehensive income (loss) attributable to noncontrolling interests	(143)	57	(214)	264
Comprehensive income (loss) attributable to Whitestone REIT	$(854)	$177	$(984)	$560

(1) Class B common shares were issued on August 25, 2010 in connection with our initial public offering and listing on the NYSE-Amex. Class B shares received a pro-rated dividend in September 2010. From October 2010 forward,

Class A and Class B shares received the same dividend.

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	Accumulated	Accumulated Other Comprehensive	Total Shareholders'	Noncontrolling interests		Total
	Shares	Amount	Shares	Amount	Capital	Deficit	Loss	Equity	Units	Dollars	Equity
Balance, December 31, 2010	3,471	$3	2,200	$2	$93,357	$(30,654)	$—	$62,708	1,815	$21,575	$84,283
Issuance of common shares	—	—	5,310	5	59,678	—	—	59,683	—	—	59,683
Dividend reinvestment plan	—	—	1	—	(16)	—	—	(16)	—	—	(16)
Share-based compensation	—	—	—	—	86	—	—	86	—	—	86
Dividends and distributions	—	—	—	—	—	(8,320)	—	(8,320)	—	(1,465)	(9,785)
Unrealized loss on change in fair value of available-for-sale marketable securities	—	—	—	—	—	—	(1,545)	(1,545)	—	(336)	(1,881)
Net income	—	—	—	—	—	561	—	561	—	122	683
Balance, September 30, 2011	3,471	$3	7,511	$7	$153,105	$(38,413)	$(1,545)	$113,157	1,815	$19,896	$133,053

See accompanying notes to Consolidated Financial Statements

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

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Income from continuing operations	$250	$775
Income from discontinued operations	433	49
Net income	683	824
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,098	5,281
Gain on sale of marketable securities	(192)	—
Loss on sale or disposal of assets	17	113
Bad debt expense	379	339
Share-based compensation	233	219
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	385	3,893
Accrued rent and accounts receivable	(994)	(213)
Unamortized lease commissions and loan costs	(728)	(514)
Prepaid expenses and other assets	599	515
Accounts payable and accrued expenses	97	(2,141)
Tenants' security deposits	188	74
Net cash provided by operating activities	6,332	8,341
Net cash provided by (used in) operating activities of discontinued operations	(8)	69
Cash flows from investing activities:		
Additions to real estate	(3,966)	(2,439)
Real estate acquisitions	(34,020)	(2,225)
Investments in marketable securities	(13,520)	—
Proceeds from sales of marketable securities	7,252	—
Net cash used in investing activities	(44,254)	(4,664)
Net cash provided by investing activities of discontinued operations	1,553	—
Cash flows from financing activities:		
Dividends paid	(6,852)	(3,534)
Distributions paid to OP unit holders	(1,544)	(1,742)
Proceeds from issuance of common shares	59,667	23,020
Proceeds from notes payable	2,905	1,430
Repayments of notes payable	(2,356)	(2,231)
Payments of loan origination costs	(374)	(98)
Repurchase of common shares	—	(249)
Net cash provided by financing activities	51,446	16,596
Net increase in cash and cash equivalents	15,069	20,342
Cash and cash equivalents at beginning of period	17,591	6,275
Cash and cash equivalents at end of period	$32,660	$26,617

See accompanying notes to Consolidated Financial Statements

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

	Nine Months Ended September 30, 2011	2010
Supplemental disclosure of cash flow information:		
Cash paid for interest	$4,271	$4,217
Cash paid for taxes	215	262
Non cash investing and financing activities:		
Disposal of fully depreciated real estate	$162	$468
Financed insurance premiums	649	616
Change in fair value of available-for-sale securities	(1,881)	—
Change in par value of Class A common shares	—	7

See accompanying notes to Consolidated Financial Statements

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011
(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, 2010 are derived from our audited consolidated financial statements at that date. The unaudited financial statements as of September 30, 2011 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 September 30, 2011, and the results of operations for the three and nine month periods ended September 30, 2011 and 2010, the consolidated statement of changes in equity for the nine month period ended September 30, 2011 and cash flows for the nine month periods ended September 30, 2011 and 2010. 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 thereto which are included in our Annual Report on Form 10-K for the year ended December 31, 2010.

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 September 30, 2011 and December 31, 2010, Whitestone owned and operated 41 and 38 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 September 30, 2011 and December 31, 2010, 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 year. Issuance of additional Class A or Class B common shares of beneficial interest in Whitestone (collectively the "common shares") and units of limited partnership interest in the Operating Partnership that are convertible into cash or, at our option, Class A 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. GAAP 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 and estimates supporting our impairment analysis for the carrying values of our real estate assets. Actual results could differ from those estimates.

Reclassifications. We have reclassified certain prior fiscal year amounts in the accompanying consolidated financial statements in order to be consistent with the current fiscal year presentation. These reclassifications had no effect on net income 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 a gain on the sale of marketable securities of approximately $154,000 and $192,000 for the three and nine months ended September 30, 2011, respectively. No gain or loss was recognized for the three or nine months ended September 30, 2010. As of September 30, 2011, our investment in available-for-sale marketable securities was approximately $4.6 million, which includes an aggregate unrealized loss of approximately $1.9 million.

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. For the three months ended September 30, 2011 and 2010, we recognized $78,000 and $76,000 in share-based compensation expense, respectively, and for the nine months ended September 30, 2011 and 2010, we recognized $233,000 and $219,000, 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.

See Whitestone's Annual Report on Form 10-K for the year ended December 31, 2010 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.

3. ACCRUED RENT AND ACCOUNTS RECEIVABLE, NET

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

	September 30, 2011	December 31, 2010
Tenant receivables	$1,729	$1,700
Accrued rent and other recoveries	4,764	4,256
Allowance for doubtful accounts	(1,184)	(1,265)
Total	$5,309	$4,691

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4. UNAMORTIZED LEASING COMMISSIONS AND LOAN COSTS

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

	September 30, 2011	December 31, 2010
Leasing commissions	$5,361	$4,939
Deferred financing cost	2,720	2,307
Total cost	8,081	7,246
Less: leasing commissions accumulated amortization	(3,027)	(2,661)
Less: deferred financing cost accumulated amortization	(1,436)	(1,011)
Total cost, net of accumulated amortization	$3,618	$3,574

5. DEBT

Debt consists of the following (in thousands):

Description	September 30, 2011	December 31, 2010
Fixed rate notes		
$3.0 million 6.00% Note, due 2021 (1)	$2,986	$—
$10.0 million 6.04% Note, due 2014	9,370	9,498
$1.5 million 6.50% Note, due 2014	1,477	1,496
$11.2 million 6.52% Note, due 2015	10,800	10,908
$21.4 million 6.53% Notes, due 2013	19,683	20,142
$24.5 million 6.56% Note, due 2013	23,708	24,030
$9.9 million 6.63% Notes, due 2014	9,292	9,498
$0.5 million 5.05% Notes, due 2011	158	13
Floating rate note		
$26.9 million LIBOR + 2.82% Note, due 2013	24,760	25,356
	$102,234	$100,941

(1) The 6.00% interest rate is fixed through March 30, 2016. On March 31, 2016 the interest rate will reset to the rate of interest for a five year balloon note with a thirty year amortization as published by the Federal Home Loan Bank.

As of September 30, 2011, our debt was collateralized by 24 properties with a carrying value of $111.6 million. Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and by assignment of certain rents and leases associated with those properties. As of September 30, 2011, we are in compliance with all loan covenants.

On June 14, 2011, Whitestone, through our Operating Partnership, entered into an agreement with Harris Bank, part of BMO Financial Group, effective June 13, 2011 for an unsecured revolving credit facility (the "Facility") with an initial committed amount of $20 million. The Facility is expandable to $75 million and matures two years from closing, with a 12-month extension available upon lender approval. We will use the Facility for general corporate purposes, including acquisitions and redevelopment of existing properties in our portfolio.

Borrowings under the Facility accrue interest (at our option), based on total indebtedness to total asset value ratio, at either the Eurodollar Loan Rate or the Base Rate at 3.5% to 4.5% and 2.5% to 3.5%, respectively. Base Rate means the higher of: (i) (a) the bank's prime commercial rate, (b) the average rate quoted the bank by two or more Federal funds brokers selected by the bank for sale to the bank at face value of Federal funds in the secondary market in an amount equal or comparable to the principal amount for which such rate is being determined, plus (ii) 1/2 of 1%, and (c) the LIBOR rate for such day plus 1.00%.

Eurodollar Loan Rate means LIBOR divided by the Eurodollar Reserve Percentage. The Eurodollar Reserve Percentage means the maximum reserve percentage at which reserves are imposed by the Board of Governors of the Federal Reserve System.

The Facility contains customary terms and conditions, including, without limitation, affirmative and negative covenants, such as information reporting requirements, maximum total indebtedness to total asset value, minimum earnings before interest, tax, depreciation and amortization ("EBITDA") to fixed charges, and maintenance of net worth. The Facility also contains customary events of default with customary cure and notice, including, without limitation, nonpayment, breach of covenant, misrepresentation of representations and warranties in a material respect, cross-default to other major indebtedness, change of control, bankruptcy, and loss of REIT tax status. We are currently in compliance with these covenants. As of September 30, 2011, no amounts were drawn on the Facility, and our borrowing capacity was $20 million.

Scheduled maturities of our debt as of September 30, 2011 are as follows (in thousands):

Year	Amount Due (in thousands)
2011	$795
2012	2,636
2013	66,488
2014	19,191
2015	10,315
2016 and thereafter	2,809
Total	$102,234

6. EARNINGS PER SHARE

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

Certain of Whitestone's performance-based 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. During the three months and nine months ended September 30, 2011 and 2010, 1,814,569 OP Units were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive.

For the three and nine months ended September 30, 2011, distributions of $53,000 and $160,000, respectively, were made to the holders of certain restricted common shares, $49,000 and $147,000 of which were charged against earnings for the three and nine months ended September 30, 2011, respectively. For the three and nine months ended September 30, 2010, distributions of $58,000 and $196,000, respectively, were made to the holders of certain restricted common shares, $52,000 and $175,000 of which were charged against earnings for the three and nine months ended September 30, 2010, respectively. See Note 11 to our accompanying consolidated financial statements for information related to restricted common shares under the 2008 Plan.

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
(in thousands, except per share data)				
Numerator:				
Income continuing operations	$289	$217	$250	$775
Less: Net income attributable to noncontrolling interests	(41)	(53)	(45)	(248)
Dividends paid on unvested restricted shares	(4)	(6)	(13)	(21)
Undistributed earnings attributable to unvested restricted shares	—	—	—	—
Income from continuing operations atributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	244	158	192	506
Income from discontinued operations	386	17	433	49
Less: Net income attributable to noncontrolling interests	(56)	(4)	(77)	(16)
Income from discontinued operations attributable to Whitestone REIT	330	13	356	33
Net income attributable to common shareholders excluding amounts attibutable to unvested restricted shares	$574	$171	$548	$539
Denominator:				
Weighted average number of common shares - basic	10,797	4,020	8,285	3,517
Effect of dilutive securities:				
Unvested restricted shares	12	20	15	31
Weighted average number of common shares - dilutive	10,809	4,040	8,300	3,548
Earnings Per Share:				
Basic:				
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	$0.02	$0.04	$0.02	$0.14
Income from discontinued operations attributable to Whitestone REIT	0.03	—	0.05	0.01
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	$0.05	$0.04	$0.07	$0.15
Diluted:				
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	$0.02	$0.04	$0.02	$0.14
Income from discontinued operations attributable to Whitestone REIT	0.03	—	0.05	0.01
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	$0.05	$0.04	$0.07	$0.15

7. INCOME TAXES

Federal income taxes are not provided because we intend to continue to and believe we qualify as a REIT under the provisions of the Internal Revenue Code (the "Code") and because we have distributed and intend to continue to distribute all of our taxable income to our shareholders. Our shareholders include their proportionate taxable income in their individual tax returns. As a REIT, we must distribute at least 90% of our real estate investment trust taxable income to our shareholders and meet certain income sources and investment restriction requirements. In addition, REITs are subject to a number of

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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.

During 2010, we discovered that we may have inadvertently violated the "5% asset test," as set forth in Section 856(c)(4)(B)(iii)(I) of the Code, for the quarter ended March 31, 2009 as a result of utilizing a certain cash management arrangement with a commercial bank. If our investment in a commercial paper investment sweep account through such cash management agreement is not treated as cash, and is instead treated as a security of a single issuer for purposes of the "5% asset test," then we failed the "5% asset test" for the first quarter of our 2009 taxable year. We believe, however, that if we failed the "5% asset test," our failure would be considered due to reasonable cause and not willful neglect and, therefore, we would not be disqualified as a REIT for our 2009 taxable year. We would be, however, subject to certain reporting requirements and a tax equal to the greater of $50,000 or 35% of the net income from the commercial paper investment account during the period in which we failed to satisfy the "5% asset test." The amount of such tax is $50,000, and we paid such tax on April 27, 2010.

If the IRS were to assert that we failed the "5% asset test" for the first quarter of our 2009 taxable year and that such failure was not due to reasonable cause, and the courts were to sustain that position, our status as a REIT would terminate as of December 31, 2008. We would not be eligible to again elect REIT status until our 2014 taxable year. Consequently, we would be subject to federal income tax on our taxable income at regular corporate rates without the benefit of the dividends-paid deduction, and our cash available for distributions to shareholders would be reduced.

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.

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") which is codified in FASB ASC 740, Income Taxes ("ASC 740") applies to the Texas Margin Tax. For the three months ended September 30, 2011 and 2010, we recognized $54,000 and $56,000 in margin tax provision, respectively, and for the nine months ended September 30, 2011 and 2010, we recognized $164,000 and $161,000 in margin tax provision, respectively.

8. RELATED PARTY TRANSACTIONS

Executive Relocation. On July 9, 2010, upon the unanimous recommendation of our Compensation Committee, we entered into an arrangement with Mr. Mastandrea with respect to the disposition of his residence in Cleveland, Ohio. Mr. Mastandrea listed the residence in the second half of 2007 and has had no offers. In the meantime, Mr. Mastandrea has continued to pay for security, taxes, insurance and maintenance expenses related to the residence. In May 2010, we engaged a professional relocation firm to market the home and assist in moving the Mastandrea family to Houston. Since the engagement of the relocation firm, no offers on the home have been received. Under the relocation arrangement, we will pay Mr. Mastandrea the shortfall, if any, in the amount realized from the sale of the Cleveland residence, below $2,450,000, not to exceed $700,000, plus tax on the amount of such payment at the maximum federal income tax rate. The first $450,000 plus any taxes will be paid in cash. Any amount payable in excess of $450,000 will be paid in common shares at the market value of the shares, as determined in the reasonable judgment of the Board, as of the time of the sale of the residence.

The common shares payable to Mr. Mastandrea, if any, will be delivered over four consecutive quarters in equal installments. In addition, the arrangement requires us to continue paying the previously agreed upon cost of housing expenses for the Mastandrea family in Houston, Texas for a period of one year following the date of sale of the residence. We have previously agreed to reimburse Mr. Mastandrea for out of pocket moving costs including packing, temporary storage, transportation and moving supplies.

9. EQUITY

Under our declaration of trust, as amended, we have authority to issue up to 50,000,000 Class A common shares of beneficial interest, $0.001 par value per share (the "Class A shares"), up to 350,000,000 Class B common shares of beneficial interest, $0.001 par value per share (the "Class B shares"), and up to 50,000,000 preferred shares of beneficial interest, $0.001 par value per share.

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Follow-On Offering

On May 10, 2011, we completed a public offering of 5,000,000 Class B common shares and the exercise of the underwriters' over-allotment option to purchase an additional 310,000 Class B common shares at the public offering price of $12 per share.

Net proceeds, after payment of underwriting commissions and transaction costs, were approximately $59.7 million. We contributed the net proceeds from this offering to our Operating Partnership in exchange for a 5,310,000 OP units, thereby increasing our ownership interest in the Operating Partnership. Our Operating Partnership intends to use the net proceeds from the offering (1) to acquire commercial properties in our target markets, directly from owners or by acquiring loans with the intent to acquire the underlying property through foreclosure or deed in lieu of foreclosure within a short period of time, (2) to redevelop and re-tenant existing properties to create Whitestone-branded Community Centered Properties and (3) for general corporate purposes.

Operating Partnership Units

Substantially all of our business is conducted through the Operating Partnership. We are the sole general partner of the Operating Partnership. As of September 30, 2011, we owned an 85.7% interest in the Operating Partnership.

Limited partners in the Operating Partnership holding OP Units have the right to convert their OP Units into cash or, at our option, Class A common shares at a ratio of one OP Unit for one Class A common share. Distributions to OP Unit holders are paid at the same rate per unit as dividends per share of Whitestone. As of September 30, 2011 and December 31, 2010, there were 12,676,115 and 7,364,943 OP Units outstanding, respectively. We owned 10,861,546 and 5,550,374 OP Units as of September 30, 2011 and December 31, 2010, respectively. The balance of the OP Units is owned by third parties, including certain of our trustees. Our weighted-average share ownership in the Operating Partnership was approximately 82.2% and 65.2% for the nine months ended September 30, 2011 and September 30, 2010, respectively, and 85.7% and 68.2% for the three months ended September 30, 2011 and September 30, 2010, respectively

Dividends and distributions

The following table summarizes the cash dividends paid or payable to holders of common shares and distributions paid or payable to holders of noncontrolling OP Units during the four quarters of 2010 and the quarters ended March 31, 2011, June 30, 2011 and September 30, 2011 (in thousands, except per share data):

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	Class A Common Shareholders		Class B Common Shareholders		Noncontrolling OP Unit Holders		Total
Quarter Paid	Dividend Per Common Share	Total Amount Paid	Dividend Per Common Share	Total Amount Paid	Distribution Per OP Unit	Total Amount Paid	Total Amount Paid
2011							
Third Quarter	$0.2850	$974	$0.2850	$2,141	$0.2850	$514	$3,629
Second Quarter	0.2850	989	0.2850	1,132	0.2850	515	2,636
First Quarter	0.2850	989	0.2850	627	0.2850	515	2,131
Total	$0.8550	$2,952	$0.8550	$3,900	$0.8550	$1,544	$8,396
2010							
Fourth Quarter	$0.2850	$989	$0.2850	$627	$0.2850	$514	$2,130
Third Quarter	0.2850	992	0.0960	211	0.2850	515	1,718
Second Quarter	0.3375	1,176	—	—	0.3375	610	1,786
First Quarter	0.3375	1,163	—	—	0.3375	610	1,773
Total	$1.2450	$4,320	$0.3810	$838	$1.2450	$2,249	$7,407

Exchange Offer

On September 2, 2011, we commenced an offer to exchange Class B common shares on a one-for-one basis for (i) up to 867,789 outstanding Class A common shares; and (ii) up to 453,642 outstanding OP units (the “Exchange Offer”). The Exchange Offer expired at 5:00 p.m., EDT, on Monday, October 3, 2011, and 867,789 Class A common shares and 453,642 OP units were accepted for exchange.

10. 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 consolidated financial statements.

Executive Relocation. On July 9, 2010, upon the unanimous recommendation of our Compensation Committee, we entered into an arrangement with Mr. Mastandrea with respect to the disposition of his residence in Cleveland, Ohio. Under the relocation arrangement, we will pay Mr. Mastandrea the shortfall, if any, in the amount realized from the sale of the Cleveland residence, below $2,450,000, not to exceed $700,000, plus tax on the amount of such payment at the maximum federal income tax rate. Any amount payable in excess of $450,000 will be paid in common shares over four consecutive quarters at the market value of the shares, as determined in the reasonable judgment of the Board, as of the time of the sale of the residence. In addition, the arrangement requires us to continue paying the previously agreed upon cost of housing expenses for the Mastandrea family in Houston, Texas for a period of one year following the date of sale of the residence. We also previously agreed to reimburse Mr. Mastandrea for out of pocket moving costs including packing, temporary storage, transportation and moving supplies. See also Note 8 above.

11. INCENTIVE SHARE PLAN

On July 29, 2008, our shareholders approved the 2008 Long-Term Equity Incentive Ownership Plan (the “2008 Plan”). On December 22, 2010, our Board amended the 2008 Plan to allow for awards in or related to Class B common shares pursuant to the 2008 Plan. The 2008 Plan, as amended, provides that awards may be made with respect to Class B common shares of Whitestone or OP units, which may be converted into cash or, at our option, Class A common shares of Whitestone. The maximum aggregate number of Class B common shares that may be issued under the 2008 Plan is increased upon each issuance of Class A or Class B common shares by Whitestone (including issuances pursuant to the 2008 Plan) so that at any time the maximum number of shares that may be issued under the 2008 Plan shall equal 12.5% of the aggregate number of

Class A and Class B 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 2008 Plan, except with respect to awards to non-employee trustees, for which the 2008 Plan is administered by Whitestone's Board of Trustees. The Compensation 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 Compensation Committee is also authorized to grant restricted Class B common shares, restricted Class B common share units, performance awards and other share-based awards.

A summary of the share-based incentive plan activity as of and for the nine months ended September 30, 2011 is as follows:

	Shares	Weighted-Average Grant Date Fair Value [(1)]
Non-vested at January 1, 2011	522,441	$12.48
Granted	—	—
Vested	(5,169)	15.45
Forfeited	(13,249)	11.17
Non-vested as of September 30, 2011	504,023	$12.48
Available for grant at September 30, 2011	1,245,638	

(1) The fair value of the Class A common shares granted were determined based on observable market transactions occurring near the date of the grants.

A summary of our nonvested and vested shares activity for the nine months ended September 30, 2011 and years ended December 31, 2010, and 2009 is presented below:

	Shares Granted		Shares Vested	
	Non-Vested Shares Issued	Weighted-Average Grant-Date Fair Value	Vested Shares	Total Vest-Date Fair Value
				(in thousands)
Nine months ended September 30, 2011	—	$ —	(5,169)	$80
Year ended December 31, 2010	31,858	14.09	(55,699)	695
Year ended December 31, 2009	600,731	12.37	—	—

Total compensation recognized in earnings for share-based payments was $69,000 and $68,000 for the three months ended September 30, 2011 and September 30, 2010, respectively, and $208,000 and $185,000 for the nine months ended September 30, 2011 and September 30, 2010, respectively, which represents achievement of the first performance-based target and anticipated vesting of certain restricted shares with time-based vesting. With our current asset base, management does not expect to achieve the next performance-based target. Should we increase our asset base, we may achieve the next performance-based target. As of September 30, 2011, there was no unrecognized compensation cost related to outstanding nonvested performance-based shares based on management's current estimates. As of September 30, 2011, there was approximately $130,000 in unrecognized compensation cost related to outstanding nonvested time-based shares which are expected to be recognized over a weighted-average period of approximately two years. The fair value of the shares granted during the years ended December 31, 2010 and 2009 was determined based on observable market transactions occurring near the date of the grants.

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12. GRANTS TO TRUSTEES
On March 25, 2009, each of our independent trustees was granted 1,667 restricted Class A common shares which vest in equal installments in 2010, 2011, and 2012. During the nine months ended September 30, 2011, 2,224 of these restricted shares vested. These restricted shares were granted pursuant to individual grant agreements and not pursuant to our 2008 Plan.
The 8,333 Class A common shares granted to our five independent trustees had a weighted average grant date fair value of $14.81 per share, resulting in total unrecognized compensation cost of approximately $15,000 as of September 30, 2011, which is expected to be recognized over a weighted-average period of approximately one year. The fair value of the shares granted during 2009 was determined based on observable market transactions occurring near the date of the grants.

13. SEGMENT INFORMATION

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

14. REAL ESTATE

Property Acquisitions. On August 8, 2011, we acquired Terravita Marketplace, a property that meets our Community Centered Property strategy, containing 102,733 leasable square feet, inclusive of 51,434 square feet leased to two tenants under ground leases, located in Scottsdale, Arizona for approximately $16.1 million in cash and net prorations. Terravita Marketplace is surrounded by the gated golf course residential community of Terravita, which was developed by DelWebb Corporation/Pulte, with homes in the $250,000 to $1 million range.

On August 16, 2011, we acquired Ahwatukee Plaza Shopping Center, a property that meets our Community Centered Property strategy for approximately $9.3 million in cash and net prorations. The center contains 72,650 leasable square feet, located in Ahwatukee Foothills neighborhood in south Phoenix, Arizona.

Discontinued Operations. On July 22, 2011, we sold Greens Road Plaza, located in Houston, Texas, for $1.8 million in cash and net prorations. We expect to reinvest the proceeds from the sale of the 20,607 square foot property located in Northeast Houston in acquisitions of Community Centered Properties in our target markets in Arizona, Texas, and Illinois. As a result of the transaction, we have identified the financial results for the the property for the three and nine months ended September 30, 2011 and 2010 and presented them as Discontinued Operations.

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	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Property revenues				
Rental revenues	$10	$43	$107	$133
Other revenues	2	34	71	105
Total property revenues	12	77	178	238
Property expenses				
Property operation and maintenance	20	37	89	121
Real estate taxes	3	8	23	24
Total property expenses	23	45	112	145
Other expenses (income)				
Depreciation and amortization	—	14	29	42
Total other expense	—	14	29	42
Income before loss on disposal of assets and income taxes	(11)	18	37	51
Provision for income taxes	—	(1)	(1)	(2)
Loss on sale or disposal of assets	397	—	397	—
Income from discontinued operations	$386	$17	$433	$49

15. SUBSEQUENT EVENTS

On September 2, 2011, we commenced an offer to exchange Class B common shares on a one-for-one basis for (i) up to 867,789 outstanding Class A common shares; and (ii) up to 453,642 outstanding OP units (the "Exchange Offer"). The Exchange Offer expired at 5:00 p.m., EDT, on Monday, October 3, 2011, and 867,789 Class A common shares and 453,642 OP units were accepted for exchange.

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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 unaudited consolidated financial statements and the notes thereto included in this quarterly report on Form 10-Q (the “Report”), and the consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2010. For more detailed information regarding the basis of presentation for the following information, you should read the notes to the unaudited consolidated financial statements included in this Report.

This Report contains forward-looking statements within the meaning of the federal securities laws, 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 “estimates” or the negative of such terms and variations of these words and similar expressions, although not all forward-looking statements include these words. 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 forego an 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;
- adverse economic or real estate developments in Texas, Arizona or Illinois;
- increases in interest rates and operating costs;
- inability to obtain necessary outside financing;
- decreases in rental rates or increases in vacancy rates;
- litigation risks;
- lease-up risks;
- inability to renew tenant or 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, 2010, as previously filed with the Securities and Exchange Commission (the “SEC”) and of this Report below.

Overview

We are a fully integrated real estate company that owns and operates Community Centered Properties in culturally diverse markets in major metropolitan areas. We define Community Centered Properties as visibly located properties in established or developing culturally diverse neighborhoods in our target markets. Founded in 1998, we are internally managed with a portfolio of commercial properties in Texas, Arizona and Illinois.

In October 2006, our current management team joined the Company and adopted a strategic plan to acquire, redevelop, own and operate Community Centered Properties. We market, lease, and manage our centers to match tenants with the shared needs of the surrounding neighborhood. Those needs may include specialty retail, grocery, restaurants and medical, educational and financial services. Our goal is for each property to become a Whitestone-branded business center or retail community that serves a neighboring five-mile radius around our property. We employ and develop a diverse group of associates who understand the needs of our multicultural communities and tenants.

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As of September 30, 2011, we owned and operated 41 commercial properties consisting of:

Operating Portfolio

- nineteen retail centers containing approximately 1.3 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of $94.3 million;
- seven office centers containing approximately 0.6 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of $44.5 million;
- eleven office/flex centers containing approximately 1.2 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of $41.0 million; and

Redevelopment, New Acquisitions Portfolio

- four retail Community Centered properties containing approximately 0.3 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of $18.0 million.

As of September 30, 2011, we had a total of 850 tenants. We have a diversified tenant base with our largest tenant comprising only 1.7% of our annualized rental revenues for the nine months ended September 30, 2011. 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 completed 224 new and renewal leases during the nine months ended September 30, 2011, totaling approximately 636,000 square feet and approximately $25.1 million in total lease value. This compares to 235 new and renewal leases totaling approximately 535,121 square feet and approximately $20.9 million in total lease value during the same period in 2010.

We employed 61 full-time employees as of September 30, 2011. As an internally 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 costs.

How We Derive Our Revenue

Substantially all of our revenue is derived from rents received from leases at our properties. We had rental income and tenant reimbursements of approximately $8,779,000 for the three months ended September 30, 2011, as compared to $7,856,000 for the three months ended September 30, 2010, an increase of $923,000, or 12%. Rental income and tenant reimbursements for the nine months ended September 30, 2011 and 2010 were approximately $24,769,000 and $23,236,000, respectively, an increase of $1,533,000, or 7%. Revenue for the three and nine months ended September 30, 2011 included approximately $792,000 and $1,319,000, respectively, in revenue from properties acquired subsequent to September 27, 2010, which are considered new stores for comparative purposes. An increase in average occupancy of 2.4% offset by a decrease in the average annual rent of approximately $0.19 per leased square foot accounted for an increase in same store tenant rental and reimbursement revenues of approximately $131,000 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. Same store tenant rental and reimbursement revenues increased approximately $214,000 for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The increase was driven by a 3.8% increase in average occupancy offset by a $0.43 decrease in average annual rent per leased square foot. Our Operating Portfolio Occupancy Rate as of September 30, 2011 was 86%, as compared to 83% as of September 30, 2010. We define Operating Portfolio Occupancy Rate as physical occupancy on all properties, excluding (i) new acquisitions, through the earlier of attainment of 90% occupancy or 18 months of ownership, and (ii) properties which are undergoing significant redeveloping or re-tenanting.

Known Trends in Our Operations; Outlook for Future Results

Rental Income

We expect our rental income to increase year-over-year due to the addition of properties. The amount of net rental income generated by our properties depends principally on our ability to maintain the occupancy rates of currently leased space and to lease currently available space, newly acquired properties with vacant space, and space available from unscheduled lease terminations. The amount of rental income we generate also depends on our ability to maintain or increase rental rates in our submarkets. Negative trends in one or more of these factors could adversely affect our rental income in future periods, although we expect modest continued improvement in the overall economy in our markets to provide slight increases in

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occupancy at certain of our properties.

Scheduled Lease Expirations

We tend to lease space to smaller businesses that desire shorter term leases. As of September 30, 2011, approximately 20% of our gross leasable square footage was subject to leases that expire prior to December 31, 2012. Over the last two years we have renewed approximately 75% of our square footage expiring as a result of lease maturities. We routinely seek to renew leases with our existing tenants prior to their expiration and typically begin discussions with tenants as early as 18 months prior to the expiration date of the existing lease. In the markets in which we operate, we obtain and analyze market rental rates by reviewing third-party publications, which provide market and submarket rental rate data, and by inquiry of property owners and property management companies as to rental rates being quoted at properties located in close proximity to our properties and which we believe display similar physical attributes as our nearby properties. We use this data to negotiate leases with new tenants and renew leases with our existing tenants at rates we believe to be competitive in the markets for our individual properties. Due to the short term nature of our leases, and based upon our analysis of market rental rates, we believe that, in the aggregate, our current leases are at market rates. The aggregate average rental rate per square foot on leases which expire prior to December 31, 2011 is slightly lower than the aggregate average rental rates per square foot of our total portfolio. As such, we expect to renew these expiring leases at rates which are at, or near, their current rates. Market conditions, including new supply of properties, and macroeconomic conditions in Houston and nationally affecting tenant income, such as employment levels, business conditions, interest rates, tax rates, fuel and energy costs and other matters, could adversely impact our renewal rate and/or the rental rates we are able to negotiate. We continue to monitor our tenants' operating performances as well as overall economic trends to evaluate any future negative impact on our renewal rates and rental rates, which could adversely affect our cash flow and ability to pay dividends to our shareholders.

Acquisitions

We expect to actively seek acquisitions in the foreseeable future. We believe that over the next few years we will continue to have excellent opportunities to acquire quality properties at historically attractive prices. We have extensive relationships with community banks, attorneys, title companies and others in the real estate industry which we believe will enable us to take advantage of these market opportunities and maintain an active acquisition pipeline.

Property Acquisitions

We seek to acquire commercial properties in high-growth markets. Our acquisition targets are properties that fit our Community Centered Properties strategy. We define Community Centered Properties as visibly located properties in established or developing, culturally diverse neighborhoods in our target markets, primarily in and around Phoenix, Chicago, Dallas, San Antonio and Houston. We market, lease and manage our centers to match tenants with the shared needs of the surrounding neighborhood. Those needs may include specialty retail, grocery, restaurants, medical, educational and financial services. Our goal is for each property to become a Whitestone-branded business center or retail community that serves a neighboring five-mile radius around our property.

On August 16, 2011, we acquired Ahwatukee Plaza Shopping Center, a property that meets our Community Centered Property strategy for approximately $9.3 million in cash and net prorations. The center contains 72,650 leasable square feet, located in Ahwatukee Foothills neighborhood in south Phoenix, Arizona.

On August 8, 2011, we acquired Terravita Marketplace, a property that meets our Community Centered Property strategy, containing 102,733 leasable square feet, inclusive of 51,434 square feet leased to two tenants under ground leases, located in Scottsdale, Arizona for approximately $16.1 million in cash and net prorations. Terravita Marketplace is surrounded by the gated golf course residential community of Terravita, which was developed by

DelWebb Corporation/Pulte, with homes in the $250,000 to $1 million range.

On June 28, 2011, we acquired Gilbert Tuscany Village, a property that meets our Community Centered Property strategy, containing 49,415 leasable square feet, located in Gilbert, Arizona for approximately $5.0 million in cash and net prorations. Gilbert Tuscany Village is surrounded by densely populated, high-end residential developments and is located approximately one mile from Banner Gateway Medical Center, a 60-acre medical complex that is partnering with MD Anderson to add a new 120,000 square foot cancer outpatient center.

On April 13, 2011, we acquired Desert Canyon Shopping Center, a property that meets our Community Centered Property strategy, for approximately $3.65 million in cash and net prorations. The center contains 62,533 leasable square feet, inclusive of 12,960 square feet leased to two tenants under ground leases, and is located in Mcdowell Mountain Ranch in

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northern Scottsdale, Arizona. Situated at a prime intersection at East McDowell Mountain Ranch Road and 105th Street, Desert Canyon is the nearest retail and office space to McDowell Mountain Elementary and Junior High Schools. Located adjacent to the Sonora Mountain Desert Preserve, a lighted trail and jogging path wind directly into the Desert Canyon site and provide access from the surrounding upscale residential neighborhoods.

On November 1, 2010, we acquired MarketPlace at Central, a property that meets our Community Centered Property strategy, containing 111,130 leasable square feet, located in central Phoenix, Arizona for approximately $6.4 million in cash and net prorations. The property is situated in an ideal location across the street from John C. Lincoln Hospital, the major employer in the area, and within a quarter mile from Sunnyslope High School.

On September 28, 2010, we acquired The Citadel, a property that meets our Community Centered Property strategy, containing 28,547 leasable square feet located in Scottsdale, Arizona for approximately $2.2 million in cash and net prorations. The property is strategically located at a prime intersection at Pinnacle Peak and Pima Roads.

Property Dispositions

On July 22, 2011, we sold Greens Road Plaza, located in Houston, Texas, for $1.8 million in cash and net prorations. We expect to reinvest the proceeds from the sale of the 20,607 square foot property located in Northeast Houston in acquisitions of Community Centered Properties in our target markets in Arizona, Texas, and Illinois.

Critical Accounting Policies

In preparing the 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, 2010, 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 three and nine months ended September 30, 2011. For disclosure regarding recent accounting pronouncements and the anticipated impact they will have on our operations, please refer to Note 2 of the accompanying consolidated financial statements.

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Results of Operations

Comparison of the Three Month Periods Ended September 30, 2011 and 2010

The following table provides a summary comparison of our results of operations for the three months ended September 30, 2011 and September 30, 2010 (dollars in thousands, except for per share and OP unit amounts):

	Three Months Ended September 30,			
	2011		2010	
Number of properties owned and operated	41		37	
Aggregate gross leasable area (sq. ft.)[1]	3,428,844		3,042,811	
Ending occupancy rate - Operating Portfolio[2]	86	%	83	%
Ending occupancy rate - all properties	84	%	82	%
Total property revenues	$8,779		$7,856	
Total property expenses	3,614		3,038	
Total other expenses	4,823		4,473	
Provision for income taxes	54		56	
Loss on disposal of assets	(1	)	72	
Income from continuing operations	289		217	
Income from discontinued operations	386		17	
Net income	675		234	
Less: Net income attributable to noncontrolling interests	97		57	
Net income attributable to Whitestone REIT	$578		$177	
Funds from operations [3]	$2,210		$2,007	
Property net operating income [4]	5,154		4,835	
Dividends and distributions paid on common shares and OP Units	3,629		1,718	
Per common share and OP Unit	$0.2850		$0.3375	
Dividends paid as a percentage of funds from operations	164	%	86	%

(1) During the first quarter of 2010, we concluded that approximately 25,000 square feet at our Kempwood Plaza and Centre South locations were no longer leasable, therefore such area is no longer included in the gross leasable area.

(2) Excludes (i) new acquisitions, through the earlier of attainment of 90% occupancy or 18 months of ownership, and (ii) properties which are undergoing significant redevelopment or re-tenanting.

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

(4) For a reconciliation of property net operating income to net income, see "Property Net Operating Income" below.

Property revenues. We had rental income and tenant reimbursements of approximately $8,779,000 for the three months ended September 30, 2011 as compared to $7,856,000 for the three months ended September 30, 2010, an increase of $923,000, or 12%. Revenue for the three months ended September 30, 2011 included approximately $792,000 in revenue from properties acquired subsequent to September 27, 2010. An increase in average occupancy of 2.4% offset by a decrease in the average annual rent of approximately $0.19 per leased square foot accounted for an increase in same store tenant rental and reimbursement revenues of approximately $131,000 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010.

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Property expenses. Our property expenses were approximately $3,614,000 and $3,038,000 for the three months ended September 30, 2011 and 2010, respectively, an increase of $576,000, or 19%. The primary components of total property expenses are detailed in the table below (in thousands):

	Three Months Ended September 30,				
	2011	2010	Increase	% Increase	
Real estate taxes	$1,259	$948	$311	33	%
Utilities	676	568	108	19	%
Contract services	590	500	90	18	%
Repairs and maintenance	387	366	21	6	%
Bad debt	165	133	32	24	%
Labor and other	537	523	14	3	%
Total property expenses	$3,614	$3,038	$576	19	%

Real estate taxes. Real estate taxes increased $311,000, or 33%, during the three months ended September 30, 2011 as compared to the same period in 2010. Real estate taxes for properties added subsequent to September 27, 2010 were approximately $148,000 for the three months ended September 30, 2011. Increased valuations from appraisal districts on certain of our properties were the primary reason for the remaining $163,000 increase during the three months ended September 30, 2011 as compared to the same period in 2010. We actively work to keep our valuations and resulting taxes as low as possible as most of these taxes are passed to our tenants through triple net leases.

Utilities. Utilities expense increased $108,000, or 19%, during the three months ended September 30, 2011 as compared to the same period in 2010. Utility expenses for properties acquired subsequent to September 27, 2010 were approximately $76,000. Same store utilities expense increased approximately $32,000 during the three months ended September 30, 2011 as compared to the same period in 2010.

Contract Services. Contract services increased $90,000, or 18%, during the three months ended September 30, 2011 as compared to the same period in 2010. The increase in contract services expense included $59,000 in contract expenses for properties acquired subsequent to September 27, 2010. Same store contract service expenses increased approximately $31,000 during the three months ended September 30, 2011 as compared to the same period in 2010. The $31,000 increase in same store contract service expenses is primarily attributable to increased security costs for certain of our Houston retail properties.

Repairs and maintenance. Repairs and maintenance increased $21,000, or 6%, during the three months ended September 30, 2011 as compared to the same period in 2010. Repairs and maintenance for the three months ended September 30, 2011 included approximately $14,000 for properties acquired subsequent to September 27, 2010. Same store repairs and maintenance increased approximately $7,000 during the three months ended September 30, 2011 as compared to the same period in 2010.

Bad debt. Bad debt for the three months ended September 30, 2011 increased $32,000, or 24%, as compared to the same period in 2010. We vigorously pursue past due accounts, but expect collection of rents to continue to be challenging for the foreseeable future.

Labor and other. Labor and other increased $14,000, or 3%, during the three months ended September 30, 2011, as compared to the same period in 2010. Labor and other for the three months ended September 30, 2011 included approximately $56,000 for properties acquired subsequent to September 27, 2010. Same store labor and other decreased approximately $42,000 during the three months ended September 30, 2011 as compared to the same period in 2010. The $42,000 decrease is primarily the result of decreases in non-recoverable property expenses, insurance and external labor costs for property maintenance.

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Same store and new store net operating income. The components of same store, new store and total property net operating income are detailed in the table below (in thousands):

	Three Months Ended September 30,					
	Same Store		New Store		Total	
	2011	2010	2011	2010	2011	2010
Property revenues	$7,987	$7,856	$792	$—	$8,779	$7,856
Property expenses	3,254	3,038	360	—	3,614	3,038
Continuing operations property net operating income	4,733	4,818	432	—	5,165	4,818
Discontinued operations net operating income	(11)	17	—	—	(11)	17
Property net operating income	$4,722	$4,835	$432	$—	$5,154	$4,835

Other expenses. Our other expenses were $4,823,000 for the three months ended September 30, 2011, as compared to $4,473,000 for the three months ended September 30, 2010, an increase of $350,000, or 8%. The primary components of other expenses, net are detailed in the table below (in thousands):

	Three Months Ended September 30,		Increase /	% Increase /
	2011	2010	(Decrease)	(Decrease)
General and administrative	$1,495	$1,263	$232	18 %
Depreciation and amortization	2,162	1,816	346	19 %
Interest expense	1,430	1,401	29	2 %
Interest, dividend and other investment income	(264)	(7)	(257)	(3,671)%
Total other expenses	$4,823	$4,473	$350	8 %

General and administrative. General and administrative expenses increased approximately $232,000, or 18%, for the three months ended September 30, 2011 as compared to the same period in 2010. The increases in general and administrative expenses included increases in salaries and benefits of $141,000, acquisition-related expenses of $127,000, travel and entertainment expenses of $52,000, other professional fees of $44,000 and other expenses of $36,000 offset by a decrease in legal expenses of $168,000. Salaries and benefits increased due to the addition of 11 full-time employees and increased health insurance, 401(k) and executive relocation costs. The majority of the employees were added to our office in Arizona to manage our recent property acquisitions. Acquisition-related expenses and travel increased due to our recent acquisitions of Terravita Marketplace and Ahwatukee Plaza Shopping Center. Professional fees include increased costs related to our transfer agent and investor relations expenses. The decrease in legal and professional fees is primarily attributable to a $190,000 settlement we received from litigation with a former tenant regarding damages to our properties.

Depreciation and amortization. Depreciation and amortization increased $346,000, or 19%, for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. Depreciation for improvements to same store properties increased $164,000 for the the three months ended September 30, 2011 as compared to the same period in 2010, and amortization of capitalized loan fees, lease commissions and depreciation of corporate assets increased $85,000 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. Depreciation for properties added subsequent to September 27, 2010 was $97,000.

Interest expense. Interest expense increased $29,000, or 2%, for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The increase in interest expense is comprised of approximately $12,000 from an approximately $0.9 million increase in the average notes payable balance during the three months ended September 30, 2011 as compared to the three months ended September 30, 2010, and $17,000 from an increase in the effective interest rate from 5.51% to 5.57% during three months ended September 30, 2011 as compared to the three months ended September 30, 2010.

Interest, dividend and other investment income. Interest, dividend and other investment income increased $257,000 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The three months

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ended September 30, 2011 included $154,000 in realized gains and $97,000 in dividend income from our investments in marketable securities that was not included in the three months ended September 30, 2010.

Discontinued operations. Greens Road Plaza, located in Houston, Texas, was sold on July 22, 2011 for $1.8 million in cash and net prorations. As such, the operations of Greens Road Plaza have been classified as discontinued operations. Below is a summary of income from discontinued operations (in thousands):

	Three Months Ended September 30,	
	2011	2010
Property revenues		
Rental revenues	$10	$43
Other revenues	2	34
Total property revenues	12	77
Property expenses		
Property operation and maintenance	20	37
Real estate taxes	3	8
Total property expenses	23	45
Other expenses		
General and administrative	—	—
Depreciation and amortization	—	14
Total other expense	—	14
Income before loss on disposal of assets and income taxes	(11)	18
Provision for income taxes	—	(1)
Gain on sale of property in discontinued operations	397	—
Income from discontinued operations	$386	$17

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Comparison of the Nine Month Periods Ended September 30, 2011 and 2010

The following table provides a summary comparison of our results of operations for the nine months ended September 30, 2011 and September 30, 2010 (dollars in thousands, except for per share and OP unit amounts):

	Nine Months Ended September 30,			
	2011		2010	
Number of properties owned and operated	41		37	
Aggregate gross leasable area (sq. ft.)[(1)]	3,428,844		3,042,811	
Ending occupancy rate - Operating Portfolio[(2)]	86	%	83	%
Ending occupancy rate - all properties	84	%	82	%
Total property revenues	$24,769		$23,236	
Total property expenses	9,605		8,930	
Total other expenses	14,733		13,207	
Provision for income taxes	164		211	
Loss on disposal of assets	17		113	
Income from continuing operations	250		775	
Income from discontinued operations	433		49	
Net income	683		824	
Less: Net income attributable to noncontrolling interests	122		264	
Net income attributable to Whitestone REIT	$561		$560	
Funds from operations [(3)]	$5,913		$5,867	
Property net operating income [(4)]	15,200		14,355	
Dividends and distributions paid on common shares and OP Units	8,396		5,276	
Per common share and OP Unit	$0.8550		$0.9600	
Dividends paid as a percentage of funds from operations	142	%	90	%

(1) During the first quarter of 2010, we concluded that approximately 25,000 square feet at our Kempwood Plaza and Centre South locations were no longer leasable, therefore such area is no longer included in the gross leasable area.
(2) Excludes (i) new acquisitions, through the earlier of attainment of 90% occupancy or 18 months of ownership, and (ii) properties which are undergoing significant redevelopment or re-tenanting.
(3) For a reconciliation of funds from operations to net income, see "Funds From Operations" below.
(4) For a reconciliation of property net operating income to net income, see "Property Net Operating Income" below.

Property revenues. Rental income and tenant reimbursements for the nine months ended September 30, 2011 and 2010 were approximately $24,769,000 and $23,236,000, respectively, an increase of $1,533,000, or 7%. Revenue for the nine months ended September 30, 2011 included approximately $1,319,000 in revenue from properties acquired subsequent to September 27, 2010. Same store tenant rental and reimbursement revenues increased approximately $214,000 for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The increase was driven by a 3.8% increase in average occupancy offset by a $0.43 decrease in average annual rent per leased square foot. Our Operating Portfolio Occupancy Rate as of September 30, 2011 was 86%, as compared to 83% as of September 30, 2010.

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Property expenses. Our property expenses were approximately $9,605,000 and $8,930,000 for the nine months ended September 30, 2011 and 2010, respectively, an increase of $675,000, or 8%. The primary components of total property expenses are detailed in the table below (in thousands):

	Nine Months Ended September 30,		Increase /	% Increase /
	2011	2010	(Decrease)	(Decrease)
Real estate taxes	$3,367	$2,978	$389	13 %
Utilities	1,815	1,696	119	7 %
Contract services	1,690	1,543	147	10 %
Repairs and maintenance	914	900	14	2 %
Bad debt	379	339	40	12 %
Labor and other	1,440	1,474	(34)	(2)%
Total property expenses	$9,605	$8,930	$675	8 %

Real estate taxes. Real estate taxes increased $389,000, or 13%, during the nine months ended September 30, 2011 as compared to the same period in 2010. Real estate taxes for properties added subsequent to September 27, 2010 were approximately $313,000 for the nine months ended September 30, 2011. We actively work to keep our valuations and resulting taxes as low as possible as most of these taxes are passed to our tenants through triple net leases.

Utilities. Utilities expense increased $119,000, or 7%, during the nine months ended September 30, 2011 as compared to the same period in 2010. Utility expenses for properties acquired subsequent to September 27, 2010 were approximately $135,000. Same store utilities expense decreased approximately $16,000 during the nine months ended September 30, 2011 as compared to the same period in 2010.

Contract Services. Contract services increased $147,000, or 10%, during the nine months ended September 30, 2011 as compared to the same period in 2010. The increase in contract services expense included $114,000 in contract expenses for properties acquired subsequent to September 27, 2010. The $33,000 increase in same store contract service expenses is primarily attributable to increased security costs for certain of our Houston retail properties.

Repairs and maintenance. Repairs and maintenance increased $14,000, or 2%, during the nine months ended September 30, 2011 as compared to the same period in 2010. Repairs and maintenance for the nine months ended September 30, 2011 included approximately $41,000 for properties acquired subsequent to September 27, 2010. Same store repairs and maintenance decreased approximately $27,000 during the nine months ended September 30, 2011 as compared to the same period in 2010.

Bad debt. Bad debt for the nine months ended September 30, 2011 increased $40,000, or 12%, as compared to the same period in 2010. We vigorously pursue past due accounts, but expect collection of rents to continue to be challenging for the foreseeable future.

Labor and other. Labor and other decreased $34,000, or 2%, during the nine months ended September 30, 2011, as compared to the same period in 2010. Labor and other for the nine months ended September 30, 2011 included approximately $114,000 for properties acquired subsequent to September 27, 2010. Same store labor and other decreased approximately $148,000 during the nine months ended September 30, 2011 as compared to the same period in 2010. The $148,000 decrease is primarily the result of decreases in non-recoverable property expenses, insurance and external labor costs for property maintenance, including expenses related to our lease with the U.S. Census Bureau, which was terminated during the fourth quarter of 2010.

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Same store and new store net operating income. The components of same store, new store and total property net operating income are detailed in the table below (in thousands):

	Nine Months Ended September 30,					
	Same Store		New Store		Total	
	2011	2010	2011	2010	2011	2010
Property revenues	$23,450	$23,236	$1,319	$—	$24,769	$23,236
Property expenses	8,868	8,930	737	—	9,605	8,930
Continuing operations property net operating income	14,582	14,306	582	—	15,164	14,306
Discontinued operations net operating income	36	49	—	—	36	49
Property net operating income	$14,618	$14,355	$582	$—	$15,200	$14,355

Other expenses. Our other expenses were $14,733,000 for the nine months ended September 30, 2011, as compared to $13,207,000 for the nine months September 30, 2010, an increase of $1,526,000, or 12%. The primary components of other expenses, net are detailed in the table below (in thousands):

	Nine Months Ended September 30,		Increase /	% Increase /
	2011	2010	(Decrease)	(Decrease)
General and administrative	$4,737	$3,735	$1,002	27 %
Depreciation and amortization	6,098	5,281	817	15 %
Interest expense	4,277	4,210	67	2 %
Interest, dividend and other investment income	(379)	(19)	(360)	(1,895)%
Total other expenses	$14,733	$13,207	$1,526	12 %

General and administrative. General and administrative expenses increased approximately $1,002,000, or 27%, for the nine months ended September 30, 2011 as compared to the same period in 2010. The increases in general and administrative expenses included increases in legal and other professional fees of $242,000, salaries and benefits of $302,000, acquisition-related expenses of $196,000, travel and entertainment expenses of $101,000, corporate office expenses of $99,000 and other expenses of $62,000. The increase in legal and professional fees is primarily attributable to litigation with a contractor at our Windsor Park Center in San Antonio and litigation with two former tenants regarding damages to our properties. Salaries and benefits increased due to the addition of 11 full-time employees and increased health insurance, 401(k) and executive relocation costs. The employees were added to our office in Arizona to manage our recent property acquisitions. Acquisition-related expenses and travel increased due to our recent acquisitions of Dessert Canyon Shopping Center, Gilbert Tuscany Village, Terravita Marketplace and Ahwatukee Plaza Shopping Center. Corporate office expenses include software, phone systems and dues and subscription expenses.

Depreciation and amortization. Depreciation and amortization increased $817,000, or 15%, for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Depreciation for improvements to same store properties increased $466,000 for the the nine months ended September 30, 2011 as compared to the same period in 2010, and amortization of capitalized loan fees and lease commissions increased $144,000 for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Depreciation for properties added subsequent to September 27, 2010 was $207,000.

Interest expense. Interest expense increased $67,000, or 2%, for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The increase in interest expense is comprised of approximately $32,000 from an approximately $783,000 increase in the average notes payable balance during the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 and $35,000 from an increase in the effective interest rate from 5.52% to 5.56% during nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

Interest, dividend and other investment income. Interest, dividend and other investment income increased $360,000 for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The nine months

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ended September 30, 2011 included $154,000 in dividend income and $192,000 in realized gains on sales from our marketable securities that was not included in the nine months ended September 30, 2010.

Discontinued operations. Greens Road Plaza, located in Houston, Texas, was sold on July 22, 2011 for $1.8 million in cash and net prorations. As such, the operations of Greens Road Plaza have been classified as discontinued operations. Below is a summary of income from discontinued operations (in thousands):

	Nine Months Ended September 30,	
	2011	2010
Property revenues		
Rental revenues	$107	$133
Other revenues	71	105
Total property revenues	178	238
Property expenses		
Property operation and maintenance	89	121
Real estate taxes	23	24
Total property expenses	112	145
Other expenses		
General and administrative	—	—
Depreciation and amortization	29	42
Total other expense	29	42
Income before loss on disposal of assets and income taxes	37	51
Provision for income taxes	(1)	(2)
Gain on sale of property in discontinued operations	397	—
Income from discontinued operations	$433	$49

Reconciliation of Non-GAAP Financial Measures

Funds From Operations

The National Association of Real Estate Investment Trusts, or NAREIT, defines funds from operations ("FFO") as net income (loss) available to common shareholders computed in accordance with U.S. GAAP, excluding gains or losses from sales of operating real estate assets and extraordinary items, plus depreciation and amortization of operating properties, including our share of unconsolidated real estate joint ventures and partnerships. We calculate FFO in a manner consistent with the NAREIT definition.

Management uses FFO as a supplemental measure to conduct and evaluate our business because there are certain limitations associated with using U.S. GAAP net income alone as the primary measure of our operating performance. Historical cost accounting for real estate assets in accordance with U.S. GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Because real estate values instead have historically risen or fallen with market conditions, management believes that the presentation of operating results for real estate companies that use historical cost accounting is insufficient by itself. In addition, securities analysts, investors and other interested parties use FFO as the primary metric for comparing the relative performance of equity REITs. There can be no assurance that FFO presented by us is comparable to similarly titled measures of other REITs.

FFO should not be considered as an alternative to net income or other measurements under U.S. GAAP, as an

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indicator of our operating performance or to cash flows from operating, investing or financing activities as a measure of liquidity. FFO does not reflect working capital changes, cash expenditures for capital improvements or principal payments on indebtedness.

FFO Core

Management believes that the computation of FFO in accordance with NAREIT's definition includes certain items that are not indicative of the results provided by our operating portfolio and affect the comparability of our period-over-period performance. These items include, but are not limited to, gains and losses on insurance claim settlements, legal and professional fees and acquisition costs. Therefore, in addition to FFO, management uses FFO core, which we define to exclude such items.

Below are the calculations of FFO and FFO Core and the reconciliations to net income, which we believe is the most comparable U.S. GAAP financial measure (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
FFO and FFO-Core				
Net income attributable to Whitestone REIT	$578	$177	$561	$560
Depreciation and amortization of real estate assets [1]	1,933	1,701	5,610	4,930
Loss (gain) on disposal of assets [1]	(398)	72	(380)	113
Net income attributable to noncontrolling interests [1]	97	57	122	264
FFO	$2,210	$2,007	$5,913	$5,867
Acquisition costs	$185	$10	$327	$11
Legal and professional costs (recoveries), net	(103)	—	254	—
FFO-Core	$2,292	$2,017	$6,494	$5,878

(1) Including amounts for discontinued operations.

Property net operating income ("NOI")

Management believes that NOI is a useful measure of our property operating performance. We define NOI as operating revenues (rental and other revenues) less property and related expenses (property operation and maintenance and real estate taxes). Other REITs may use different methodologies for calculating NOI, and accordingly, our NOI may not be comparable to other REITs. Because NOI excludes general and administrative expenses, depreciation and amortization, involuntary conversion, interest expense, interest income, provision for income taxes and loss on sale or disposition of assets, it provides a performance measure that, when compared year over year, reflects the revenues and expenses directly associated with owning and operating commercial real estate properties and the impact to operations from trends in occupancy rates, rental rates and operating costs, providing perspective not immediately apparent from net income. We use NOI to evaluate our operating performance since NOI allows us to evaluate the impact that factors such as occupancy levels, lease structure, lease rates and tenant base have on our results, margins and returns. In addition, management believes that NOI provides useful information to the investment community about our property and operating performance when compared to other REITs since NOI is generally recognized as a standard measure of property performance in the real estate industry. However, NOI should not be viewed as a measure of our overall financial performance since it does not reflect general and administrative expenses, depreciation and amortization, involuntary conversion, interest expense, interest income, provision for income taxes and loss on sale or disposition of assets, the level of capital expenditures and leasing costs necessary to maintain the operating performance of our properties.

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Below is the calculation of NOI and the reconciliations to net income, which we believe is the most comparable GAAP financial measure (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Property Net Operating Income				
Net income attributable to Whitestone REIT	$578	$177	$561	$560
General and administrative expenses	1,495	1,263	4,737	3,735
Depreciation and amortization	2,162	1,816	6,098	5,281
Interest expense	1,430	1,401	4,277	4,210
Interest, dividend and other investment income	(264)	(7)	(379)	(19)
Provision for income taxes	54	56	164	211
Gain (loss) on disposal of assets	(1)	72	17	113
Gain on sale of property from discontinued operations	(397)	—	(397)	—
Net income attributable to noncontrolling interests	97	57	122	264
NOI	$5,154	$4,835	$15,200	$14,355

Liquidity and Capital Resources

Our short-term liquidity requirements consist primarily of dividends and distributions to holders of our common shares and OP units, including those required to maintain REIT status and satisfy our current quarterly distribution target of $0.2850 per share and OP unit, recurring expenditures, such as repairs and maintenance of our properties, non-recurring expenditures, such as capital improvements and tenant improvements, debt service requirements, and, potentially, acquisitions of additional properties.

During the nine months ended September 30, 2011, our cash provided from operating activities was $6,332,000 and our total dividends and distributions were $8,396,000. Therefore, we had distributions in excess of cash flow from operations of approximately $2,064,000. We anticipate that cash flows from operating activities and our borrowing capacity under the facility (see Note 5 to our accompanying consolidated financial statements) will provide adequate capital for our working capital requirements, anticipated capital expenditures and scheduled debt payments in the short term. 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 for federal income tax purposes.

Our long-term capital requirements consist primarily of maturities under our longer-term debt agreements, development and redevelopment costs, and potential acquisitions. We expect to meet our long-term liquidity requirements with net cash from operations, long-term indebtedness, sales of common shares, issuance of OP units, sales of underperforming properties and other financing opportunities including equity issuance and debt financing. We believe we have access to multiple sources of capital to fund our long-term liquidity requirements, including the incurrence of additional debt and the issuance of additional equity. However, our ability to incur additional debt will be dependent on a number of factors, including our degree of leverage, the value of our unencumbered assets and borrowing restrictions that may be imposed by lenders. Our ability to access the equity markets will be dependent on a number of factors as well, including general market conditions for REITs and market perceptions about our company.

We expect that our rental income will increase as we continue to acquire additional properties, subsequently increasing our cash flows generated from operating activities. We intend to continue acquiring such additional properties through equity issuance, including proceeds from our follow-on offering of Class B common shares, our initial public offering of Class B shares in August 2010, and through debt financing.

Our capital structure includes non-recourse secured debt that we assumed or originated on certain properties. We may hedge the future cash flows of certain debt transactions principally through interest rate swaps with major financial institutions.

Cash and Cash Equivalents

We had cash and cash equivalents of approximately $32,660,000 at September 30, 2011, as compared to $17,591,000

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on December 31, 2010. The increase of $15,069,000 was primarily the result of the following:

Sources of Cash

- Cash flow from operations of $6,332,000 for the nine months ended September 30, 2011;
- Net proceeds of $59,667,000 from the issuance of common shares;
- Net proceeds of $2,531,000 million from issuance of notes payable net of origination costs;
- Proceeds from sales of marketable securities of $7,252,000 million;
- Net proceeds $1,545,000 from the sale and operations of our discontinued operations;

Uses of Cash

- Payment of dividends and distributions to common shareholders and OP Unit holders of $8,396,000;
- Investments in marketable securities of $13,520,000;
- Real estate acquisitions of $34,020,000;
- Additions to real estate of $3,966,000;
- Payments of loans of $2,356,000.

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

Debt

Debt consists of the following (in thousands):

Description	September 30, 2011	December 31, 2010
Fixed rate notes		
$3.0 million 6.00% Note, due 2021 (1)	$2,986	$—
$10.0 million 6.04% Note, due 2014	9,370	9,498
$1.5 million 6.50% Note, due 2014	1,477	1,496
$11.2 million 6.52% Note, due 2015	10,800	10,908
$21.4 million 6.53% Notes, due 2013	19,683	20,142
$24.5 million 6.56% Note, due 2013	23,708	24,030
$9.9 million 6.63% Notes, due 2014	9,292	9,498
$0.5 million 5.05% Notes, due 2011	158	13
Floating rate note		
$26.9 million LIBOR + 2.82% Note, due 2013	24,760	25,356
	$102,234	$100,941

(1) The 6.00% interest rate is fixed through March 30, 2016. On March 31, 2016 the interest rate will reset to the rate of interest for a five year balloon note with a thirty year amortization as published by the Federal Home Loan Bank.

As of September 30, 2011, our debt was collateralized by 24 properties with a carrying value of $111.6 million. Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and by assignment of certain rents and leases associated with those properties. As of September 30, 2011, we are in compliance with all loan covenants.

On June 14, 2011, Whitestone, through our Operating Partnership, entered into an agreement with Harris Bank, part of BMO Financial Group, effective June 13, 2011 for an unsecured revolving credit facility (the "Facility") with an initial committed amount of $20 million. The Facility is expandable to $75 million and matures two years from closing, with a 12-month extension available upon lender approval. We will use the Facility for general corporate purposes, including acquisitions

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and redevelopment of existing properties in our portfolio.

Borrowings under the Facility accrue interest (at our option), based on total indebtedness to total asset value ratio, at either the Eurodollar Loan Rate or the Base Rate at 3.5% to 4.5% and 2.5% to 3.5%, respectively. Base Rate means the higher of: (i) (a) the bank's prime commercial rate, (b) the average rate quoted the bank by two or more Federal funds brokers selected by the bank for sale to the bank at face value of Federal funds in the secondary market in an amount equal or comparable to the principal amount for which such rate is being determined, plus (ii) 1/2 of 1%, and (c) the LIBOR rate for such day plus 1.00%.
Eurodollar Loan Rate means LIBOR divided by the Eurodollar Reserve Percentage. The Eurodollar Reserve Percentage means the maximum reserve percentage at which reserves are imposed by the Board of Governors of the Federal Reserve System.

The Facility contains customary terms and conditions, including, without limitation, affirmative and negative covenants, such as information reporting requirements, maximum total indebtedness to total asset value, minimum earnings before interest, tax, depreciation and amortization ("EBITDA") to fixed charges, and maintenance of net worth. The Facility also contains customary events of default with customary cure and notice, including, without limitation, nonpayment, breach of covenant, misrepresentation of representations and warranties in a material respect, cross-default to other major indebtedness, change of control, bankruptcy, and loss of REIT tax status. We are currently in compliance with these covenants. As of September 30, 2011, no amounts were drawn on the Facility, and our borrowing capacity was $20 million.

Scheduled maturities of our debt as of September 30, 2011 are as follows (in thousands):

Year	Amount Due (in thousands)
2011	$795
2012	2,636
2013	66,488
2014	19,191
2015	10,315
2016 and thereafter	2,809
Total	$102,234

Capital Expenditures

We continually evaluate our properties' performance and value. We may determine it is in our shareholders' best interest 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 continue investing 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.

Dividends and Distributions

The following tables summarize the cash dividends paid or payable to holders of our common shares and distributions paid or payable to holders of noncontrolling OP Units during the four quarters of 2010 and the quarters ended March 31, 2011, June 30, 2011 and September 30, 2011 (in thousands, except per share data):

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	Class A Common Shareholders		Class B Common Shareholders		Noncontrolling OP Unit Holders		Total
Quarter Paid	Dividend Per Common Share	Total Amount Paid	Dividend Per Common Share	Total Amount Paid	Distribution Per OP Unit	Total Amount Paid	Total Amount Paid
2011							
Third Quarter	$0.2850	$974	$0.2850	$2,141	$0.2850	$514	$3,629
Second Quarter	0.2850	989	0.2850	1,132	0.2850	515	2,636
First Quarter	0.2850	989	0.2850	627	0.2850	515	2,131
Total	$0.8550	$2,952	$0.8550	$3,900	$0.8550	$1,544	$8,396
2010							
Fourth Quarter	$0.2850	$989	$0.2850	$627	$0.2850	$514	$2,130
Third Quarter	0.2850	992	0.0960	211	0.2850	515	1,718
Second Quarter	0.3375	1,176	—	—	0.3375	610	1,786
First Quarter	0.3375	1,163	—	—	0.3375	610	1,773
Total	$1.2450	$4,320	$0.3810	$838	$1.2450	$2,249	$7,407

Taxes

We elected to be taxed as a REIT under the Internal Revenue Code (the "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 a manner to qualify and 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 the majority of 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. Although our ability to raise rental rates may be limited by a weak economic environment and increased competition in the areas in which we operate, 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 September 30, 2011 and December 31, 2010.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our future income, cash flows and fair value relevant to our financial instruments depends upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. Based upon the nature of our operations, we are not subject to foreign exchange rate or commodity price risk. The principal market risk to which we are exposed is the risk related to interest rate fluctuations. Many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors that are beyond our control contribute to interest rate risk. Our interest rate risk objective is to limit the impact of interest rate fluctuations on earnings and cash flows and to lower our overall borrowing costs. To achieve this objective, we manage our exposure to fluctuations in market interest rates for our borrowings through the use of fixed rate debt instruments to the extent that reasonably favorable rates are obtainable.

All of our financial instruments were entered into for other than trading purposes.

Fixed Interest Rate Debt

As of September 30, 2011, approximately 76% of our outstanding debt was subject to fixed interest rates, which limit the risk of fluctuating interest rates. Though a change in the market interest rates affects the fair market value, it does not impact net income to shareholders or cash flows. Our total outstanding fixed interest rate debt has an average effective interest rate at this time of approximately 6.47% per annum with expirations ranging from 2011 to 2021 (see Note 5 to our accompanying consolidated financial statements for further detail). As of September 30, 2011, we had approximately $77.5 million of fixed rate debt outstanding. Holding other variables constant, a 1% increase or decrease in interest rates would cause a $1.7 million decline or increase, respectively, in the fair value for our fixed rate debt.

Variable Interest Rate Debt

As of September 30, 2011, we had $24.8 million of loans, or approximately 24% of our outstanding debt, with a floating interest rate of LIBOR + 2.82%. As of September 30, 2011, we did not have a fixed rate hedge in place, leaving $24.8 million subject to interest rate fluctuations. The impact of a 1% increase or decrease in interest rates on our debt would result in a decrease or increase of annual net income of approximately $247,600, respectively.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The management of Whitestone REIT, under the supervision and with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, including ensuring that such information is accumulated and communicated to Whitestone REIT's management as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective as of September 30, 2011 (the end of the period covered by this Quarterly Report on Form 10-Q).

Changes in Internal Control Over Financial Reporting

During the quarter ended September 30, 2011, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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 financial position, results of operation or liquidity.

Item 1A. Risk Factors

The following risk factor is added to the risk factors disclosed in the “Risk Factors” section of Whitestone's Annual Report on Form 10-K for the year ended December 31, 2010:

The downgrade of the U.S. credit rating and the economic crisis in Europe could negatively impact our liquidity, financial condition and earnings.

Recent U.S. debt ceiling and budget deficit concerns, together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns. Although U.S. lawmakers passed legislation to raise the federal debt ceiling, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the United States (the “U.S.”) from “AAA” to “AA+” in August 2011. The impact of this or any further downgrades to the U.S. government's sovereign credit rating, or its perceived creditworthiness, and the impact of the current crisis in Europe with respect to the ability of certain European Union countries to continue to service their sovereign debt obligations is inherently unpredictable and could adversely effect the U.S. and global financial markets and economic conditions. There can be no assurance that governmental or other measures to aid economic recovery will be effective. These developments and the government's credit concerns in general, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. In addition, the decreased credit rating could create broader financial turmoil and uncertainty, which may exert downward pressure on the price of our Class B common shares. Continued adverse economic conditions could have a material adverse effect on our business, financial condition and results of operations.

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

(a) During the period covered by this Form 10-Q, we did not sell any equity securities that were not registered under the Securities Act of 1933.

(b) Not applicable.

(c) On September 2, 2011, we commenced an offer to exchange Class B common shares on a one-for-one basis for (i) up to 867,789 outstanding Class A common shares; and (ii) up to 453,642 outstanding OP units (the “Exchange Offer”). The Exchange Offer expired at 5:00 p.m., EDT, on Monday, October 3, 2011, and 867,789 Class A common shares and 453,642 OP units were accepted for exchange.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved.]

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed on the accompanying Exhibit index are filed, furnished and incorporated by reference (as stated therein) as part of this Report.

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SIGNATURES

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

	WHITESTONE REIT
Date: November 7, 2011	/s/ James C. Mastandrea James C. Mastandrea Chief Executive Officer (Principal Executive Officer)
Date: November 7, 2011	/s/ David K. Holeman David K. Holeman Chief Financial Officer (Principal Financial and Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit No.	Description
3.1.1	Articles of Amendment and Restatement of Declaration of Trust of Whitestone REIT (previously filed as and incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on July 31, 2008)
3.1.2	Articles Supplementary (previously filed as and incorporated by reference to Exhibit 3(i).1 to the Registrant's Current Report on Form 8-K, filed on December 6, 2006)
3.1.3	Articles of Amendment (previously filed as and incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on August 24, 2010)
3.1.4	Articles of Amendment (previously filed as and incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K, filed on August 24, 2010)
3.1.5	Articles Supplementary (previously filed as and incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K, filed on August 24, 2010)
3.2	Amended and Restated Bylaws (previously filed as and incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed on October 9, 2008)
4.1	Dividend Reinvestment Plan (previously filed as and incorporated by reference to Exhibit A of the Registrant's Registration Statement of Form S-3 (No. 333-174608), filed on May 13, 2011)
31.1*	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS***	XBRL Instance Document
101. SCH***	XBRL Taxonomy Extension Schema Document
101.CAL***	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB***	XBRL Taxonomy Extension Label Linkbase Document
101.PRE***	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF***	XBRL Taxonomy Extension Definition Linkbase Document

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* Filed herewith.

** Furnished herewith.

*** The following financial information of the Registrant for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Operations and Comprehensive Income (Loss) (unaudited), (iii) Consolidated Statements of Changes in Equity (unaudited), (iv) Consolidated Statements of Cash Flows (unaudited) and (v) Notes to Consolidated Financial Statements (unaudited).

Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.