

Whitestone REIT  
Form S-11/A  
April 25, 2011  
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As filed with the Securities and Exchange Commission on April 25, 2011

Registration No. 333-173209

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Pre-Effective Amendment No. 1**

**to**

**Form S-11**

**FOR REGISTRATION UNDER THE SECURITIES ACT OF 1933**

**OF SECURITIES OF CERTAIN REAL ESTATE COMPANIES**

**Whitestone REIT**

(Exact name of registrant as specified in governing instruments)

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**2600 South Gessner, Suite 500**

**Houston, Texas 77063**

**(713) 827-9595**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**James C. Mastandrea**

**President and Chief Executive Officer**

**Whitestone REIT**

**2600 South Gessner, Suite 500**

**Houston, Texas 77063**

**(713) 827-9595**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If any of the Securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box: "

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. "

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)

Smaller reporting company "

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Prospectus

*Subject to completion, dated April 25, 2011*

5,000,000

Class B Common Shares

## Whitestone REIT

Whitestone REIT is a fully integrated, internally managed real estate company founded in 1998 that seeks to own and operate Community Centered Properties, which we define as visibly located properties in established or developing, culturally diverse neighborhoods in our target markets. We conduct our operations so as to qualify as a real estate investment trust, or REIT, for federal income tax purposes.

We are selling all of the Class B common shares of beneficial interest offered by this prospectus at a public offering price of \$ per share. Our Class B common shares are listed on the NYSE Amex under the symbol WSR. The last reported sale price of our Class B common shares on the NYSE Amex on April 21, 2011 was \$14.30 per share.

Our declaration of trust contains certain restrictions relating to the ownership and transfer of our Class B common shares, including, subject to certain exceptions, a limit on ownership of more than 9.8% in value or number of shares, whichever is more restrictive, of our outstanding Class B common shares. See Description of Securities Restrictions on Ownership and Transfer.

**Investing in our Class B common shares involves a high degree of risk. See Risk Factors beginning on page 15 of this prospectus for a discussion of certain risks that you should consider before investing.**

|                                       | Per Share | Total |
|---------------------------------------|-----------|-------|
| Public offering price                 | \$        | \$    |
| Underwriting discount and commissions | \$        | \$    |
| Net proceeds to us, before expenses   | \$        | \$    |

We have granted the underwriters an option to purchase up to an additional 750,000 Class B common shares from us at the public offering price, less underwriting discount and commissions, within 30 days after the date of this prospectus solely to cover over-allotments, if any.

The underwriters expect to deliver the Class B common shares on or about , 2011.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

*Joint Book-running Managers*

**BMO Capital Markets    JMP Securities    Wunderlich Securities**

*Lead Manager*

**Ladenburg Thalmann & Co. Inc.**

*Co-Managers*

**J.J.B. Hilliard, W.L. Lyons, LLC    Southwest Securities, Inc.    Maxim Group LLC**

The date of this prospectus is                      , 2011.

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**You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information that is different from that contained in this prospectus. We are offering to sell Class B common shares and seeking offers to buy Class B common shares only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of Class B common shares.**

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**PROSPECTUS SUMMARY**

*You should read the following summary together with the more detailed information regarding our company and the financial statements appearing elsewhere in this prospectus, including under the caption Risk Factors. Unless the context suggests otherwise, references in this prospectus to our company, we, us, and our mean Whitestone REIT, a Maryland real estate investment trust, and its consolidated subsidiaries, including Whitestone REIT Operating Partnership, L.P., a Delaware limited partnership, of which we are the sole general partner and to which we refer in this prospectus as our Operating Partnership. Unless otherwise indicated, the information included in this prospectus assumes (1) no exercise by the underwriters of the over-allotment option to purchase up to an additional 750,000 Class B common shares and (2) that the per unit value of the units of partnership interest in our Operating Partnership, or OP units, that we will purchase with the proceeds of this offering is equal to the public offering price per share of the Class B common shares indicated on the front cover of this prospectus, less the underwriting discount and expenses. Each OP unit is redeemable at the election of the holder for cash, or, at our option, one of our Class A common shares.*

**Our Company**

We are a fully integrated real estate company that owns and operates commercial properties in culturally diverse markets in major metropolitan areas. 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 define Community Centered Properties as visibly located properties in established or developing culturally diverse neighborhoods in our target markets. 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. We employ and develop a diverse group of seasoned professionals who understand the needs of our multicultural communities and tenants.

Our current portfolio is concentrated in Houston, with additional properties in the Phoenix, Chicago, Dallas and San Antonio metropolitan areas. According to the United States Census Bureau's *Estimates of Population Change for Metropolitan Statistical Areas and Rankings: July 1, 2008 to July 1, 2009*, Dallas and Houston ranked first and second, respectively, in population growth out of 366 metropolitan statistical areas, and Phoenix, Chicago and San Antonio ranked seventh, eighth and sixteenth, respectively. We believe the management infrastructure and capacity we have built can accommodate substantial growth in those markets. We also believe that those cities have expanding multi-cultural neighborhoods, providing us with excellent opportunities to execute our strategic plan in those markets.

We believe that over the next few years we will have opportunities to acquire quality properties at historically attractive prices. Many of these properties will be distressed due to over-leverage, mismanagement or the lack of liquidity in the financial markets. 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.

Our Class B common shares are listed on the NYSE Amex under the symbol WSR.



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**Our Strengths**

We believe a number of factors differentiate us from other commercial real estate owners in our markets, including:

***Strong Occupancy Upside in Current Portfolio.*** As of December 31, 2010, 20 of our 38 properties had significant upside in occupancy with occupancy rates lower than 90%. We believe that through our:

Community Centered Property operating model,

focus on the fastest growing ethnic groups in our defined markets,

proactive marketing and leasing efforts, and

proven management team,

we will be able to increase occupancy in these properties to our individual property occupancy goals of 90% or higher. This occupancy upside provides the opportunity to increase property net operating income and funds from operations through leasing of vacant spaces at these properties. At our current average base rent of approximately \$10 per square foot and a total of approximately 3.2 million leasable square feet, each increase of 1% in occupancy will contribute approximately \$320,000 to our annual funds from operations.

***Community Centered Property Investment Focus.*** We seek to invest in properties that are or can become Community Centered Properties from which our tenants deliver needed services to the surrounding community. We focus on niche properties with smaller rental spaces that present opportunities for attractive returns. We target properties that: (1) typically require relatively low capital investment, are management and leasing intensive and do not draw the interest of larger national real estate companies; (2) can be redeveloped at a low cost utilizing our internal management capabilities; and/or (3) can be Whitestone-branded and re-tenanted, resulting in lower tenant turnover and higher occupancy and rental rates, together with corresponding increases in tenant reimbursement of operating expenses.

***Multi-Cultural Community Focus.*** Our multi-cultural community focus sets us apart from traditional commercial real estate operators. We value diversity in our team and maintain in-house leasing, property management, marketing, construction and maintenance departments with culturally diverse and multi-lingual associates who understand the particular needs of our tenants and neighborhoods.

***Proactive Marketing and Leasing.*** Our proactive marketing and leasing programs are designed to utilize market research to determine the common and distinctive characteristics and needs of the neighborhood and attract tenants who meet those needs. Our in-depth local knowledge in each of our major markets and in-house research capabilities allow us to quickly access and analyze neighborhood demographics and cultural nuances, market rental trends and valuation metrics. Our streamlined and efficient leasing process allows us to attract tenants and to lease spaces quickly. We typically market and lease our properties to smaller tenants who rent on average less than 3,000 square feet. As of December 31, 2010, our average rent per square foot for our smaller tenants represents a 57% premium over rent paid by our larger tenants, or those tenants leasing more than 3,000 square feet.

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***Extensive Pipeline of Acquisition Opportunities Generated through Relationships and Reputation.*** Our extensive pipeline of potential acquisitions has been developed over the last several years through our reputation in the markets in which we operate and our relationships with property owners, community banks, attorneys, title companies, and others in the real estate industry. The size of our pipeline of potential properties will allow us to be selective and close quickly on properties as single-asset or multi-asset purchases from various sellers.

***Proven Real Estate and Repositioning Track Record.*** Our nine-person senior management team, composed of James C. Mastandrea, John J. Dee, David K. Holeman, Daniel Nixon, Valarie King,

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Bradford Johnson, Gregory Belsheim, Charles M. Taylor and Anne Gregory, has more than 150 years of collective experience acquiring, developing, redeveloping, owning, managing and operating commercial real estate properties, portfolios and companies. Messrs. Mastandrea, Dee and Nixon each has over 30 years of experience and Mesdames King, Gregory and Messrs. Holeman, Johnson, Taylor and Belsheim each has 17, 3, 5, 29, 14 and 8 years of experience, respectively. Our senior management team has extensive national real estate contacts and investment expertise in our target markets. In particular, our management team has significant expertise in repositioning properties with complex problems. Our team executes a coordinated strategy, utilizing our corporate branding, philosophy and culture, operational systems and experience to renovate and re-tenant properties, with an intention to increase their net operating income and value.

**Our Growth Strategy**

Our primary business objective is to increase shareholder value by acquiring, owning and operating Community Centered Properties. The key elements of our strategy include:

***Strategically Acquiring Properties.***

*Seeking High Growth Markets.* We seek to strategically acquire commercial properties in high-growth markets. Our acquisition targets are located in densely populated, culturally diverse neighborhoods, primarily in and around Phoenix, Chicago, Dallas, San Antonio and Houston, five of the top 20 markets in the United States in terms of population growth.

*Diversifying Geographically.* Our current portfolio is concentrated in Houston. We believe that continued geographic diversification into markets where we have substantial knowledge and experience will help offset the economic risk from a single market concentration. We intend to continue to focus our expansion efforts on the Phoenix, Chicago, Dallas and San Antonio markets. We believe our management infrastructure and capacity can accommodate substantial growth in those markets. We may also pursue opportunities in other Southwestern and Western regions that are consistent with our Community Centered Property strategy.

*Capitalizing on Availability of Distressed Assets.* We believe that during the next few years there will be excellent opportunities in our target markets to acquire quality properties at historically attractive prices. We intend to acquire distressed assets directly from owners or financial institutions holding foreclosed real estate and debt instruments that are either in default or on bank watch lists. Many of these assets may benefit from our corporate strategy and our management team's experience in turning around distressed properties, portfolios and companies. We have extensive relationships with community banks, attorneys, title companies, and others in the real estate industry with whom we regularly work to identify properties for potential acquisition.

***Maximizing Value by Redeveloping and Re-tenanting Existing Properties.*** We reposition properties and seek to add value through renovating and re-tenanting our properties to create Whitestone-branded Community Centered Properties. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

***Recycling Capital for Greater Returns.*** We seek to continually upgrade our portfolio by opportunistically selling properties that do not have the potential to meet our Community Centered Property strategy and redeploying the sale proceeds into properties that better fit our strategy. Some of our properties which were acquired prior to the tenure of our current management team may not fit our Community Centered Property strategy, and we may look for opportunities to dispose of these properties as we continue to execute our strategy.



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***Orienting Our Capital Structure for Growth.*** We intend to use the net proceeds of this offering to fund acquisitions and the selective redevelopment of existing properties. We do not have any debt maturities until October 2013, and we currently have 15 properties that are not mortgaged. We may seek to add mortgage indebtedness to existing and newly acquired unencumbered properties to provide additional capital for acquisitions. As a general policy, we intend to maintain a ratio of total indebtedness to undepreciated book value of real estate assets that is less than 60%. As of December 31, 2010, our ratio of total indebtedness to undepreciated book value of real estate assets was 49%. Assuming full deployment of the proceeds from this offering at 50% leverage in addition to our revolving line of credit that we expect to enter into concurrently with this offering, we will have approximately \$           million available for investment in properties.

***Investing in People.*** We believe that our people are the heart of our culture, philosophy and strategy. We continually focus on developing associates who are self-disciplined, motivated and display at all times a high degree of character and competence. We provide them with equity incentives to align their interests with those of our shareholders. We also focus on their training and development. Our annual in-house Real Estate Executive Development, or REED, program is designed to provide us with knowledgeable and well-trained associates to meet our strategic goals and provide continuity in our leadership and management. The 12-month REED program promotes in-depth understanding of all aspects of investing in, owning and operating commercial real estate by providing select associates with detailed training from real estate professionals from both within and outside Whitestone.

**Summary Risk Factors**

You should carefully consider the risks discussed in the section entitled **Risk Factors** before deciding to invest in our common shares. Some of these risks include:

Recent market disruptions may continue to adversely affect our occupancy, rental rates, access to capital, financial condition and results of operations in the future.

Current conditions in the credit markets could adversely affect our ability to refinance existing indebtedness or obtain additional financing on acceptable terms or at all, which could adversely affect our ability to grow, our interest costs and our results of operations.

The current geographical concentration of our portfolio leaves us vulnerable to an economic downturn in Texas, and particularly the Houston metropolitan area, which could adversely impact our operations and ability to pay dividends to our shareholders.

We lease our properties to approximately 800 tenants, with leases for approximately 10% to 20% of our gross leasable area expiring annually. Each year we face the risk of non-renewal of a material percentage of our leases and the cost of re-leasing a significant amount of our available space, and our failure to meet leasing targets and control the cost of re-leasing our properties could adversely affect our rental revenue, operating expenses and results of operations.

Many of our tenants are small businesses that depend primarily on cash flows from their businesses to pay their rent and without other resources could be at a higher risk of bankruptcy or insolvency than larger, national tenants. The bankruptcy or insolvency of a number of smaller tenants may have an adverse impact on our income and our ability to pay dividends.

We may not be successful in identifying suitable properties or other assets that meet our acquisition criteria or in consummating acquisitions or investments on satisfactory terms or at all. Failure to identify or consummate acquisitions or investment opportunities, or to integrate successfully any acquired properties without substantial expense, delay or other operational or financial problems, would slow our growth, which could in turn adversely affect our Class B common share price.



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Our acquisition strategy is focused on distressed and foreclosed commercial real estate, and we could face significant competition from other investors, REITs, hedge funds, private equity funds and other private real estate investors with greater financial resources and access to capital than us. This could result in competition for accretive acquisition opportunities and delay our business plan, our ability to successfully invest the proceeds of this offering and our ability to maintain our current dividend rate.

Our Community Centered Property strategy is newly adopted and requires intensive management of a large number of small spaces and small tenant relationships. Lack of market acceptance of our Community Centered Property strategy or our inability to successfully manage a large number of tenant relationships could adversely affect our occupancy rates, operating results and dividend rate.

We depend on key personnel, particularly our nine senior managers, the loss of any of whom could threaten our ability to execute our strategy and operate our business successfully.

If we fail to maintain our status as a REIT for federal income tax purposes, our distributions to shareholders will not be deductible by us, and we will pay substantial corporate-level income and excise taxes, reducing our earnings available for distribution.

There can be no assurance that we will be able to pay or maintain cash dividends or that dividends will increase over time. Dividends are based upon our funds from operations, financial condition, cash flows and liquidity, debt service requirements, capital expenditure requirements for our properties and other matters our Board may deem relevant from time to time.

**Exchange of our Class A Common Shares and OP Units**

On August 24, 2010, we amended our Articles of Amendment and Restatement, or our declaration of trust, to (i) change the name of all of our common shares of beneficial interest, par value \$0.001 per share, to Class A common shares, (ii) effect a 1-for-3 reverse share split of our Class A common shares and (iii) change the par value of the Class A common shares to \$0.001 per share after the reverse share split. Pursuant to the partnership agreement for our Operating Partnership, the reverse share split of our Class A common shares also resulted in a 1-for-3 reverse split of our OP units. All prior period share and per share amounts in this prospectus have been retroactively restated to reflect the reverse share split. The rights of the Class A common shareholders did not change with the change in the title of the class. In addition, we created a new class of common shares of beneficial interest, par value \$0.001 per share, entitled Class B common shares. We refer to the Class A and Class B common shares collectively as the common shares. Our Class A common shares are identical to our Class B common shares except that our Class A common shares are not currently listed on a national securities exchange, and we do not intend to list our Class A shares on a national securities exchange.

On August 31, 2010, we completed an offering of 2.2 million of our Class B common shares for approximately \$23.0 million in net offering proceeds to us and listed our Class B common shares on the NYSE Amex. As of December 31, 2010, we had 3,471,187 Class A common shares, 2,200,000 Class B common shares, and 1,814,569 OP units, not held by us, outstanding.

Following this offering, we intend to conduct a series of exchange offers to exchange our Class A common shares and OP units for Class B common shares. In exchange for one Class A common share or one OP unit, we will issue one Class B common share. We intend to commence the exchange offers for all outstanding Class A common shares and OP units in 25% increments on the following schedule:

on or about 90 days following the date of this prospectus (                      , 2011);

on or about 180 days following the date of this prospectus (                      , 2011);

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on or about 270 days following the date of this prospectus ( , 2012); and

on or about 360 days following the date of this prospectus ( , 2012).



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Following the completion of the series of exchange offers, we intend to submit to our shareholders for approval at our 2012 Annual Meeting of Shareholders an amendment to our declaration of trust to change the Class A common shares remaining outstanding after the completion of the exchange offers to Class B common shares and rename our Class B common shares as common shares. If the change is approved by our shareholders, we intend to amend the partnership agreement for our Operating Partnership such that unissued and outstanding OP units may be redeemed for cash or, at our option, our Class B common shares (which will, prior to that time, be renamed common shares ).

**Our Properties**

As of December 31, 2010, we owned 38 commercial properties, including

31 properties in Houston, Texas;

two properties in Dallas, Texas;

one property in Windcrest, Texas, a suburb of San Antonio;

one property in Scottsdale, Arizona;

one property in Carefree, Arizona;

one property in Phoenix, Arizona; and

one property in Buffalo Grove, Illinois, a suburb of Chicago.

Our tenants consist of national, regional and local businesses. Our properties generally attract a mix of tenants who provide basic staples, convenience items and services tailored to the specific cultures, needs and preferences of the surrounding community. These types of tenants are the core of our strategy of creating Whitestone-branded Community Centered Properties. We also believe daily sales of these basic items are less sensitive to fluctuations in the business cycle than higher priced retail items. Our largest tenant represented 1.9% of total revenues for the year ended December 31, 2010.

We directly manage the operations and leasing of our properties. Substantially all of our revenues consist of base rents received under leases that generally have terms that range from less than one year to 15 years. As of December 31, 2010, approximately 72% of our existing leases with terms greater than one year contained step up rental clauses that provide for increases in the base rental payments. The following table summarizes certain information relating to our properties as of December 31, 2010:

|   | No. of Properties | Leasable Square Feet | Average Occupancy as of 12/31/10 | Annualized Base Rental Revenue (in thousands) <sup>(1)</sup> | Average Annualized Base Rental Revenue Per Leased Sq. Ft. <sup>(2)</sup> | Average Net Effective Annual Base Rental Revenue Per Leased Sq. Ft. <sup>(3)</sup> |
|---|-------------------|----------------------|----------------------------------|--|--|--|
| <b>Commercial Properties Operating Portfolio:</b> |                   |                      |                                  |  |  |  |

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|  |           |                  |            |                  |                |                 |
|--|-----------|------------------|------------|------------------|----------------|-----------------|
| Retail   | 18        | 1,188,830        | 88%        | \$ 9,843         | \$ 9.41        | \$ 10.60        |
| Office/Flex  | 11        | 1,201,672        | 88%        | 7,670            | 7.25           | 7.16            |
| Office   | 7         | 631,841          | 79%        | 8,084            | 16.20          | 16.52           |
| <b>Subtotal Operating Portfolio</b>                    | <b>36</b> | <b>3,022,343</b> | <b>86%</b> | <b>25,597</b>    | <b>9.85</b>    | <b>10.35</b>    |
| <b>Redevelopment, New Acquisitions <sup>(4)</sup>:</b> |           |                  |            |                  |                |                 |
| Retail   | 2         | 139,677          | 40%        | 612              | 10.95          | 11.65           |
| <b>Total</b>   | <b>38</b> | <b>3,162,020</b> | <b>84%</b> | <b>\$ 26,209</b> | <b>\$ 9.87</b> | <b>\$ 10.38</b> |

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- (1) Calculated as the tenant's actual December 31, 2010 base rent (defined as cash base rent including abatements) multiplied by 12. Excludes vacant space as of December 31, 2010. Because annualized base rental revenue is not derived from historical results that were accounted for in accordance with U.S. generally accepted accounting principles, or GAAP, historical results differ from the annualized amounts. Total abatements for leases in effect as of December 31, 2010 equaled approximately \$125,000 for the month ended December 31, 2010.
- (2) Calculated as annualized base rent divided by net rentable square feet leased at December 31, 2010. Excludes vacant space as of December 31, 2010.
- (3) Represents (i) the contractual base rent for leases in place as of December 31, 2010, calculated on a straight-line basis to reflect changes in rental rates throughout the lease term and amortize free rent periods and abatements, but without regard to tenant improvement allowances and leasing commissions, divided by (ii) square footage under commenced leases as of December 31, 2010.
- (4) Includes (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.

**Recent Developments**

On April 13, 2011, we completed the purchase of Desert Canyon Shopping Center, or Desert Canyon, in McDowell Mountain Ranch, located in northern Scottsdale, Arizona. This was our third off-market acquisition in the Phoenix area since September 2010. Desert Canyon, which contains 62,533 leasable square feet, inclusive of 12,960 square feet leased to two tenants with ground leases, was purchased out of foreclosure from a regional bank in an all cash transaction for \$3.65 million, or approximately \$58 per leasable square foot. The amount paid is significantly below Desert Canyon's replacement cost. Occupancy at Desert Canyon at closing was approximately 65%, including the two ground leases mentioned above. In-place annualized base rental revenues were approximately \$550,000 at the time of purchase, and we are also entitled to recover the operating expenses from the majority of the existing tenants. We expect to further increase the value of this investment through lease up and application of financial leverage.

Desert Canyon is strategically located within McDowell Mountain Ranch, a 3,200 acre master planned community. Situated at a prime intersection at East McDowell Mountain Ranch Road and N. 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 to the surrounding upscale residential neighborhoods.

We believe Desert Canyon is a very strong fit with our Community Centered Property business model with high roadside visibility, service-oriented tenants and a location surrounded by thousands of residential rooftops. Despite Desert Canyon being in foreclosure, it has been well maintained and we anticipate minimal capital expenditures over the next several years.

**Our Ownership Structure**

Our properties are owned and substantially all of our business is conducted through Whitestone REIT Operating Partnership, L.P., a Delaware limited partnership organized in 1998, which we refer to as our Operating Partnership, and its wholly-owned subsidiaries. Whitestone REIT is the sole general partner of the Operating Partnership. As of December 31, 2010, we owned approximately a 75.4% interest in our Operating Partnership, and other limited partners collectively owned approximately a 24.6% limited partnership interest. Each unit of limited partnership interest in our Operating Partnership, which we call an OP unit, is redeemable at the election of the holder for cash or, at our option, one of our Class A common shares. This operating structure is sometimes referred to as an Umbrella Partnership Real Estate Investment Trust, or UPREIT. Our UPREIT structure enables a seller to contribute property to our Operating Partnership on a tax-deferred basis in exchange for OP units while affording us the opportunity to issue equity on an efficient basis without commissions and without a lag period to invest the equity proceeds in productive assets. We believe this structure allows us to

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pursue acquisition opportunities that might not otherwise be available if the only consideration that could be offered to the seller was cash. See The Operating Partnership Agreement.

The following chart illustrates our operating structure and ownership as of December 31, 2010:

- (1) Whitestone REIT is the 75.4% owner and the general partner of our Operating Partnership. We anticipate this percentage will increase to 85.3% after completion of this offering, assuming the issuance of 5,000,000 Class B common shares.
- (2) Management and Board ownership of Class A common shares, Class B common shares and OP units currently represents 7.1% of all common shares assuming conversion of all OP units.

**Restriction on Ownership and Transfer**

Our declaration of trust, with certain exceptions, authorizes our trustees to take such actions as are necessary and desirable to preserve our qualification as a REIT. Unless exempted by our Board, no person or entity may beneficially own, or be deemed to own by virtue of the applicable constructive ownership provisions of the Internal Revenue Code of 1986, as amended, or the Code, more than 9.8% (by value or by number of shares, whichever is more restrictive) of our outstanding Class A or Class B common shares or more than 9.8% (by value or by number of shares, whichever is more restrictive) of the outstanding shares of any class or series of our preferred shares. See Description of Securities Restrictions on Ownership and Transfer. These restrictions on transferability and ownership will not apply if our Board determines that it is no longer in our best interests to continue to qualify as a REIT.

With certain limited exceptions, our OP units may not be transferred, in whole or in part, without our written consent as the general partner, which consent we may withhold at our sole discretion. We may not consent to any transfer that would cause our Operating Partnership to be treated as a corporation for federal income tax purposes.

**Our Tax Status**

We elected to be treated as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 1999. To maintain our REIT status, we must meet a number of organizational and operational requirements, including a requirement that we annually distribute to our shareholders at least 90% of

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our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gains. As a REIT, we generally are not subject to federal income tax on our REIT taxable income that we distribute currently to our shareholders. If we fail to maintain our status 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 rates. Even if we qualify for taxation as a REIT, we may be subject to some federal, state and local taxes on our income or property. See Material U.S. Federal Income Tax Considerations.

Our REIT status depends upon our ability to meet, for each taxable year, various requirements imposed under the Code. Those requirements involve the percentage of income that we earn from specified sources, the percentage of our assets that falls within specified categories, the diversity of our share ownership, and the percentage of our earnings that we distribute. For a discussion of the tax consequences of our failure to qualify as a REIT, see Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT Failure to Qualify as a REIT.

Our REIT status also depends upon our Operating Partnership continuing to be treated as a partnership for federal income tax purposes and not as a publicly traded partnership taxable as a corporation under the Code. This treatment is dependent upon at least 90% of our Operating Partnership's gross income for each taxable year being specified passive income including real property rents, gains from the sale or other disposition of real property, interest and dividends. If our Operating Partnership fails to qualify for taxation as a partnership, we will fail certain asset and income tests required for REIT status.

**Our Distribution Policy**

In order to maintain our status as a REIT, we must annually distribute to our shareholders an amount at least equal to: (i) 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gains; plus (ii) 90% of the excess of our net income from foreclosure property over the tax imposed on such income by the Code; less (iii) any excess non-cash income, as determined under Section 857 of the Code.

We declared the following distributions to our shareholders and holders of OP units with respect to 2009, 2010 and the three months ended March 31, 2011:

|                    | <b>Distributions<br/>Per<br/>Share/OP<br/>Unit <sup>(1)</sup></b> |
|--------------------|---|
| <b><u>2009</u></b> |   |
| First Quarter      | \$ 0.3375   |
| Second Quarter     | 0.3375  |
| Third Quarter      | 0.3375  |
| Fourth Quarter     | 0.3375  |
| <b><u>2010</u></b> |   |
| First Quarter      | \$ 0.3375   |
| Second Quarter     | 0.2850  |
| Third Quarter      | 0.2850  |
| Fourth Quarter     | 0.2850  |
| <b><u>2011</u></b> |   |
| First Quarter      | \$ 0.2850   |

<sup>(1)</sup> Distributions paid with respect to Class A common shares and, since September 2010, with respect to Class A common shares and Class B common shares. Distributions have been adjusted to reflect the 1-for-3 reverse share split of our Class A common shares and OP units in August 2010.



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The timing and frequency of all distributions will be authorized by our Board and declared by us based upon a number of factors, including:

our funds from operations;

our debt service requirements;

our capital expenditure requirements for our properties;

our taxable income, combined with the annual distribution requirements necessary to maintain REIT qualification;

requirements of Maryland law;

our overall financial condition; and

other factors deemed relevant by our Board.

Our distribution rate for the year ended December 31, 2010 was approximately 88% of our funds from operations per share. We typically declare our distributions quarterly and pay our distributions in three equal monthly installments. For the fourth quarter of 2010, we declared a distribution per common share and OP unit of \$0.2850, which was paid as follows: \$0.0950 on January 3, 2011, \$0.0950 on February 8, 2011 and \$0.0950 on March 8, 2011. For the first quarter of 2011, we declared a distribution per common share and OP unit of \$0.2850, which was paid or will be paid as follows: \$0.0950 on April 7, 2011, \$0.0950 on May 6, 2011 and \$0.0950 on June 7, 2011.

We cannot assure you that our distributions will be made or sustained. Our actual results of operations may differ materially from our current expectations. Our actual results of operations will be affected by a number of factors, including the revenue we receive from our properties, our operating expenses, our ability to attract and retain tenants, interest expense, the ability of our tenants to meet their obligations and unanticipated expenditures. There can be no assurance that we will be able to pay or maintain cash distributions or that distributions will increase over time.

**Revolving Credit Facility**

Concurrently with the completion of this offering, we anticipate entering into a \$20 million unsecured revolving credit facility, which may be expandable to \$75 million under certain circumstances. We expect to use this facility for general corporate purposes, including acquisitions and development and redevelopment of properties in our portfolio, working capital and the payment of capital expenses.

Certain affiliates of BMO Capital Markets Corp. may participate as lenders under our unsecured revolving credit facility. In their capacity as lenders, these affiliates will receive certain customary cash fees in connection with the credit facility.

**Our Principal Office**

Our principal office is located at 2600 South Gessner, Suite 500, Houston, Texas 77063. Our telephone number is (713) 827-9595. We maintain a website at [www.whitestonereit.com](http://www.whitestonereit.com). Our website and the information contained therein or connected thereto do not constitute a part of this prospectus.





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**THE OFFERING**

Class B common shares offered by us 5,000,000  
 Common shares and OP units outstanding after this offering:

Class A common shares 3,471,187

Class B common shares 7,200,000<sup>(1)</sup>

OP units 1,814,599<sup>(2)</sup>

Use of proceeds We estimate that the net proceeds from this offering will be approximately \$ , based upon the public offering price of \$ per Class B common share and after deducting the underwriting discount and estimated offering expenses of \$400,000 payable by us. If the underwriters over-allotment option is exercised in full, our net proceeds will be approximately \$ . We will contribute the net proceeds from this offering to our Operating Partnership in exchange for a number of OP units equal to the number of Class B common shares sold in this offering, 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. Pending these uses, we intend to invest the net offering proceeds in interest-bearing, short-term, marketable investment grade securities or money market accounts that are consistent with our intention to qualify as a REIT.

NYSE Amex symbol for Class B common shares WSR

- (1) Excludes 473,814 Class B common shares available for issuance under our 2008 Long-Term Equity Incentive Ownership Plan, and up to 750,000 Class B common shares that may be issued upon exercise of the underwriters over-allotment option.
- (2) OP units are redeemable for cash or, at our option, Class A common shares on a one-for-one basis.

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The following table sets forth our summary historical consolidated financial, operating and other data. You should read the following historical information in conjunction with our historical consolidated financial statements and notes thereto included elsewhere in this prospectus.

Our historical consolidated balance sheet data as of December 31, 2010, 2009 and 2008 and consolidated statement of operations data for the years ended December 31, 2010, 2009 and 2008 have been derived from our audited historical combined financial statements. All per share data set forth below has been adjusted to reflect the 1-for-3 reverse share split of our Class A common shares that occurred in August 2010.

Our historical consolidated financial data included below and set forth elsewhere in this prospectus are not necessarily indicative of our future performance.

You should read the following summary financial and other data together with Business and Properties, Management's Discussion and Analysis of Financial Condition and Results of Operations and our historical financial statements and related notes appearing elsewhere in this prospectus.

|   | Year Ended December 31,<br>(in thousands, except per share data) |           |           |
|---|--|-----------|-----------|
|   | 2010   | 2009      | 2008      |
| <b>Operating Data:</b>  |  |           |           |
| Revenues  | \$ 31,533  | \$ 32,685 | \$ 31,201 |
| Property expenses   | 12,283   | 12,991    | 12,835    |
| General and administrative <sup>(1)</sup>   | 4,992  | 6,072     | 6,708     |
| Depreciation and amortization   | 7,225  | 6,958     | 6,859     |
| Involuntary conversion  | (558)  | (1,542)   | 358       |
| Interest expense, net   | 5,592  | 5,713     | 5,675     |
| Income (loss) from continuing operations before loss on disposal of assets and income taxes | 1,999  | 2,493     | (1,234)   |
| Provision for income taxes  | (264)  | (222)     | (219)     |
| Loss on disposal of assets  | (160)  | (196)     | (223)     |
| Income (loss) from continuing operations  | 1,575  | 2,075     | (1,676)   |
| Loss from discontinued operations   |  |           | (188)     |
| Gain on sale of properties from discontinued operations                                     |  |           | 3,619     |
| Net income  | 1,575  | 2,075     | 1,755     |
| Less: net income attributable to noncontrolling interests                                   | 470  | 733       | 621       |
| Net income attributable to Whitestone REIT  | \$ 1,105   | \$ 1,342  | \$ 1,134  |

<sup>(1)</sup> General and administrative expenses for the year ended December 31, 2008 includes approximately \$1.5 million of legal costs resulting from litigation with our former CEO and our former external advisor.

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|   | Year Ended December 31,<br>(in thousands, except per share data) |            |            |
|---|--|------------|------------|
|   | 2010   | 2009       | 2008       |
| <b>Earnings per share basic</b>   |  |            |            |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27  | \$ 0.41    | \$ (0.32)  |
| Income from discontinued operations attributable to Whitestone REIT   |  |            | 0.67       |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares                           | \$ 0.27  | \$ 0.41    | \$ 0.35    |
| <b>Earnings per share diluted</b>   |  |            |            |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27  | \$ 0.40    | \$ (0.32)  |
| Income from discontinued operations attributable to Whitestone REIT   |  |            | 0.67       |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares                           | \$ 0.27  | \$ 0.40    | \$ 0.35    |
| <b>Balance Sheet Data:</b>  |  |            |            |
| Real estate (net)   | \$ 165,398   | \$ 158,398 | \$ 150,847 |
| Other assets  | 31,047   | 23,602     | 27,098     |
| Total assets  | \$ 196,445   | \$ 182,000 | \$ 177,945 |
| Liabilities   | \$ 112,162   | \$ 115,141 | \$ 110,773 |
| Whitestone REIT shareholders' equity  | 62,708   | 43,590     | 45,891     |
| Noncontrolling interest in subsidiary   | 21,575   | 23,269     | 21,281     |
|   | \$ 196,445   | \$ 182,000 | \$ 177,945 |
| <b>Other Data:</b>  |  |            |            |
| Proceeds from issuance of common shares   | \$ 22,970  | \$         | \$         |
| Additions to and acquisitions of real estate  | 12,768   | 12,855     | 5,153      |
| Dividends per share <sup>(1)</sup>  | 1.17   | 1.35       | 1.59       |
| Funds from operations <sup>(2)</sup>  | 8,432  | 8,618      | 4,236      |
| Funds from operations-Core <sup>(2)</sup>   | 7,920  | 6,759      | 6,085      |
| Property net operating income <sup>(3)</sup>  | 19,250   | 19,694     | 18,366     |
| Operating Portfolio Occupancy at year end   | 86%  | 82%        | 84%        |
| Average aggregate gross leasable area   | 3,058,340  | 3,039,044  | 3,008,085  |
| Average revenue per average aggregate gross leasable square foot  | \$ 10.31   | \$ 10.76   | \$ 10.37   |

(1) The dividends per share represent total cash payments divided by weighted average common shares.

(2) We believe that Funds From Operations, or FFO, is an appropriate supplemental measure of operating performance because it helps our investors compare our operating performance relative to other REITs. The National Association of Real Estate Investment Trusts, or NAREIT, defines FFO as net income (loss) available to common shareholders computed in accordance with GAAP, excluding gains or losses from sales of operating properties and extraordinary items, plus depreciation and amortization of real estate assets, including our share of unconsolidated partnerships and joint ventures. We calculate FFO in a manner consistent with the NAREIT definition. 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, acquisition costs and certain costs paid as a result of our



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litigation with our former external manager. We define FFO-Core as FFO excluding these items. Below is the calculation of FFO and FFO-Core and the reconciliation to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|  | <b>Year Ended December 31,</b><br><b>(in thousands, except per share</b><br><b>data)</b> |                 |                 |
|--|--|-----------------|-----------------|
|  | <b>2010</b>  | <b>2009</b>     | <b>2008</b>     |
| Net income attributable to Whitestone REIT                         | \$ 1,105   | \$ 1,342        | \$ 1,134        |
| Depreciation and amortization of real estate assets <sup>(1)</sup> | 6,697  | 6,347           | 5,877           |
| (Gain) loss on sale or disposal of assets <sup>(1)</sup>           | 160  | 196             | (3,396)         |
| Net income attributable to noncontrolling interests                | 470  | 733             | 621             |
| <b>FFO</b>   | <b>8,432</b>   | <b>8,618</b>    | <b>4,236</b>    |
| Acquisition costs  | 46   | 75              |                 |
| (Gain) loss on insurance settlement <sup>(2)</sup>                 | (558)  | (1,934)         | 358             |
| Litigation costs with our former external manager                  |  |                 | 1,491           |
| <b>FFO-Core</b>  | <b>\$ 7,920</b>  | <b>\$ 6,759</b> | <b>\$ 6,085</b> |

<sup>(1)</sup> Including amounts for discontinued operations.

<sup>(2)</sup> \$392 included in rental revenue for the twelve months ended December 31, 2009.

<sup>(3)</sup> We believe that property Net Operating Income (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 gain or loss on sale or disposal 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.

The following is a reconciliation of our historical NOI to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|   | <b>Year Ended December 31</b> |                  |                  |
|---|-------------------------------|------------------|------------------|
|   | <b>2010</b>                   | <b>2009</b>      | <b>2008</b>      |
| Net Income Attributable to Whitestone REIT              | \$ 1,105                      | \$ 1,342         | \$ 1,134         |
| General and administrative expense                      | 4,992                         | 6,072            | 6,708            |
| Depreciation and amortization                           | 7,225                         | 6,958            | 6,859            |
| Involuntary conversion                                  | (558)                         | (1,542)          | 358              |
| Interest expense  | 5,620                         | 5,749            | 5,857            |
| Interest income   | (28)                          | (36)             | (182)            |
| Provision for income taxes                              | 264                           | 222              | 219              |
| Loss on disposal of assets                              | 160                           | 196              | 223              |
| Loss from discontinued operations                       |                               |                  | 188              |
| Gain on sale of properties from discontinued operations |                               |                  | (3,619)          |
| Net income attributable to noncontrolling interests     | 470                           | 733              | 621              |
| <b>NOI</b>  | <b>\$ 19,250</b>              | <b>\$ 19,694</b> | <b>\$ 18,366</b> |



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**RISK FACTORS**

An investment in our common shares involves risks. In addition to other information contained in this prospectus, you should carefully consider the following factors before acquiring our Class B common shares offered by this prospectus. The occurrence of any of the following risks might cause you to lose all or a part of your investment. Some statements in this prospectus, including statements in the following risk factors, constitute forward-looking statements, as described in the section entitled Forward-Looking Statements.

**Risks Associated with Real Estate**

*Recent market disruptions may significantly and adversely affect our financial condition and results of operations.*

The U.S. economy is still experiencing weakness from recent economic conditions, which resulted in increased unemployment, weakening of tenant financial condition, large-scale business failures and tight credit markets. Our results of operations may be sensitive to changes in overall economic conditions that impact tenant leasing practices. Adverse economic conditions affecting tenant income, such as employment levels, business conditions, interest rates, tax rates, fuel and energy costs and other matters, could reduce overall tenant leasing or cause tenants to shift their leasing practices. In addition, periods of economic slowdown or recession, rising interest rates or declining demand for real estate, or the public perception that any of these events may occur, could result in a general decline in rents or an increased incidence of defaults under existing leases. Although the U.S. economy has emerged from the recent recession, high levels of unemployment have persisted, and rental rates and valuations for retail space have not fully recovered to pre-recession levels and may not for a number of years. At this time, it is difficult to determine the breadth and duration of the impact of the recent economic and financial market problems and the many ways in which they could affect our tenants and our business in general. A general reduction in the level of tenant leasing could adversely affect our ability to maintain our current tenants and gain new tenants, affecting our growth and profitability. Accordingly, continuation or further worsening of these difficult financial and macroeconomic conditions could have a significant adverse effect on our cash flows, profitability and results of operations.

*Real estate property investments are illiquid due to a variety of factors and therefore we may not be able to dispose of properties when appropriate or on favorable terms.*

Our strategy includes opportunistically selling properties that do not have the potential to meet our Community Centered Property strategy. However, real estate property investments generally cannot be disposed of quickly. In addition, the Code imposes restrictions on the ability of a REIT to dispose of properties that are not applicable to other types of real estate companies. Therefore, we may not be able to vary our portfolio in response to economic or other conditions promptly or on favorable terms, which could cause us to incur extended losses, reduce our cash flows and adversely affect distributions to shareholders.

We cannot predict whether we will be able to sell any property for the price or on the terms set by us or whether any price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a property. To the extent we are unable to sell any properties for our book value, we may be required to take a non-cash impairment charge or loss on the sale, either of which would reduce our net income.

We may be required to expend funds and time to correct defects or to make improvements before a property can be sold. We cannot assure you that we will have funds available to correct those defects or to make those improvements, which may impede our ability to sell a property. Further, we may agree to transfer restrictions that materially restrict us from selling that property for a period of time or impose other restrictions, such as a limitation on the amount of debt that can be placed or repaid on that property. These transfer restrictions would impede our ability to sell a property even if we deem it necessary or appropriate. These facts and any others that would further contribute to the illiquid character of real estate properties and impede our ability to respond to

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adverse changes in the performance of our properties may have a material adverse effect on our business, financial condition, results of operations, our ability to make distributions to our shareholders and the trading price of our Class B common shares.

***Our business is dependent upon our tenants successfully operating their businesses and their failure to do so could have a material adverse effect on our ability to successfully and profitably operate our business.***

We depend on our tenants to operate the properties we own in a manner which generates revenues sufficient to allow them to meet their obligations to us, including their obligations to pay rent, maintain certain insurance coverage, pay real estate taxes and maintain the properties in a manner so as not to jeopardize their operating licenses or regulatory status. The ability of our tenants to fulfill their obligations under our leases may depend, in part, upon the overall profitability of their operations. Cash flow generated by certain tenant businesses may not be sufficient for a tenant to meet its obligations to us. Our financial position could be weakened and our ability to fulfill our obligations under our indebtedness could be limited if a number of our tenants were unable to meet their obligations to us or failed to renew or extend their relationship with us as their lease terms expire, or if we were unable to lease or re-lease our properties on economically favorable terms. These adverse developments could arise due to a number of factors, including those described in the risk factors discussed in this prospectus.

***Turmoil in capital markets could adversely impact acquisition activities and pricing of real estate assets.***

Volatility in capital markets could adversely affect acquisition activities by impacting certain factors, including the tightening of underwriting standards by lenders and credit rating agencies and the significant inventory of unsold collateralized mortgage backed securities in the market. These factors directly affect a lender's ability to provide debt financing as well as increase the cost of available debt financing. As a result, we may not be able to obtain favorable debt financing in the future or at all. This may impair our ability to acquire properties or result in future acquisitions generating lower overall economic returns, which may adversely affect our results of operations and distributions to shareholders. Furthermore, any turmoil in the capital markets could adversely impact the overall amount of capital available to invest in real estate, which may result in price or value decreases of real estate assets.

***The value of investments in our common shares will be directly affected by general economic and regulatory factors we cannot control or predict.***

Investments in real estate typically involve a high level of risk as the result of factors we cannot control or predict. One of the risks of investing in real estate is the possibility that our properties will not generate income sufficient to meet operating expenses or will generate income and capital appreciation, if any, at rates lower than those anticipated or available through investments in comparable real estate or other investments. The following factors may affect income from properties and yields from investments in properties and are generally outside of our control:

conditions in financial markets;

over-building in our markets;

a reduction in rental income as a result of the inability to maintain occupancy levels;

adverse changes in applicable tax, real estate, environmental or zoning laws;

changes in general economic conditions;

a taking of any of our properties by eminent domain;



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adverse local conditions (such as changes in real estate zoning laws that may reduce the desirability of real estate in the area);

acts of God, such as hurricanes, earthquakes or floods and uninsured losses;

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changes in supply of or demand for similar or competing properties in an area;

changes in interest rates and availability of debt capital, which may render the sale of a property difficult or unattractive; and

periods of high interest rates, inflation or tight money supply.

Some or all of these factors may affect our properties, which could adversely affect our operations and ability to pay dividends to shareholders.

***We may face significant competition in our efforts to acquire financially distressed properties and debt.***

Our acquisition strategy is focused on distressed commercial real estate, and we could face significant competition from other investors, REITs, hedge funds, private equity funds and other private real estate investors with greater financial resources and access to capital than us. Therefore, we may not be able to compete successfully for investments. In addition, the number of entities and the amount of purchasers competing for suitable investments may increase, all of which could result in competition for accretive acquisition opportunities and adversely affect our business plan, our ability to successfully invest the proceeds of this offering and our ability to maintain our current dividend rate.

***All of our properties are subject to property taxes that may increase in the future, which could adversely affect our cash flow.***

Our properties are subject to property taxes that may increase as property tax rates change and as the properties are assessed or reassessed by taxing authorities. As the owner of the properties, we are ultimately responsible for payment of the taxes to the government. If property taxes increase, our tenants may be unable to make the required tax payments, ultimately requiring us to pay the taxes. In addition, we will generally be responsible for property taxes related to any vacant space in our properties.

***Our assets may be subject to impairment charges.***

We periodically evaluate our real estate investments and other assets for impairment indicators. The judgment regarding the existence of impairment indicators is based on factors such as market conditions, tenant performance and legal structure. If we determine that a significant impairment has occurred, we would be required to make an adjustment to the net carrying value of the asset, which could have a material adverse effect on our results of operations and funds from operations in the period in which the write-off occurs.

***Compliance or failure to comply with laws requiring access to our properties by disabled persons could result in substantial cost.***

The Americans with Disabilities Act, or ADA, and other federal, state and local laws generally require public accommodations be made accessible to disabled persons. Noncompliance could result in the imposition of fines by the government or the award of damages to private litigants. These laws may require us to modify our existing properties. These laws may also restrict renovations by requiring improved access to such buildings by disabled persons or may require us to add other structural features which increase our construction costs. Legislation or regulations adopted in the future may impose further burdens or restrictions on us with respect to improved access by disabled persons. We may incur unanticipated expenses that may be material to our financial condition or results of operations to comply with ADA and other federal, state and local laws, or in connection with lawsuits brought by private litigants.

***We face intense competition, which may decrease, or prevent increases of, the occupancy and rental rates of our properties.***

We compete with a number of developers, owners and operators of commercial real estate, many of whom own properties similar to ours in the same markets in which our properties are located. If our competitors offer space at rental rates below current market rates, or below the rental rates we currently charge our tenants, we may

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lose existing or potential tenants and we may be pressured to reduce our rental rates below those we currently charge or to offer more substantial rent abatements, tenant improvements, early termination rights or below-market renewal options in order to retain tenants when our tenants leases expire. This competitive environment could have a material adverse effect on our ability to lease our properties or any newly developed or acquired property, as well as on the rents charged.

**Risks Associated with Our Operations**

*Because of the current geographic concentration of our portfolio, an economic downturn in the Houston metropolitan area could adversely impact our operations and ability to pay dividends to our shareholders.*

The majority of our assets and revenues are currently derived from properties located in the Houston metropolitan area. As of December 31, 2010, we had 75% of our gross leasable square feet in Houston. Our results of operations are directly contingent on our ability to attract financially sound commercial tenants. A significant economic downturn may adversely impact our ability to locate and retain financially sound tenants and could have an adverse impact on our tenants' revenues, costs and results of operations and may adversely affect their ability to meet their obligations to us. Likewise, we may be required to lower our rental rates to attract desirable tenants in such an environment. Consequently, because of the geographic concentration among our current assets, if the Houston metropolitan area experiences an economic downturn, our operations and ability to pay dividends to our shareholders could be adversely impacted.

*We lease our properties to approximately 800 tenants, with leases for approximately 10% to 20% of our gross leasable area expiring annually. Each year we face the risk of non-renewal of a material percentage of our leases and the cost of re-leasing a significant amount of our available space, and our failure to meet leasing targets and control the cost of re-leasing our properties could adversely affect our rental revenue, operating expenses and results of operations.*

The nature of our business model warrants shorter term leases to smaller, non-national tenants, and substantially all of our revenues consist of base rents received under these leases. As of December 31, 2010, approximately 36% of the aggregate gross leasable area of our properties is subject to leases that expire prior to December 31, 2012. We are subject to the risk that:

tenants may choose not to, or may not have the financial resources to, renew these leases;

we may experience significant costs associated with re-leasing a significant amount of our available space;

we may not be able to easily re-lease the space subject to these leases, which may cause us to fail to meet our leasing targets or control the costs of re-leasing; and

the terms of any renewal or re-lease may be less favorable than the terms of the current leases.

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. While our early renewal program and other leasing and marketing efforts target these expiring leases, and while we hope to re-lease most of that space prior to expiration of the leases at rates comparable to or slightly in excess of the current rates, market conditions, including new supply of properties, and macroeconomic conditions in Houston and nationally could adversely impact our renewal rate and/or the rental rates we are able to negotiate. If any of these risks materialize, our rental revenue, operating expenses and results of operations could be adversely affected.

*Many of our tenants are small businesses, which may have a higher risk of bankruptcy or insolvency.*

Many of our tenants are small businesses that depend primarily on cash flows from their businesses to pay their rent and without other resources could be at a higher risk of bankruptcy or insolvency than larger, national tenants. If tenants are unable to comply with the terms of our leases, we may be forced to modify the leases in



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ways that are unfavorable to us. Alternatively, the failure of a tenant to perform under a lease could require us to declare a default, repossess the space and find a suitable replacement tenant. There is no assurance that we would be able to lease the space on substantially equivalent or better terms than the prior lease, or at all, or successfully reposition the space for other uses.

If one or more of our tenants files for bankruptcy relief, the Bankruptcy Code provides that a debtor has the option to assume or reject the unexpired lease within a certain period of time. For example, on November 10, 2008, one of our tenants, Circuit City, which leased space at one of our properties and represented approximately 1.3% of our total rent for the year ended December 31, 2008, filed for reorganization under Chapter 11 of the Bankruptcy Code. The tenant elected to reject our lease.

Any bankruptcy filing by or relating to one or more of our tenants could bar all efforts by us to collect pre-bankruptcy debts from that tenant or seize its property. A tenant bankruptcy could also delay our efforts to collect past due balances under the lease and could ultimately preclude collection of all or a portion of these sums. It is possible that we may recover substantially less than the full value of any unsecured claims we hold, if any. Furthermore, dealing with a tenant's bankruptcy or other default may divert management's attention and cause us to incur substantial legal and other costs. The bankruptcy or insolvency of a number of smaller tenants may have an adverse impact on our business, financial condition and results of operations, our ability to make distributions to our shareholders and the trading price of our Class B common shares.

***Uninsured losses relating to real property or excessively expensive premiums for insurance coverage may adversely affect our returns.***

We attempt to adequately insure all of our properties to cover casualty losses. However, there are types of losses, generally catastrophic in nature, such as losses due to wars, acts of terrorism, earthquakes, floods, hurricanes, pollution or environmental matters, which are uninsurable or not economically insurable, or may be insured subject to limitations, such as large deductibles or co-payments. Our current geographic concentration in the Houston metropolitan area potentially increases the risk of damage to our portfolio due to hurricanes. Insurance risks associated with potential terrorism acts could sharply increase the premiums we pay for coverage against property and casualty claims. In some instances, we may be required to provide other financial support, either through financial assurances or self-insurance, to cover potential losses. We cannot assure you that we will have adequate coverage for these losses. Also, to the extent we must pay unexpectedly large insurance premiums, we could suffer reduced earnings that would result in less cash to be distributed to shareholders as dividends.

***Discovery of previously undetected environmentally hazardous conditions may adversely affect our operating results.***

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the cost of removal or remediation of hazardous or toxic substances on, under or in its property. The costs of removal or remediation could be substantial. These laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of any hazardous or toxic substances. Environmental laws also may impose restrictions on the manner in which property may be used or businesses may be operated, and these restrictions may require substantial expenditures. Environmental laws provide for sanctions in the event of noncompliance and may be enforced by governmental agencies or, in certain circumstances, by private parties. Certain environmental laws and common law principles could be used to impose liability for release of and exposure to hazardous substances, including asbestos containing materials into the air. In addition, third parties may seek recovery from owners or operators of real properties for personal injury or property damage associated with exposure to released hazardous substances. The cost of defending against claims of liability, of compliance with environmental regulatory requirements, of remediating any contaminated property, or of paying personal injury claims could materially adversely affect our business, assets or results of operations and, consequently, amounts available for payments of dividends to our shareholders.

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*We may not be successful in consummating suitable acquisitions or investment opportunities, which may impede our growth and negatively affect our results of operations.*

Our ability to expand through acquisitions is integral to our business strategy and requires us to consummate suitable acquisition or investment opportunities that meet our criteria and are compatible with our growth strategy. We may not be successful in consummating acquisitions or investments in properties that meet our acquisition criteria on satisfactory terms or at all. Failure to consummate acquisitions or investment opportunities, or to integrate successfully any acquired properties without substantial expense, delay or other operational or financial problems, would slow our growth, which could in turn adversely affect the trading price of our Class B common shares.

Our ability to acquire properties on favorable terms may be constrained by the following significant risks:

competition from other real estate investors with significant capital, including REITs and institutional investment funds;

competition from other potential acquirers which may significantly increase the purchase price for a property we acquire, which could reduce our growth prospects;

unsatisfactory results of our due diligence investigations or failure to meet other customary closing conditions; and

failure to finance an acquisition on favorable terms or at all.

If any of these risks are realized, our business, financial condition and results of operations, our ability to make distributions to our shareholders and the trading price of our Class B common shares may be materially and adversely affected.

*Our success depends in part on our ability to execute our Community Centered Property strategy.*

Our Community Centered Property strategy is newly adopted and requires intensive management of a large number of small spaces and small tenant relationships. Our success will depend in part upon our management's ability to identify potential Community Centered Properties and find and maintain the appropriate tenants to create such a property. Lack of market acceptance of our Community Centered Property strategy or our inability to successfully attract and manage a large number of tenant relationships could adversely affect our occupancy rates, operating results and dividend rate.

*Loss of our key personnel, particularly our nine senior managers, could threaten our ability to execute our strategy and operate our business successfully.*

We are dependent on the experience and knowledge of our key executive personnel, particularly our nine senior managers who have been instrumental in setting our strategic direction, operating our business, identifying, recruiting and training key personnel and arranging necessary financing. Losing the services of any of these individuals could adversely affect our business until qualified replacements could be found. We also believe that they could not quickly be replaced with managers of equal experience and capabilities and their successors may not be as effective.

*Our systems may not be adequate to support our growth, and our failure to successfully oversee our portfolio of properties could adversely affect our results of operations.*

We cannot assure you that we will be able to adapt our portfolio management, administrative, accounting and operational systems, or hire and retain sufficient operational staff, to support any growth we may experience. Our failure to successfully oversee our current portfolio of properties or any future acquisitions or developments could have a material adverse effect on our results of operations and financial condition and our ability to make distributions.



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*There can be no assurance that we will be able to pay or maintain cash dividends or that dividends will increase over time.*

There are many factors that can affect the availability and timing of cash dividends to shareholders. Dividends are based upon our funds from operations, financial condition, cash flows and liquidity, debt service requirements, capital expenditure requirements for our properties and other matters our Board may deem relevant from time to time. If we do not have sufficient cash available for dividends, we may need to fund the shortage out of working capital or borrow to provide funds for such distributions, which would reduce the amount of proceeds available for real estate investments and increase our future interest costs.

We can give no assurance that we will be able to pay or maintain dividends or that dividends will increase over time. In addition, we can give no assurance that rents from the properties will increase, or that future acquisitions of real properties, mortgage loans or our investments in securities will increase our cash available for dividends to shareholders. Our actual results may differ significantly from the assumptions used by our Board in establishing the dividend rate to shareholders. Our inability to make distribution, or to make distributions at expected levels, could result in a decrease in the trading price of our Class B common shares.

**Risks Associated with Our Indebtedness and Financing**

*Current market conditions could adversely affect our ability to refinance existing indebtedness or obtain additional financing for growth on acceptable terms or at all, which could adversely affect our ability to grow, our interest cost and our results of operations.*

The United States credit markets have recently experienced significant dislocations and liquidity disruptions, including the bankruptcy, insolvency or restructuring of certain financial institutions. These circumstances have materially impacted liquidity in the debt markets, making financing terms for borrowers less attractive, and in certain cases have resulted in the unavailability of various types of debt financing. Reductions in our available borrowing capacity, or inability to establish a credit facility when required or when business conditions warrant, could have a material adverse effect on our business, financial condition and results of operations. In addition, we mortgage most of our properties to secure payment of indebtedness. If we are not successful in refinancing our mortgage debt upon maturity, then the property could be foreclosed upon or transferred to the mortgagee, or we might be forced to dispose of some of our properties upon disadvantageous terms, with a consequent loss of income and asset value. A foreclosure or disadvantageous disposal on one or more of our properties could adversely affect our ability to grow, financial condition, interest cost, results of operations, cash flow and ability to pay dividends to our shareholders.

Furthermore, if prevailing interest rates or other factors at the time of refinancing result in higher interest rates upon refinancing, then the interest expense relating to that refinanced indebtedness would increase. Higher interest rates on newly incurred debt may negatively impact us as well. If interest rates increase, our interest costs and overall costs of capital will increase, which could adversely affect our transaction and development activity, financial condition, results of operation, cash flow, our ability to pay principal and interest on our debt and our ability to pay dividends to our shareholders.

*If we invest in mortgage loans, these investments may be affected by unfavorable real estate market conditions, including interest rate fluctuations, which could decrease the value of those loans and the return on your investment.*

If we invest in mortgage loans, we will be at risk of defaults by the borrowers on those mortgage loans as well as interest rate risks. To the extent we incur delays in liquidating such defaulted mortgage loans, we may not be able to obtain all amounts due to us under the mortgage loans. Further, we will not know whether the values of the properties securing the mortgage loans will remain at the levels existing on the dates of origination of those mortgage loans or the dates of our investment in the loans. If the values of the underlying properties fall, our risk will increase because of the lower value of the security associated with such loans.



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***Our failure to hedge effectively against interest rate changes may adversely affect results of operations.***

We currently have mortgages that bear interest at a variable rate and we may incur additional variable rate debt in the future. Accordingly, increases in interest rates on variable rate debt would increase our interest expense, which could reduce net earnings and cash available for payment of our debt obligations and distributions to our shareholders.

We may seek to manage our exposure to interest rate volatility by using interest rate hedging arrangements, such as interest cap agreements and interest rate swap agreements. These agreements involve risks, such as the risk that counterparties may fail to honor their obligations under these arrangements, that these arrangements may not be effective in reducing our exposure to interest rate changes and that a court could rule that such an agreement is not legally enforceable. In the past, we have used derivative financial instruments to hedge interest rate risks related to our variable rate borrowings. We will not use derivatives for speculative or trading purposes and intend only to enter into contracts with major financial institutions based on their credit rating and other factors, but we may choose to change this practice in the future. We may enter into interest rate swap agreements for our variable rate debt, which totals \$25.4 million as of December 31, 2010. Hedging may reduce the overall returns on our investments. Failure to hedge effectively against interest rate changes may materially adversely affect our results of operations.

***We currently have and may incur additional mortgage indebtedness and other borrowings, which may increase our business risks and may adversely affect our ability to make distributions to our shareholders.***

If it is determined to be in our best interests, we may, in some instances, acquire real properties by using either existing financing or borrowing new funds. In addition, we may incur or increase our current mortgage debt to obtain funds to acquire additional properties. We may also borrow funds if necessary to satisfy the REIT distribution requirement described above, or otherwise as may be necessary or advisable to assure that we maintain our qualification as a REIT for federal income tax purposes.

We may incur mortgage debt on a particular property if we believe the property's projected cash flow is sufficient to service the mortgage debt. As of December 31, 2010, we had approximately \$100.9 million of mortgage debt secured by 23 of our properties. If there is a shortfall in cash flow, however, the amount available for dividends to shareholders may be affected. In addition, incurring mortgage debt increases the risk of loss because defaults on such indebtedness may result in loss of property in foreclosure actions initiated by lenders. For tax purposes, a foreclosure of any of our properties would be treated as a sale of the property for a purchase price equal to the outstanding balance of the debt secured by the mortgage. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we would recognize taxable income on foreclosure, but would not receive any cash proceeds. We may give lenders full or partial guarantees for mortgage debt incurred by the entities that own our properties. When we give a guaranty on behalf of an entity that owns one of our properties, we will be responsible to the lender for satisfaction of the debt if it is not paid by that entity. If any mortgages contain cross-collateralization or cross-default provisions, there is a risk that more than one property may be affected by a default. If any of our properties are foreclosed upon due to a default, our ability to pay cash dividends to our shareholders will be adversely affected. For more discussion, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.

***High mortgage rates and/or unavailability of mortgage debt may make it difficult for us to finance or refinance properties, which could reduce the number of properties we can acquire, our net income and the amount of cash distributions we can make.***

If mortgage debt is unavailable at rates acceptable to us, we may not be able to finance the purchase of properties. If we place mortgage debt on properties, we may be unable to refinance the properties when the loans become due, or to refinance on favorable terms. If interest rates are higher when we refinance our properties, our payments on our indebtedness would increase and our income could be reduced. If any of these events occur, our

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cash flow could be reduced. This, in turn, could reduce cash available for distribution to our shareholders and may hinder our ability to raise more capital by issuing more stock or by borrowing more money.

*We expect that our revolving credit facility will restrict our ability to engage in some business activities, including our ability to incur additional indebtedness, make capital expenditures and make certain investments, which could adversely affect our financial condition, results of operations, cash flow and trading price of our Class B common shares.*

We anticipate that our revolving credit facility will contain customary negative covenants and other financial and operating covenants that, among other things:

restrict our ability to incur additional indebtedness;

restrict our ability to incur additional liens;

restrict our ability to make certain investments (including certain capital expenditures);

restrict our ability to merge with another company;

restrict our ability to sell or dispose of assets;

restrict our ability to make distributions to shareholders; and

require us to satisfy minimum financial coverage ratios, minimum tangible net worth requirements and maximum leverage ratios. These limitations will restrict our ability to engage in some business activities, which could adversely affect our financial condition, results of operations, cash flow and the trading price of our Class B common shares. In addition, our credit facility may contain specific cross-default provisions with respect to specified other indebtedness, giving the lenders the right to declare a default if we are in default under other loans in some circumstances.

*If we set aside insufficient working capital or are unable to secure funds for future tenant improvements, we may be required to defer necessary property improvements, which could adversely impact our ability to pay cash distributions to our shareholders.*

When tenants do not renew their leases or otherwise vacate their space, it is possible that, in order to attract replacement tenants, we may be required to expend substantial funds for tenant improvements and tenant refurbishments to the vacated space. If we have insufficient working capital reserves, we will have to obtain financing from other sources. Because most of our leases will provide for tenant reimbursement of operating expenses, we do not anticipate that we will establish a permanent reserve for maintenance and repairs for our properties. However, to the extent that we have insufficient funds for such purposes, we may establish reserves for maintenance and repairs of our properties from gross proceeds of this offering, out of cash flow generated by operating properties or out of non-liquidating net sale proceeds. If these reserves or any reserves otherwise established are insufficient to meet our cash needs, we may have to obtain financing from either affiliated or unaffiliated sources to fund our cash requirements. We cannot assure you that sufficient financing will be available or, if available, will be available on economically feasible terms or on terms acceptable to us. Additional borrowing for working capital purposes will increase our interest expense, and therefore our financial condition and our ability to pay cash distributions to our shareholders may be adversely affected. In addition, we may be required to defer necessary improvements to our properties that may cause our properties to suffer from a greater risk of obsolescence or a decline in value, or a greater risk of decreased cash flow as a result of fewer potential tenants being attracted to our properties. If this happens, we may not be able to maintain projected rental rates for affected properties, and our results of operations may be negatively impacted.



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*We may structure acquisitions of property in exchange for limited partnership units in our Operating Partnership on terms that could limit our liquidity or our flexibility.*

We may acquire properties by issuing limited partnership units in our Operating Partnership in exchange for a property owner contributing property to the Operating Partnership. If we enter into such transactions, in order to induce the contributors of such properties to accept units in our Operating Partnership, rather than cash, in exchange for their properties, it may be necessary for us to provide them with additional incentives. For instance, our Operating Partnership's limited partnership agreement provides that any holder of units may redeem limited partnership units for cash, or, at our option, Class A common shares on a one-for-one exchange basis. We may, however, enter into additional contractual arrangements with contributors of property under which we would agree to redeem a contributor's units for our Class A common shares or cash, at the option of the contributor, at set times. If the contributor required us to redeem units for cash pursuant to such a provision, it would limit our liquidity and thus our ability to use cash to make other investments, satisfy other obligations or pay distributions to you. Moreover, if we were required to redeem units for cash at a time when we did not have sufficient cash to fund the redemption, we might be required to sell one or more properties to raise funds to satisfy this obligation. Furthermore, we might agree that if distributions the contributor received as a limited partner in our Operating Partnership did not provide the contributor with a defined return, then upon redemption of the contributor's units we would pay the contributor an additional amount necessary to achieve that return. Such a provision could further negatively impact our liquidity and flexibility. Finally, in order to allow a contributor of a property to defer taxable gain on the contribution of property to our Operating Partnership, we might agree not to sell a contributed property for a defined period of time or until the contributor redeemed the contributor's units for cash or our Class A common shares. Such an agreement would prevent us from selling those properties, even if market conditions made such a sale favorable to us.

*We may issue preferred shares with a preference in distributions over our common shares, and our ability to issue preferred shares and additional common shares may deter or prevent a sale of our common shares in which you could profit.*

Our declaration of trust authorizes our Board to issue up to 50,000,000 Class A common shares, 350,000,000 Class B common shares and 50,000,000 preferred shares. Our Board may amend our declaration of trust from time to time to increase or decrease the aggregate number of shares or the number of shares of any class or series that we have authority to issue. In addition, our Board may classify or reclassify any unissued common shares or preferred shares and may set the preferences, rights and other terms of the classified or reclassified shares. The terms of preferred shares could include a preference in distributions over our common shares. If we authorize and issue preferred shares with a distribution preference over our common shares, payment of any distribution preferences of outstanding preferred shares would reduce the amount of funds available for the payment of distributions on our common shares. Further, holders of preferred shares are normally entitled to receive a preference payment in the event we liquidate, dissolve or wind up before any payment is made to our common shareholders, likely reducing the amount our common shareholders would otherwise receive upon such an occurrence. In addition, under certain circumstances, the issuance of preferred shares or a separate class or series of common shares may render more difficult or tend to discourage:

a merger, tender offer or proxy contest;

assumption of control by a holder of a large block of our shares; or

removal of incumbent management.

**Risks Associated with Income Tax Laws**

*If we fail to qualify as a REIT, our operations and dividends to shareholders would be adversely impacted.*

We intend to continue to be organized and to operate so as to qualify as a REIT under the Code. A REIT generally is not taxed at the corporate level on income it currently distributes to its shareholders. Qualification as a REIT involves the application of highly technical and complex rules for which there are only limited judicial or



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administrative interpretations. The determination of various factual matters and circumstances not entirely within our control may affect our ability to continue to qualify as a REIT. In addition, new legislation, new regulations, administrative interpretations or court decisions could significantly change the tax laws, possibly with retroactive effect, with respect to qualification as a REIT or the federal income tax consequences of such qualification.

If we were to fail to qualify as a REIT in any taxable year:

we would not be allowed to deduct our distributions to shareholders when computing our taxable income;

we would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates;

we would be disqualified from being taxed as a REIT for the four taxable years following the year during which qualification was lost, unless entitled to relief under certain statutory provisions;

our cash available for dividends to shareholders would be reduced; and

we may be required to borrow additional funds or sell some of our assets in order to pay corporate tax obligations that we may incur as a result of our disqualification.

***If the Internal Revenue Service, or IRS, were to determine that (i) we failed the 5% asset test for the first quarter of our 2009 taxable year and (ii) our failure of that test was not attributable to reasonable cause, but rather, willful neglect, we would fail to qualify as a REIT for our 2009 taxable year, which would adversely affect our operations and our shareholders.***

In 2010, we discovered that we may have inadvertently violated the 5% asset test for the quarter ended March 31, 2009 as a result of utilizing a certain cash management arrangement with a commercial bank. If that investment in a commercial paper investment account is not treated as cash, and is instead treated as a security for purposes of the quarterly 5% asset test applicable to REITs, then we have failed that test for the first quarter of our 2009 taxable year.

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 and our cash available for distributions to shareholders would be reduced. See Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT Failure to Qualify as a REIT, which describes the consequences of our failure to qualify as a REIT.

Additionally, if we in fact failed the 5% test, but failure is considered due to reasonable cause and not willful neglect, we would be subject to 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.

***We may need to incur additional borrowings to meet the REIT minimum distribution requirement and to avoid excise tax.***

In order to maintain our qualification as a REIT, we are required to distribute to our shareholders at least 90% of our annual real estate investment trust taxable income (excluding any net capital gain and before application of the dividends paid deduction). In addition, we are subject to a 4% nondeductible excise tax on the amount, if any, by which certain distributions paid by us with respect to any calendar year are less than the sum of (i) 85% of our ordinary income for that year, (ii) 95% of our net capital gain for that year and (iii) 100% of our undistributed taxable income from prior years. Although we intend to pay dividends to our shareholders in a manner that allows us to meet the 90%

distribution requirement and avoid this 4% excise tax, we cannot assure you that we will always be able to do so.

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Our income consists almost solely of our share of our Operating Partnership's income, and the cash available for distribution by us to our shareholders consists of our share of cash distributions made by our Operating Partnership. Because we are the sole general partner of our Operating Partnership, our Board determines the amount of any distributions made by it. Our Board may consider a number of factors in authorizing distributions, including:

the amount of the cash available for distribution;

our Operating Partnership's financial condition;

our Operating Partnership's capital expenditure requirements; and

our annual distribution requirements necessary to maintain our qualification as a REIT.

Differences in timing between the actual receipt of income and actual payment of deductible expenses and the inclusion of income and deduction of expenses when determining our taxable income, as well as the effect of nondeductible capital expenditures and the creation of reserves or required debt amortization payments could require us to borrow funds on a short-term or long-term basis or make taxable distributions to our shareholders of our shares or debt securities to meet the REIT distribution requirement and to avoid the 4% excise tax described above. In these circumstances, we may need to borrow funds to avoid adverse tax consequences even if our management believes that the then prevailing market conditions generally are not favorable for borrowings or that borrowings would not be advisable in the absence of the tax consideration.

***If our Operating Partnership were classified as a publicly traded partnership taxable as a corporation for federal income tax purposes under the Code, we would cease to qualify as a REIT and would suffer other adverse tax consequences.***

We structured our Operating Partnership so that it would be classified as a partnership for federal income tax purposes. In this regard, the Code generally classifies publicly traded partnerships (as defined in Section 7704 of the Code) as associations taxable as corporations (rather than as partnerships), unless substantially all of their taxable income consists of specified types of passive income. In order to minimize the risk that the Code would classify our Operating Partnership as a publicly traded partnership for tax purposes, we placed certain restrictions on the transfer and/or redemption of partnership units in our Operating Partnership. If the IRS were to assert successfully that our Operating Partnership is a publicly traded partnership, and substantially all of its gross income did not consist of the specified types of passive income, the Code would treat our Operating Partnership as an association taxable as a corporation.

These topics are discussed in greater detail in the Material U.S. Federal Income Tax Considerations Other Tax Consequences Tax Aspects of Our Investments in Our Operating Partnership section of this prospectus. In such event, the character of our assets and items of gross income would change and would prevent us from continuing to qualify as a REIT. In addition, the imposition of a corporate tax on our Operating Partnership would reduce our amount of cash available for payment of distributions by us to our shareholders.

***Complying with REIT requirements may cause us to forego otherwise attractive opportunities or liquidate otherwise attractive investments.***

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our shareholders and the ownership of our shares. In order to meet these tests, we may be required to forego investments we might otherwise make. Thus, compliance with the REIT requirements may hinder our performance.

In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value





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of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total assets can be represented by the securities of one or more taxable REIT subsidiaries. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our shareholders.

***We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our Class B common shares.***

At any time, the federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. We cannot predict when or if any new federal income tax law, regulation, or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation, or interpretation may take effect retroactively. We and our shareholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation.

***Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.***

The maximum tax rate applicable to income from qualified dividends payable to U.S. shareholders that are individuals, trusts and estates has been reduced by legislation to 15% (currently through 2012). Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our common shares.

***Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.***

The REIT provisions of the Code substantially limit our ability to hedge our liabilities. Any income from a hedging transaction that we enter into to manage risk of interest rate changes, price changes or currency fluctuations with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute gross income for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. See Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT Hedging Transactions. As a result of these rules, we may need to limit our use of advantageous hedging techniques or implement those hedges through taxable REIT subsidiaries.

This could increase the cost of our hedging activities because any taxable REIT subsidiary that we may form would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in taxable REIT subsidiaries will generally not provide any tax benefit, except for being carried forward against future taxable income in the taxable REIT subsidiaries.

**Risks Related to This Offering and Ownership of our Class B Common Shares**

***Following exchange offers that we intend to conduct in the future, large numbers of our Class A shareholders receiving Class B common shares may create a significant demand to sell our Class B common shares. Significant sales of our Class B common shares, or the perception that significant sales of such shares could occur, may cause the price of our Class B common shares to decline significantly.***

Our Class A common shares are not listed on any national securities exchange and the ability of shareholders to liquidate their investments in Class A common shares is limited. We do not intend to list shares

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our Class A common shares on a national securities exchange. However, beginning on or about 90 days from the date of this prospectus, we intend to conduct a series of exchange offers to exchange our Class A common shares and our OP units for Class B common shares. See

Exchange of Class A Common Shares and OP Units. Following each such exchange offer, if our former Class A shareholders and OP unitholders sell, or the market perceives that our shareholders intend to sell, substantial numbers of our Class B common shares in the public market, the market price of our Class B common shares could decline significantly. As of December 31, 2010, we had 3,471,187 Class A common shares and 1,814,569 OP units, not held by us, outstanding.

In addition, because our Class A common shares are not subject to transfer restrictions (other than the restrictions on ownership and transfer of shares set forth in our declaration of trust), such shares are freely tradable. As a result, notwithstanding that such shares will not be listed on a national securities exchange, it is possible that a market may develop for shares of our Class A common shares, and sales of such shares, or the perception that such sales could occur, could have a material adverse effect on the trading price of our Class B common shares.

*The market price and trading volume of our Class B common shares may be volatile following this offering.*

The market price of our Class B common shares may fluctuate widely. In addition, the trading volume in our Class B common shares may fluctuate and cause significant price variations to occur. If the market price of our Class B common shares declines significantly, you may be unable to resell your Class B common shares at or above the public offering price. We cannot assure you that the market price of our Class B common shares will not fluctuate or decline significantly, including a decline below the public offering price, in the future.

Some of the factors that could negatively affect our share price or result in fluctuations in the market price or trading volume of our Class B common shares include:

actual or anticipated declines in our quarterly operating results or distributions;

reductions in our funds from operations or earnings estimates;

publications of research reports about us or the real estate industry;

increases in market interest rates that lead purchasers of our common shares to demand a higher yield;

changes in market valuations of similar companies;

adverse market reaction to any increased indebtedness we incur in the future;

additions or departures of key management personnel;

actions by institutional shareholders;

speculation in the press or investment community;

the realization of any of the other risk factors presented in this prospectus; and

general market and economic conditions.

The public offering price does not necessarily bear any relationship to our book value or the fair market value of our assets.

***Increases in market interest rates may result in a decrease in the value of our Class B common shares.***

One of the factors that may influence the price of our Class B common shares will be the dividend distribution rate on the Class B common shares (as a percentage of the price of our Class B common shares) relative to market interest rates. If market interest rates rise, prospective purchasers of shares of our Class B common shares may expect a higher distribution rate. Higher interest rates would not, however, result in more funds being available for distribution and, in fact, would likely increase our borrowing costs and might decrease our funds available for distribution. We therefore may not be able, or we may not choose, to provide a higher

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distribution rate. As a result, prospective purchasers may decide to purchase other securities rather than our Class B common shares, which would reduce the demand for, and result in a decline in the market price of, our Class B common shares.

***Broad market fluctuations could negatively impact the market price of our Class B common shares.***

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performances. These broad market fluctuations could reduce the market price of our Class B common shares. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations. Either of these factors could lead to a material decline in the market price of our Class B common shares.

***The common shares issued in this offering and any common shares eligible for future sale may adversely affect the prevailing market prices for our common shares.***

Our shares have traded on the NYSE Amex since August 26, 2010. Assuming the underwriters do not exercise their overallotment option, we are selling 5,000,000 of our Class B common shares in this offering, an amount equal to 227.3% of our Class B common shares outstanding prior to the offering. Excluding the Class B common shares owned by our management that are subject to the lock up agreement with our underwriters, the Class B common shares being offered will represent approximately 69.8% of the Class B common shares available to trade after this offering. Also, the three month average trading volume in our Class B common shares as reported by the NYSE Amex as of April 21, 2011 was 11,936 shares per day. In addition, beginning on or about 90 days following the date of this prospectus ( , 2011), we intend to conduct a series of exchange offers to exchange our Class A common shares for Class B common shares. See Exchange of Class A Common Shares and OP Units. We also may issue from time to time additional Class B common shares or OP units in connection with the acquisition of properties and we may grant demand or piggyback registration rights in connection with these issuances. We cannot predict the effect, if any, of this offering, future sales of Class B common shares, or the availability of Class B common shares for future sale, on the market price of our Class B common shares. Sales of substantial amounts of Class B common shares (including shares issued to our trustees and officers), or the perception that these sales could occur, may adversely affect the liquidity of the market for our Class B common shares or prevailing market prices for our Class B common shares. Large price changes or low volume may preclude you from buying or selling our Class B common shares at all, or at any particular price or during a time frame that meets your investment objectives.

Our trustees and executive officers have agreed with the underwriters not to offer, sell, contract to sell, pledge or otherwise dispose of any common shares or other securities convertible or exchangeable into our common shares for a period of 90 days after the date of this prospectus. If any or all of these holders cause a large number of their shares to be sold in the public market, the sales could reduce the trading price of our Class B common shares and could impede our ability to raise future capital.

***This offering is expected to be dilutive, and there may be future dilution related to our Class B common shares.***

Giving effect to the issuance of Class B common shares in this offering, which may include shares issued pursuant to a full or partial exercise by the underwriters of their overallotment option, the receipt of the expected net proceeds and the use of those proceeds, we expect that this offering will have a dilutive effect on our expected earnings per share and FFO per share for the year ending December 31, 2011. The actual amount of dilution cannot be determined at this time and will be based upon numerous factors. Additionally, subject to the 90-day lock up restrictions described in Underwriting, we are not restricted from issuing additional securities. The market price of our Class B common shares could decline as a result of issuances or sales of a large number of our Class B common shares in the market after this offering or the perception that such issuances or sales could occur. Additionally, future issuances or sales of substantial amounts of our Class B common shares may be

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at prices below the offering price of the Class B common shares offered by this prospectus and may result in further dilution in our earnings and FFO per share and/or adversely impact the market price of our Class B common shares.

*Maryland takeover statutes may deter others from seeking to acquire us and prevent you from making a profit in such transactions.*

The Maryland General Corporation Law, or the MGCL, contains many provisions, such as the business combination statute and the control share acquisition statute, that are designed to prevent, or have the effect of preventing, someone from acquiring control of us. The business combination statute, subject to limitations, prohibits certain business combinations between us and an interested shareholder (defined generally as any person who beneficially owns 10% or more of the voting power of our outstanding voting shares or an affiliate or associate of our company who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then outstanding shares) or an affiliate of an interested shareholder for five years after the most recent date on which the person becomes an interested shareholder and thereafter imposes supermajority voting requirements on these combinations. The control share acquisition statute provides that control shares of our company (defined as shares which, when aggregated with other shares controlled by the shareholder (except solely by virtue of a revocable proxy), entitle the shareholder to exercise one of three increasing ranges of voting power in electing trustees) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of issued and outstanding control shares) have no voting rights except to the extent approved by our shareholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

We are currently subject to the control share acquisition statute, although our Board may amend our Amended and Restated Bylaws, or our bylaws, without shareholder approval, to exempt any acquisition of our shares from the statute. Our Board has adopted a resolution exempting any business combination with any person from the business combination statute. The business combination statute (if our Board revokes the foregoing exemption) and the control share acquisition statute could delay or prevent offers to acquire us and increase the difficulty of consummating any such offers, even if such a transaction would be in our shareholders' best interest.

*The MGCL, the Maryland REIT Law and our organizational documents limit your right to bring claims against our officers and trustees.*

The MGCL and the Maryland REIT Law provide that a trustee will not have any liability as a trustee so long as he performs his duties in good faith, in a manner he reasonably believes to be in our best interests, and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In addition, our declaration of trust provides that no trustee or officer will be liable to us or to any shareholder for money damages except to the extent that (a) the trustee or officer actually received an improper benefit or profit in money, property or services, for the amount of the benefit or profit in money, property, or services actually received; or (b) a judgment or other final adjudication adverse to the trustee or officer is entered in a proceeding based on a finding in the proceeding that the trustee's or officer's action or failure to act was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding. Finally, our declaration of trust authorizes our company to obligate itself, and our bylaws obligate us, to indemnify and advance expenses to our trustees and officers to the maximum extent permitted by Maryland law.

*Our classified Board may prevent others from effecting a change in the control of our Board.*

We believe that classification of our Board will help to assure the continuity and stability of our business strategies and policies as determined by the Board. However, the classified board provision could have the effect of making the replacement of incumbent trustees more time-consuming and difficult. At least two annual meetings of shareholders, instead of one, will generally be required to effect a change in a majority of our Board. Thus, the classified board provision could increase the likelihood that incumbent trustees will retain their

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positions. The staggered terms of trustees may delay, defer or prevent a transaction or a change in control that might involve a premium price for our common shares or otherwise be in the best interest of the shareholders.

*Future offerings of debt, which would be senior to our common shares upon liquidation, and/or preferred equity securities that may be senior to our common shares for purposes of dividends or other distributions or upon liquidation, may adversely affect the market price of our Class B common shares.*

In the future, we may attempt to increase our capital resources by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred shares. Upon liquidation, holders of our debt securities and preferred shares and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common shares. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common shares, or both. Holders of our common shares are not entitled to preemptive rights or other protections against dilution. Our preferred shares, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to pay a dividend or make another distribution to the holders of our common shares. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our Class B common shareholders bear the risk of our future offerings reducing the market price of our Class B common shares and diluting their share holdings in us.

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**FORWARD-LOOKING STATEMENTS**

We make statements in this prospectus that are forward-looking statements within the meaning of the federal securities laws. In particular, statements pertaining to our capital resources, portfolio performance and results of operations contain forward-looking statements. Likewise, all of our statements regarding anticipated growth in our funds from operations and anticipated market conditions, demographics and results of operations are forward-looking statements. You can identify forward-looking statements by the use of forward-looking terminology such as believes, expects, may, will, should, could, would, seeks, approximately, intends, plans, pro forma, estimates or any of these words and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans or intentions.

Forward-looking statements involve numerous risks and uncertainties and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements:

adverse economic or real estate developments in Texas, Arizona or Illinois;

general economic conditions;

market trends;

projected capital expenditures;

use of the proceeds of this offering;

estimates relating to our ability to make distributions to our shareholders in the future;

our understanding of our competition and our ability to compete effectively;

defaults on or non-renewal of leases by tenants;

increased interest rates and operating costs;

our failure to obtain necessary outside financing;

decreased rental rates or increased vacancy rates;



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difficulties in identifying properties to complete, and consummating, real estate acquisitions, developments, joint ventures and dispositions;

our failure to successfully operate acquired properties and operations;

our failure to maintain our status as a REIT;

government approvals, actions or initiatives, including the need for compliance with environmental requirements;

environmental uncertainties and risks related to natural disasters;

financial market fluctuations;

changes in foreign currency exchange rates;

changes in real estate and zoning laws and increases in real property tax rates; and

other factors affecting real estate markets generally.

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While forward-looking statements reflect our good faith beliefs, they are not guaranties of future performance. We disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, of new information, data or methods, future events or other changes. For a further discussion of these and other factors that could impact our future results, performance or transactions, see the section above entitled Risk Factors.

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**USE OF PROCEEDS**

We estimate that the net proceeds from this offering will be approximately \$ , based upon the public offering price of \$ per Class B common share and after deducting the underwriting discount and estimated offering expenses of \$400,000 payable by us. If the underwriters over-allotment option is exercised in full, our net proceeds will be approximately \$ . We will contribute the net proceeds from this offering to our Operating Partnership in exchange for a number of OP units equal to the number of Class B common shares sold in this offering, 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. Pending these uses, we intend to invest the net offering proceeds in interest-bearing, short-term, marketable investment grade securities or money market accounts that are consistent with our intention to qualify as a REIT.

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**EXCHANGE OF CLASS A COMMON SHARES AND OP UNITS**

On August 24, 2010, we amended our Articles of Amendment and Restatement, or our declaration of trust, to (i) change the name of all of our common shares of beneficial interest, par value \$0.001 per share, to Class A common shares, (ii) effect a 1-for-3 reverse share split of our Class A common shares and (iii) change the par value of the Class A common shares to \$0.001 per share after the reverse share split. Pursuant to the partnership agreement for our Operating Partnership, the reverse share split of our Class A common shares also resulted in a 1-for-3 reverse split of our OP units. All prior period share and per share amounts in this prospectus have been retroactively restated to reflect the reverse share split. The rights of the Class A common shareholders did not change with the change in the title of the class. In addition, we created a new class of common shares of beneficial interest, par value \$0.001 per share, entitled Class B common shares. We refer to the Class A and Class B common shares collectively as the common shares. Our Class A common shares are identical to our Class B common shares except that our Class A common shares are not currently listed on a national securities exchange, and we do not intend to list our Class A shares on a national securities exchange.

On August 31, 2010, we completed an offering of 2.2 million of our Class B common shares for approximately \$23.0 million in net offering proceeds to us and listed our Class B common shares on the NYSE Amex. As of December 31, 2010, we had 3,471,187 Class A common shares, 2,200,000 Class B common shares, and 1,814,569 OP units, not held by us, outstanding.

Following this offering, we intend to conduct a series of exchange offers to exchange our Class A common shares and OP units for Class B common shares. In exchange for one Class A common share or one OP unit, we will issue one Class B common share. We intend to commence the exchange offers for all outstanding Class A common shares and OP units in 25% increments on the following schedule:

on or about 90 days following the date of this prospectus (                      , 2011);

on or about 180 days following the date of this prospectus (                      , 2011);

on or about 270 days following the date of this prospectus (                      , 2012); and

on or about 360 days following the date of this prospectus (                      , 2012).

Following the completion of the series of exchange offers, we intend to submit to our shareholders for approval at our 2012 Annual Meeting of Shareholders an amendment to our declaration of trust to change the Class A common shares remaining outstanding after the completion of the exchange offers to Class B common shares and rename our Class B common shares as                      common shares. If the change is approved by our shareholders, we intend to amend the partnership agreement for our Operating Partnership such that unissued and outstanding OP units may be redeemed for cash or, at our option, our Class B common shares (which will, prior to that time, be renamed                      common shares                      ).

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Subsequent to this offering, we intend to continue to declare distributions to holders of our common shares and OP units, payable monthly. U.S. federal income tax law generally requires that a REIT distribute annually to its shareholders at least 90% of its REIT taxable income, without regard to the deduction for dividends paid and excluding net capital gains, and that it pay tax at regular corporate rates on any taxable income that it does not distribute. We generally intend over time to pay dividends in an amount equal to our taxable income. You should read the following discussion and in the information set forth in the table and footnotes below together with Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related notes that are located elsewhere in this prospectus.

Any distributions we make will be at the discretion of our Board and we cannot assure you that our distributions will be made or sustained.

The timing and frequency of distributions will be authorized by our Board and declared by us based upon a number of factors, including:

our funds from operations;

our debt service requirements;

our capital expenditure requirements for our properties;

our taxable income, combined with the annual distribution requirements necessary to maintain REIT qualification;

requirements of Maryland law;

our overall financial condition; and

other factors deemed relevant by our Board.

We declared the following distributions to our shareholders and holders of OP units with respect to the fiscal years ended 2009 and 2010 and the three months ended March 31, 2011:

|                    | <b>Distributions<br/>Per<br/>Share/OP<br/>Unit <sup>(1)</sup></b> |
|--------------------|---|
| <b><u>2009</u></b> |   |
| First Quarter      | \$ 0.3375   |
| Second Quarter     | 0.3375  |
| Third Quarter      | 0.3375  |
| Fourth Quarter     | 0.3375  |
| <b><u>2010</u></b> |   |
| First Quarter      | \$ 0.3375   |
| Second Quarter     | 0.2850  |

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|                    |           |
|--------------------|-----------|
| Third Quarter      | 0.2850    |
| Fourth Quarter     | 0.2850    |
| <b><u>2011</u></b> |           |
| First Quarter      | \$ 0.2850 |

- (1) Distributions paid with respect to Class A common shares and, since September 2010, with respect to the Class A and Class B common shares. Distributions have been adjusted to reflect the 1-for-3 reverse share split of our Class A common shares and OP units in August 2010.

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Our distribution rate for the year ended December 31, 2010 was approximately 88% of our funds from operations per share. We typically declare our distributions quarterly and pay our distributions in three equal monthly installments. For the fourth quarter of 2010, we declared a distribution per common share and OP unit of \$0.2850, which was paid as follows: \$0.0950 on January 3, 2011, \$0.0950 on February 8, 2011 and \$0.0950 on March 8, 2011. For the first quarter of 2011, we declared a distribution per common share and OP unit of \$0.2850, which was paid or will be paid as follows: \$0.0950 on April 7, 2011, \$0.0950 on May 6, 2011 and \$0.0950 on June 7, 2011.

We cannot assure you that our distributions will be made or sustained. Our actual results of operations may differ materially from our current expectations. Our actual results of operations will be affected by a number of factors, including the revenue we receive from our properties, our operating expenses, our ability to attract and retain tenants, interest expense, the ability of our tenants to meet their obligations and unanticipated expenditures. There can be no assurance that we will be able to pay or maintain cash distributions or that distributions will increase over time.

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The following table sets forth the quarterly high, low, and closing prices per share of Class B common shares reported on the NYSE Amex for the year ended December 31, 2010.

|                                     | <b>High</b> | <b>Low</b> | <b>Close</b> |
|-------------------------------------|-------------|------------|--------------|
| <b>Year Ended December 31, 2010</b> |             |            |              |
| First Quarter                       | N/A         | N/A        | N/A          |
| Second Quarter                      | N/A         | N/A        | N/A          |
| Third Quarter                       | \$ 12.03    | \$ 11.32   | \$ 11.74     |
| Fourth Quarter                      | \$ 14.94    | \$ 11.79   | \$ 14.80     |

On April 21, 2011, the closing price of our Class B common shares reported on the NYSE Amex was \$14.30 per share.



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The following table sets forth as of December 31, 2010:

our historical capitalization; and

our as-adjusted capitalization after application of the net proceeds of this offering as described in Use of Proceeds.

This table should be read in conjunction with the sections captioned Use of Proceeds, Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited financial information and related notes included elsewhere in this prospectus.

|  | <b>As of December 31, 2010</b> |                    |
|--|--------------------------------|--------------------|
|  | <b>Historical</b>              | <b>As Adjusted</b> |
| Notes payable <sup>(1)</sup>   | \$ 100,941                     | \$ 100,941         |
| Equity:  |                                |                    |
| Preferred shares, \$0.001 par value per share, 50,000,000 shares authorized and no shares issued and outstanding   |                                |                    |
| Class A common shares, \$0.001 par value per share; 50,000,000 shares authorized, 3,471,187 shares issued and outstanding  | 3                              | 3                  |
| Class B common shares, \$0.001 par value per share; 350,000,000 shares authorized, 2,200,000 shares issued and outstanding, 7,200,000 shares issued and outstanding as adjusted <sup>(2)</sup> | 2                              | 7                  |
| Additional paid in capital   | 93,357                         |                    |
| Accumulated deficit  | (30,654)                       | (30,654)           |
| Noncontrolling interest in subsidiary  | 21,575                         | 21,575             |
| <b>Total equity</b>  | <b>84,283</b>                  |                    |
| <b>Total capitalization</b>  | <b>\$ 185,224</b>              | <b>\$</b>          |

<sup>(1)</sup> We also expect to enter into a \$20 million unsecured revolving credit facility, which may be expandable to \$75 million under certain circumstances, concurrently with the completion of this offering, which we expect to be undrawn at the closing of this offering.

<sup>(2)</sup> Excludes 473,814 Class B common shares available for issuance under our 2008 Long-Term Equity Incentive Ownership Plan, and excludes up to 750,000 Class B common shares that may be issued upon exercise of underwriters' over-allotment option.

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The following table sets forth our selected historical consolidated financial, operating and other data for our historical consolidated balance sheet data as of December 31, 2010, 2009, 2008, 2007 and 2006, and consolidated statement of operations data for the years ended December 31, 2010, 2009, 2008, 2007 and 2006, have been derived from our audited historical combined financial statements. All per share data set forth below has been adjusted to reflect the 1-for-3 reverse share split of our Class A common shares that occurred in August 2010.

Our historical consolidated financial data included below and set forth elsewhere in this prospectus are not necessarily indicative of our future performance.

You should read the following summary financial and other data together with Business and Properties, Management's Discussion and Analysis of Financial Condition and Results of Operations and our historical financial statements and related notes appearing elsewhere in this prospectus.

|   | Year Ended December 31,<br>(in thousands, except per share data) |           |           |           |           |
|---|--|-----------|-----------|-----------|-----------|
|   | 2010   | 2009      | 2008      | 2007      | 2006      |
| <b>Operating Data:</b>  |  |           |           |           |           |
| Revenues  | \$ 31,533  | \$ 32,685 | \$ 31,201 | \$ 29,374 | \$ 28,378 |
| Property expenses   | 12,283   | 12,991    | 12,835    | 12,236    | 11,438    |
| General and administrative <sup>(1)</sup>   | 4,992  | 6,072     | 6,708     | 6,721     | 2,299     |
| Property and other asset management fees to an affiliate                                    |  |           |           |           | 1,482     |
| Depreciation and amortization   | 7,225  | 6,958     | 6,859     | 6,048     | 6,181     |
| Involuntary conversion  | (558)  | (1,542)   | 358       |           |           |
| Interest expense, net   | 5,592  | 5,713     | 5,675     | 4,825     | 4,910     |
| Other expense (income), net   |  |           |           | 30        | (30)      |
| Income (loss) from continuing operations before loss on disposal of assets and income taxes | 1,999  | 2,493     | (1,234)   | (486)     | 2,098     |
| Provision for income taxes  | (264)  | (222)     | (219)     | (217)     |           |
| Income (loss) on disposal of assets   | (160)  | (196)     | (223)     | (9)       | 197       |
| Income (loss) from continuing operations  | 1,575  | 2,075     | (1,676)   | (712)     | 2,295     |
| Income (loss) from discontinued operations  |  |           | (188)     | 589       | 554       |
| Gain on sale of properties from discontinued operations                                     |  |           | 3,619     |           |           |
| Net income (loss)   | 1,575  | 2,075     | 1,755     | (123)     | 2,849     |
| Less: net income attributable to noncontrolling interests                                   | 470  | 733       | 621       | (46)      | 1,068     |
| Net income (loss) attributable to Whitestone REIT   | \$ 1,105   | \$ 1,342  | \$ 1,134  | \$ (77)   | \$ 1,781  |

(1) General and administrative expenses for the years ended December 31, 2008 and 2007 include approximately \$1.5 million and \$2.2 million, respectively, of legal costs resulting from litigation with our former CEO and our former external advisor.

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|   | Year Ended December 31, |   |            |            |            |
|---|-------------------------|---|------------|------------|------------|
|   | 2010                    | (in thousands, except per share data and gross leasable area) |            |            | 2006       |
|   | 2009                    | 2008  | 2007       |            |            |
| <b>Earnings per share basic</b>   |                         |   |            |            |            |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27                 | \$ 0.41   | \$ (0.32)  | \$ (0.13)  | \$ 0.45    |
| Income from discontinued operations attributable to Whitestone REIT   |                         | 0.67  | 0.11       |            | 0.10       |
| Net income (loss) attributable to common shareholders excluding amounts attributable to unvested restricted shares                    | \$ 0.27                 | \$ 0.41   | \$ 0.35    | \$ (0.02)  | \$ 0.55    |
| <b>Earnings per share diluted</b>   |                         |   |            |            |            |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27                 | \$ 0.40   | \$ (0.32)  | \$ (0.04)  | \$ 0.45    |
| Income from discontinued operations attributable to Whitestone REIT   |                         | 0.67  | 0.03       |            | 0.10       |
| Net income (loss) attributable to common shareholders excluding amounts attributable to unvested restricted shares                    | \$ 0.27                 | \$ 0.40   | \$ 0.35    | \$ (0.01)  | \$ 0.55    |
| <b>Balance Sheet Data:</b>  |                         |   |            |            |            |
| Real estate (net)   | \$ 165,398              | \$ 158,398  | \$ 150,847 | \$ 146,460 | \$ 141,236 |
| Other assets  | 31,047                  | 23,602  | 27,098     | 20,752     | 17,599     |
| Total assets  | \$ 196,445              | \$ 182,000  | \$ 177,945 | \$ 175,144 | \$ 167,087 |
| Liabilities   | \$ 112,162              | \$ 115,141  | \$ 110,773 | \$ 94,262  | \$ 76,464  |
| Whitestone REIT shareholders' equity  | 62,708                  | 43,590  | 45,891     | 52,843     | 58,914     |
| Noncontrolling interest in subsidiary   | 21,575                  | 23,269  | 21,281     | 28,039     | 31,709     |
|   | \$ 196,445              | \$ 182,000  | \$ 177,945 | \$ 175,144 | \$ 167,087 |
| <b>Other Data:</b>  |                         |   |            |            |            |
| Proceeds from issuance of common shares   | \$ 22,970               | \$  | \$         | \$ 261     | \$ 9,453   |
| Additions to and acquisitions of real estate  | 12,768                  | 12,855  | 5,153      | 10,205     | 1,833      |
| Dividends per share <sup>(1)</sup>  | 1.17                    | 1.35  | 1.59       | 1.80       | 1.89       |
| Funds from operations <sup>(2)</sup>  | 8,432                   | 8,618   | 4,236      | 6,001      | 8,993      |
| Property net operating income <sup>(3)</sup>  | 19,250                  | 19,694  | 18,366     | 17,138     | 16,940     |
| Operating Portfolio Occupancy at year end   | 86%                     | 82%   | 84%        | 86%        | 83%        |
| Average aggregate gross leasable area   | 3,058,340               | 3,039,044   | 3,008,085  | 3,093,063  | 3,121,039  |
| Average revenue per average aggregate gross leasable square foot  | \$ 10.31                | \$ 10.76  | \$ 10.37   | \$ 9.50    | \$ 9.09    |

(1) The dividends per share represent total cash payments divided by weighted average common shares.

(2)

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We believe that FFO is an appropriate supplemental measure of operating performance because it helps our investors compare our operating performance relative to other REITs. NAREIT defines FFO as net income (loss) available to common shareholders computed in accordance with GAAP, excluding gains or losses from sales of operating properties and extraordinary items, plus depreciation and

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amortization of real estate assets, including our share of unconsolidated partnerships and joint ventures. We calculate FFO in a manner consistent with the NAREIT definition. Below is the calculation of FFO and the reconciliation to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|  | Year Ended December 31,<br>(in thousands, except per share data) |                 |                 |                 |                 |
|--|--|-----------------|-----------------|-----------------|-----------------|
|  | 2010   | 2009            | 2008            | 2007            | 2006            |
| Net income attributable to Whitestone REIT                         | \$ 1,105   | \$ 1,342        | \$ 1,134        | \$ (77)         | \$ 1,781        |
| Depreciation and amortization of real estate assets <sup>(1)</sup> | 6,697  | 6,347           | 5,877           | 6,108           | 6,341           |
| (Gain) loss on sale or disposal of assets <sup>(1)</sup>           | 160  | 196             | (3,396)         | 16              | (197)           |
| Net income attributable to noncontrolling interests                | 470  | 733             | 621             | (46)            | 1,068           |
| <b>FFO</b>   | <b>\$ 8,432</b>  | <b>\$ 8,618</b> | <b>\$ 4,236</b> | <b>\$ 6,001</b> | <b>\$ 8,993</b> |

(1) Including amounts for discontinued operations.

(3) We believe 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 gain or loss on sale or disposal 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.

The following is a reconciliation of our historical NOI to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|  | Year Ended December 31 |                  |                  |                  |                  |
|--|------------------------|------------------|------------------|------------------|------------------|
|  | 2010                   | 2009             | 2008             | 2007             | 2006             |
| Net Income Attributable to Whitestone REIT               | \$ 1,105               | \$ 1,342         | \$ 1,134         | \$ (77)          | \$ 1,781         |
| General and administrative expense                       | 4,992                  | 6,072            | 6,708            | 6,721            | 2,299            |
| Property and other asset management fees to an affiliate |                        |                  |                  |                  | 1,482            |
| Depreciation and amortization                            | 7,225                  | 6,958            | 6,859            | 6,048            | 6,181            |
| Involuntary conversion                                   | (558)                  | (1,542)          | 358              |                  |                  |
| Interest expense   | 5,620                  | 5,749            | 5,857            | 5,402            | 5,296            |
| Interest income  | (28)                   | (36)             | (182)            | (577)            | (386)            |
| Provision for income taxes                               | 264                    | 222              | 219              | 217              |                  |
| Loss on disposal of assets                               | 160                    | 196              | 223              | 9                | (197)            |
| Loss (gain) from discontinued operations                 |                        |                  | 188              | (589)            | (554)            |
| Change in value of derivative instrument                 |                        |                  |                  | 30               | (30)             |
| Gain on sale of properties from discontinued operations  |                        |                  | (3,619)          |                  |                  |
| Net income attributable to noncontrolling interests      | 470                    | 733              | 621              | (46)             | 1,068            |
| <b>NOI</b>   | <b>\$ 19,250</b>       | <b>\$ 19,694</b> | <b>\$ 18,366</b> | <b>\$ 17,138</b> | <b>\$ 16,940</b> |

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**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 audited consolidated financial statements and the notes thereto included in this prospectus. For more detailed information regarding the basis of presentation for the following information, you should read the notes to our audited consolidated financial statements included in this prospectus.

**Overview of Our Company**

We are a fully integrated real estate company that owns and operates commercial properties in culturally diverse markets in major metropolitan areas. 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 define Community Centered Properties as visibly located properties in established or developing culturally diverse neighborhoods in our target markets. 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. We employ and develop a diverse group of seasoned professionals who understand the needs of our multicultural communities and tenants.

As of December 31, 2010, we owned and operated 38 commercial properties consisting of:

**Operating Portfolio**

eighteen retail centers containing approximately 1.2 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$70.0 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 \$41.6 million; and

seven office centers containing approximately 0.6 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$44.9 million.

**Redevelopment, New Acquisitions Portfolio**

two retail properties containing approximately 0.1 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$8.9 million.

As of December 31, 2010, we had 792 total tenants. We have a diversified tenant base with our largest tenant comprising 1.9% of our total revenues for the year ended December 31, 2010. 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 298 new and renewal leases during 2010, totaling 0.7 million square feet and \$31.9 million in total lease value.

On August 24, 2010, we amended our declaration of trust that (i) changed the name of all of our common shares of beneficial interest, par value \$0.001 to Class A common shares, (ii) effected a 1-for-3 reverse share split of our Class A common shares and (iii) changed the par value of our Class A common shares to \$0.001 per share after the reverse share split. In addition, we created a new class of common shares of beneficial

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interest, par value \$0.001, entitled Class B common shares. Each Class B common share has the following rights:

the right to vote together with Class A common shareholders on all matters submitted to our shareholders;

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one vote on all matters voted upon by our shareholders;

the right to receive dividends equal to any dividends declared on the Class A common shares; and

liquidation rights equal to the liquidation rights of each Class A common share.

On August 31, 2010, we completed an offering of 2.2 million of our Class B common shares for approximately \$23.0 million in net offering proceeds to us and listed our Class B common shares on the NYSE Amex. As of December 31, 2010, we had 3,471,187 Class A common shares, 2,200,000 Class B common shares, and 1,814,569 OP units, not held by us, outstanding.

We employed 53 full-time employees as of December 31, 2010. 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 \$31.5 million for the year ended December 31, 2010 as compared to \$32.7 million for the year ended December 31, 2009, a decrease of \$1.2 million, or 4%. The twelve months ended December 31, 2009 included a \$0.4 million business interruption settlement that was not repeated during the year ended December 31, 2010. Additionally, tenant reimbursement revenues decreased approximately \$0.7 million during the twelve months ended December 31, 2010 as compared to the twelve months ended December 31, 2009. The decrease in tenant reimbursement revenues was primarily the result of a \$0.7 million decrease in total property expenses. Our Operating Portfolio Occupancy Rate as of December 31, 2010 was 86%, as compared to 82% as of December 31, 2009.

**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. We also expect modest continued improvement in the overall economy in Houston to provide slight increases in occupancy at certain of our properties, which should result in some growth in rental income.

***Scheduled Lease Expirations***

We tend to lease space to smaller businesses that desire shorter term leases. As of December 31, 2010, approximately 36% of our gross leasable square footage is 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. While our early renewal program and other leasing and marketing efforts target these expiring leases, we hope to re-lease most of that space prior to expiration of the leases. In the markets in which we operate, we obtain and analyze market rental rates through review of third-party publications which provide market and submarket rental rate data and through inquiry of property owners and property management companies as to rental rates being quoted at properties which are located in close proximity to our properties and 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, 2012 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



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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 that meet our Community-Centered strategy 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 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.

In November 2010, we acquired 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 proratons. The property, Sunnyslope Village, is strategically located across the street from John C. Lincoln Hospital, the major employer in the area, and within a quarter mile from Sunnyslope High School.

In September 2010, we acquired 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 proratons. The property, The Citadel, is strategically located at the intersection of Pinnacle Peak and Pima Roads.

In January 2009, we acquired a property that meets our Community Centered Property strategy, containing 41,455 leasable square feet located in Buffalo Grove, Illinois for approximately \$9.4 million, including cash of \$5.5 million, issuance of 234,637 OP units valued at approximately \$3.6 million and credit for net proratons of \$0.3 million. The property, Spoerlein Commons, is a two-story complex of retail, medical and professional office tenants. We acquired the property from Midwest Development Venture IV, or MDV IV, an Illinois limited partnership controlled by James C. Mastandrea, our Chairman, President and Chief Executive Officer. Because of Mr. Mastandrea's relationship with the seller, a special committee consisting solely of our independent trustees negotiated the terms of the transaction, which included the use of an independent appraiser to value the property.

### **Summary of Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements. We prepared these financial statements in conformity with GAAP. The preparation of these financial statements required us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances. Our results may differ from these estimates. Currently, we believe that our accounting policies do not require us to

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make estimates using assumptions about matters that are highly uncertain. You should read Note 2, Summary of Significant Accounting Policies, to our consolidated financial statements in conjunction with this *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

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

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

*Development Properties.* Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges and development costs. Carrying charges, primarily interest, real estate taxes and loan acquisition costs, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases when the property, or any completed portion, becomes available for occupancy. Prior to that time, we expense these costs as acquisition expense. No interest was capitalized for the years ended December 31, 2010 and 2009. Approximately \$0.4 million in interest was capitalized for the year ended December 31, 2008.

*Acquired Properties and Acquired Lease Intangibles.* We allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.

*Depreciation.* Depreciation is computed using the straight-line method over the estimated useful lives of five to 39 years for the buildings and improvements. Tenant improvements are depreciated using the straight-line method over the life of the lease.

*Impairment.* We review our properties for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the property exceeds its fair value. Management has determined that there has been no impairment in the carrying value of our real estate assets as of December 31, 2010.

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*Accrued Rent and Accounts Receivable.* Included in accrued rent and accounts receivable are base rents, tenant reimbursements and receivables attributable to recording rents on a straight-line basis. An allowance for the uncollectible portion of accrued rents and accounts receivable is determined based upon customer credit-worthiness (including expected recovery of our claim with respect to any tenants in bankruptcy), historical bad debt levels, and current economic trends. As of December 31, 2010 and 2009, we had an allowance for uncollectible accounts of \$1.3 million and \$0.9 million, respectively. As of December 31, 2010, 2009 and 2008, we recorded bad debt expense in the amount of \$0.5 million, \$0.9 million and \$0.7 million, respectively, related to tenant receivables that we specifically identified as potentially uncollectible based on our assessment of each tenant's credit-worthiness. Bad debt expenses and any related recoveries are included in property operation and maintenance expense.

*Unamortized Lease Commissions and Loan Costs.* Leasing commissions are amortized using the straight-line method over the terms of the related lease agreements. Loan costs are amortized on the straight-line method over the terms of the loans, which approximates the interest method.

*Prepays and Other Assets.* Prepays and other assets include escrows established pursuant to certain mortgage financing arrangements for real estate taxes and insurance and acquisition deposits which include earnest money deposits on future acquisitions.

*Federal Income Taxes.* We elected to be taxed as a REIT under 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 currently distribute to our shareholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate rates. We believe that we are organized and operate in such a manner as to qualify to be taxed as a REIT, and we intend to operate so as to remain qualified as a REIT for federal income tax purposes.

*State Taxes.* In May 2006, the State of Texas adopted House Bill 3, which modified the state's franchise tax structure, replacing the previous tax based on capital or earned surplus with one based on margin (often referred to as 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, Financial Accounting Standards Board, or FASB, Accounting Standards Codification, *Income Taxes*, or ASC 740, applies to the Texas Margin Tax. We have recorded a margin tax provision of \$0.3 million, \$0.2 million and \$0.2 million for the Texas Margin Tax for each of the years ended December 31, 2010, 2009 and 2008, respectively.

*Derivative Instruments.* We have initiated a program designed to manage exposure to interest rate fluctuations by entering into financial derivative instruments. The primary objective of this program is to comply with debt covenants on any credit facility we may enter into. We sometimes enter into interest rate swap agreements with respect to amounts borrowed under certain of our credit facilities, which effectively exchanges existing obligations to pay interest based on floating rates for obligations to pay interest based on fixed LIBOR rates.

We have adopted provisions of ASC 820, *Fair Value Measurements and Disclosures*, or ASC 820, which requires for items appropriately classified as cash flow hedges, that changes in the market value of the instrument and in the market value of the hedged item be recorded as other comprehensive income or loss with the exception of the portion of the hedged items that are considered ineffective. The derivative instruments are reported at fair value as other assets or other liabilities as applicable. As of December 31, 2010 and 2009, we did not have any interest rate swaps.

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**Liquidity and Capital Resources**

Our primary liquidity demands are distributions to holders of our common shares and OP units, capital improvements and repairs and maintenance for our properties, acquisition of additional properties, tenant improvements and debt repayments.

Primary sources of capital for funding our acquisitions and redevelopment programs are cash flows generated from operating activities, equity issuances, sales of underperforming properties, sales of non-Community Centered Properties and other financing opportunities including equity issuance and debt financing. 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 this offering and our recent initial public offering of Class B common shares, and through debt financing. Concurrently with the completion of this offering, we anticipate entering into a \$20 million unsecured revolving credit facility, which may be expandable to \$75 million under certain circumstances. We believe this line of credit will provide additional cash flow to meet our cash needs.

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.

During the year ended December 31, 2010, our cash provided from operating activities was \$10.4 million and our total distributions were \$7.4 million. Therefore we had cash flow from operations in excess of distributions of approximately \$3.0 million. We 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. When we are unable to pay distributions entirely out of our cash flow from operations and funds from operations, we may use cash flows from working capital, borrowings under any lines of credit available to us at the time, obtaining other debt and proceeds from notes payable.

We anticipate that cash flows from operating activities and our borrowing capacity will provide adequate capital for our working capital requirements, anticipated capital expenditures and scheduled debt payments during the next 12 months. We also believe that cash flows from operating activities and our borrowing capacity will allow us to make all distributions required for us to continue to qualify to be taxed as a REIT for federal income tax purposes. We have approximately \$100.9 million in debt obligations due to mature over the next five years. We expect these debt obligations to be satisfied through growth in cash generated by operations and external sources of debt and equity capital. The United States credit markets recently experienced significant dislocations and liquidity disruptions, including the bankruptcy, insolvency or restructuring of certain financial institutions. These circumstances materially impacted liquidity in the debt markets, making financing terms for borrowers less attractive, and in certain cases have resulted in the unavailability of various types of debt financing. In addition, the stock market recently experienced extreme price and volume fluctuations. Although economic conditions have improved, the effects of these broad market fluctuations could adversely impact our ability to utilize the capital markets.

**Cash and Cash Equivalents**

We had cash and cash equivalents of approximately \$17.6 million at December 31, 2010, as compared to \$6.3 million on December 31, 2009. The increase of \$11.3 million was primarily the result of the following:

***Sources of Cash***

Cash flow from operations of \$10.4 million for the year ended December 31, 2010;

Net proceeds of approximately \$23.0 million from issuance of Class B common shares;

Net proceeds of \$1.3 million from issuance of notes payable net of origination costs;

**Table of Contents****Index to Financial Statements*****Uses of Cash***

Payment of dividends and distributions to common shareholders and OP unit holders of \$7.4 million;

Payments of loans of \$3.0 million;

Acquisitions of and additions to real estate of \$12.8 million; and

Repurchases of Class A common shares of \$0.2 million.

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

***Debt***

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

| Description                                  | Year Ended<br>December 31, |            |
|--|----------------------------|------------|
|  | 2010                       | 2009       |
| Fixed rate notes                             |                            |            |
| \$10.0 million 6.04% Note, due 2014          | \$ 9,498                   | \$ 9,646   |
| \$1.5 million 6.50% Note, due 2014           | 1,496                      |            |
| \$11.2 million 6.52% Note, due 2015          | 10,908                     | 11,043     |
| \$21.4 million 6.53% Notes, due 2013         | 20,142                     | 20,721     |
| \$24.5 million 6.56% Note, due 2013          | 24,030                     | 24,435     |
| \$9.9 million 6.63% Notes, due 2014          | 9,498                      | 9,757      |
| \$0.5 million 5.05% Notes, due 2011 and 2010 | 13                         | 52         |
| Floating rate note                           |                            |            |
| \$26.9 million LIBOR + 2.60% Note, due 2013  | 25,356                     | 26,128     |
|  | \$ 100,941                 | \$ 101,782 |

Our debt was collateralized by 23 operating properties as of December 31, 2010 with a combined net book value of \$110.1 million and 21 operating properties at December 31, 2009 with a combined net book value of \$108.7 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 the assignment of certain rents and leases associated with those properties.

On September 10, 2010, a subsidiary of the Operating Partnership executed a promissory note in the amount of \$1.5 million, or the new loan, payable to MidFirst Bank, a federally chartered savings association, or MidFirst, with an applicable interest rate of 6.5% per annum. Monthly payments of \$10,128 began on November 1, 2010 and are scheduled to continue thereafter on the first day of each calendar month until February 1, 2014. The promissory note is secured by a second lien deed of trust on our Windsor Park retail facility located in Windcrest, Texas, a first lien deed of trust on our Brookhill office/flex building located in Houston, Texas and a first lien deed of trust on our Zeta office building located in Houston, Texas. The funds from the promissory note are being used for capital improvements to Windsor Park.

The loan documents executed in connection with the promissory note included a limited guaranty by us of the promissory note until the Windsor Park construction is completed. Following this event, we will remain liable for the deficiency, if any, following a foreclosure of property

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securing the promissory note; provided that upon the occurrence of certain Full Recourse Events defined in the loan documents, our obligations shall convert to a full guarantee of the new loan.

In connection with the promissory note, the loan documents also provided for a modification of our existing loan with MidFirst, or the existing loan, in the amount of \$10 million. The loan documents provide that the

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promissory note executed in connection with the existing loan is modified to be secured, in part, by second liens on the Brookhill and Zeta Buildings, as well as certain other modifications for the purpose of cross collateralizing and cross-defaulting the two loans. The existing loan is also modified by the modification of promissory note which provided that payments of \$61,773 began on October 1, 2010 and are scheduled to continue thereafter on the first day of each calendar month until February 1, 2014. Finally, the loan documents include a modification of limited guaranty which provided that the limited guaranty executed in connection with the existing loan is only for the deficiency, if any, following the foreclosure of property securing the existing loan; provided that upon the occurrence of certain Full Recourse Events defined in the modification of limited guaranty, our obligations shall convert to a full guarantee of the existing loan.

Our loans are subject to customary terms and conditions. As of December 31, 2010, we were in compliance with all loan covenants.

Annual maturities of notes payable as of December 31, 2010 are due during the following years:

| Year                | Amount Due<br>(in thousands) |
|---------------------|------------------------------|
| 2011                | \$ 2,459                     |
| 2012                | 2,579                        |
| 2013                | 66,424                       |
| 2014                | 19,209                       |
| 2015                | 10,270                       |
| 2016 and thereafter |                              |
| <b>Total</b>        | <b>\$ 100,941</b>            |

***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.

***Contractual Obligations***

As of December 31, 2010, we had the following contractual debt obligations (see Note 8 of the Consolidated Financial Statements for further discussion regarding the specific terms of our debt):

| Contractual Obligations                         | Total             | Payment due by period (in thousands) |                              |                              |                                      |
|---|-------------------|--------------------------------------|------------------------------|------------------------------|--------------------------------------|
|   |                   | Less than 1<br>year<br>(2011)        | 1 - 3 years<br>(2012 - 2013) | 3 - 5 years<br>(2014 - 2015) | More than<br>5 years<br>(after 2015) |
| Long-Term Debt Principal                        | \$ 100,941        | \$ 2,459                             | \$ 69,003                    | \$ 29,479                    | \$                                   |
| Long-Term Debt Fixed Interest                   | 15,253            | 4,854                                | 8,923                        | 1,476                        |                                      |
| Long-Term Debt Variable Interest <sup>(1)</sup> | 2,017             | 714                                  | 1,303                        |                              |                                      |
| Operating Lease Obligations                     | 93                | 47                                   | 41                           | 5                            |                                      |
| <b>Total</b>                                    | <b>\$ 118,304</b> | <b>\$ 8,074</b>                      | <b>\$ 79,270</b>             | <b>\$ 30,960</b>             | <b>\$</b>                            |

(1)

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As of December 31, 2010, we had one loan totaling \$25.4 million which bore interest at a floating rate. The variable interest rate payments are based on LIBOR plus 2.6%. The information in the table above reflects our projected interest rate obligations for the floating rate payments based on one-month LIBOR as of December 31, 2010, which was 0.26%.



**Table of Contents****Index to Financial Statements****Distributions**

During, 2010, we paid dividends to our common shareholders and distributions to our OP unit holders of \$7.4 million, compared to \$6.9 million in 2009. Payments of dividends and distributions are declared quarterly and paid monthly. The dividends paid to common shareholders and distributions paid to OP unit holders in the first quarter of 2011, 2010 and 2009 follow (in thousands):

|                | Common<br>Shareholders <sup>(1)</sup> | OP Unit<br>Holders | Total           |
|----------------|---------------------------------------|--------------------|-----------------|
| <b>2009</b>    |                                       |                    |                 |
| Fourth Quarter | \$ 1,163                              | \$ 610             | \$ 1,773        |
| Third Quarter  | 1,163                                 | 610                | 1,773           |
| Second Quarter | 1,163                                 | 530                | 1,693           |
| First Quarter  | 1,156                                 | 531                | 1,687           |
| <b>Total</b>   | <b>\$ 4,645</b>                       | <b>\$ 2,281</b>    | <b>\$ 6,926</b> |
| <b>2010</b>    |                                       |                    |                 |
| Fourth Quarter | \$ 1,616                              | \$ 514             | \$ 2,130        |
| Third Quarter  | 1,203                                 | 515                | 1,718           |
| Second Quarter | 1,176                                 | 610                | 1,786           |
| First Quarter  | 1,163                                 | 610                | 1,773           |
| <b>Total</b>   | <b>\$ 5,158</b>                       | <b>\$ 2,249</b>    | <b>\$ 7,407</b> |
| <b>2011</b>    |                                       |                    |                 |
| First Quarter  | \$ 1,616                              | \$ 515             | \$ 2,131        |

<sup>(1)</sup> Distributions paid with respect to Class A common shareholders, and since September 2010, with respect to Class A and Class B common shareholders.

**Results of Operations****Year Ended December 31, 2010 Compared to Year Ended December 31, 2009**

The following table provides a general comparison of our results of operations for the years ended December 31, 2010 and December 31, 2009 (dollars in thousands, except per share and OP unit data):

|   | Year Ended December 31, |           |
|---|-------------------------|-----------|
|   | 2010                    | 2009      |
| Number of properties owned and operated                   | 38                      | 36        |
| Aggregate gross leasable area (sq. ft.) <sup>(1)</sup>    | 3,162,020               | 3,039,044 |
| Ending occupancy rate operating portfolio <sup>(2)</sup>  | 86%                     | 82%       |
| Ending occupancy rate all properties                      | 84%                     | 82%       |
| Total property revenues                                   | \$ 31,533               | \$ 32,685 |
| Total property expenses                                   | 12,283                  | 12,991    |
| Total other expenses                                      | 17,251                  | 17,201    |
| Provision for income taxes                                | 264                     | 222       |
| Loss on disposal of assets                                | 160                     | 196       |
| Net income  | 1,575                   | 2,075     |
| Less: Net income attributable to noncontrolling interests | 470                     | 733       |

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|  |    |       |    |       |
|--|----|-------|----|-------|
| Net income attributable to Whitestone REIT                     | \$ | 1,105 | \$ | 1,342 |
| Funds from operations <sup>(3)</sup>                           | \$ | 8,432 | \$ | 8,618 |
| Dividends and distributions paid on common shares and OP units |    | 7,407 |    | 6,926 |
| Per Class A common share and OP unit                           |    | 1.25  |    | 1.35  |
| Per Class B common share <sup>(4)</sup>                        |    | 0.38  |    |       |
| Dividends paid as a % of funds from operations                 |    | 88%   |    | 80%   |

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- (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) Dividend rate is the same as Class A common shares, but represents a partial year for Class B common shares, which were issued on August 31, 2010 and began receiving dividends in September 2010.

*Property revenues.* We had rental income and tenant reimbursements of approximately \$31.5 million for the year ended December 31, 2010 as compared to \$32.7 million for the year ended December 31, 2009, a decrease of \$1.2 million, or 4%. The twelve months ended December 31, 2009 included a \$0.4 million business interruption settlement that was not repeated during the twelve months ended December 31, 2010. Additionally, tenant reimbursement revenues decreased approximately \$0.7 million during the twelve months ended December 31, 2010 as compared to the twelve months ended December 31, 2009. The decrease in tenant reimbursement revenues was primarily the result of a \$0.7 million decrease in total property expenses.

*Property expenses.* Our property expenses were \$12.3 million for the year ended December 31, 2010, as compared to \$13.0 million for the year ended December 31, 2009, a decrease of \$0.7 million, or 5%. The primary components of total property expenses are detailed in the table below (in thousands):

|                                | Year Ended December 31, |                  | Increase /<br>(Decrease) | % Increase<br>/<br>(Decrease) |
|--------------------------------|-------------------------|------------------|--------------------------|-------------------------------|
|                                | 2010                    | 2009             |                          |                               |
| Real estate taxes              | \$ 3,925                | \$ 4,472         | \$ (547)                 | (12)%                         |
| Utilities                      | 2,277                   | 2,387            | (110)                    | (5)%                          |
| Contract services              | 2,140                   | 2,108            | 32                       | 2%                            |
| Repairs and maintenance        | 1,403                   | 1,408            | (5)                      | 0%                            |
| Bad debt                       | 536                     | 877              | (341)                    | (39)%                         |
| Labor and other                | 2,002                   | 1,739            | 263                      | 15%                           |
| <b>Total property expenses</b> | <b>\$ 12,283</b>        | <b>\$ 12,991</b> | <b>\$ (708)</b>          | <b>(5)%</b>                   |

*Real estate taxes.* Real estate taxes decreased \$0.5 million, or 12%, during the twelve months ended December 31, 2010 as compared to the same period in 2009, primarily as a result of lower valuations by the various county appraisal districts. In 2010, primarily as a result of our formal protests of assessed values, the various appraisal districts agreed to lower valuations and resulting taxes by significant amounts. We work actively to keep our valuations and resulting taxes as low as possible as most of these taxes are passed through to our tenants through triple net leases.

*Utilities.* Utilities decreased \$0.1 million, or 5%, during the twelve months ended December 31, 2010 as compared to the same period in 2009. The decrease in utility expenses was primarily attributed to the electricity usage of our six office buildings in Texas, which were charged at a lower rate per kilowatt hour during 2010 due to our new contracts with our electricity provider for lower fixed rates.

*Bad debt.* Bad debt for the twelve months ended December 31, 2010 decreased \$0.3 million, or 39%, as compared to the same period in 2009. We vigorously pursue past due accounts, but expect collection of rents to continue to be challenging for the foreseeable future.

*Labor and other.* Increases of \$0.3 million, or 15%, in labor and other during 2010 were the result of the internalization of many maintenance functions and increased focus on tenant service and property conditions by property management personnel. We have been able to accomplish a greater focus on tenant service and property conditions as a result of realignment of duties and reductions in administrative duties required of these individuals. This decrease in administrative duties is a result of improvements in systems, processes and reporting.

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*Other expenses.* Our other expenses were \$17.3 million for the year ended December 31, 2010, as compared to \$17.2 million for the year ended December 31, 2009, an increase of \$0.1 million. The primary components of other expenses, net are detailed in the table below (in thousands):

|                               | Year Ended December 31, |           | Increase /<br>(Decrease) | % Increase<br>/<br>(Decrease) |
|-------------------------------|-------------------------|-----------|--------------------------|-------------------------------|
|                               | 2010                    | 2009      |                          |                               |
| General and administrative    | \$ 4,992                | \$ 6,072  | \$ (1,080)               | (18)%                         |
| Depreciation and amortization | 7,225                   | 6,958     | 267                      | 4%                            |
| Involuntary conversion        | (558)                   | (1,542)   | 984                      | (64)%                         |
| Interest expense              | 5,620                   | 5,749     | (129)                    | (2)%                          |
| Interest income               | (28)                    | (36)      | 8                        | (22)%                         |
| Total other expenses          | \$ 17,251               | \$ 17,201 | \$ 50                    | 0%                            |

*General and administrative.* General and administrative expenses decreased approximately \$1.1 million or 18% for the twelve months ended December 31, 2010 as compared to the same period in 2009. Share-based compensation expense decreased approximately \$0.7 million during 2010. The majority of share-based compensation recognized during 2009 represented the achievement of the first performance-based target on certain share-based compensation grants. With our current asset base, management does not expect to achieve the second performance-based target, and share-based compensation was significantly lower during 2010 than 2009 because fewer unvested shares are expected to vest. Should we increase our asset base, we may achieve the next performance-based target and begin expensing the shares expected to vest upon the achievement of the second target.

Salaries and benefits, excluding share-based compensation, were approximately \$0.2 million less during the twelve months ended December 31, 2010 than during the same period in 2009, primarily as a result of company wide salary reductions taken in October 2009. Additionally, our allocation of internal labor to properties increased \$0.4 million in 2010, reducing general and administrative expense and increasing property expenses. Property management personnel have been able to achieve a greater focus on tenant service and property conditions because much of their administrative burden was removed by a realignment of duties and system and process improvements. Professional fees increased \$0.2 million during the twelve months ended December 31, 2010 as compared to the same period in 2009.

*Depreciation and amortization.* Depreciation and amortization increased \$0.3 million, or 4%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. The increase in depreciation expense was primarily comprised of tenant improvements at our Uptown Tower property located in Dallas, Texas and our Westbelt Plaza and Plaza Park locations located in Houston, Texas. The Uptown Tower spending was for office tenants, while the Westbelt Plaza and Plaza Park improvements were for leases that ended during 2010 with the U.S. Census Bureau. We expect depreciation and amortization to increase as we acquire properties.

*Involuntary conversion.* Involuntary conversion was a gain of \$0.6 million for the year ended December 31, 2010, as compared to a gain of \$1.5 million during the same period in 2009. The involuntary conversion gain of \$0.6 million recognized during the year ended December 31, 2010 represents the completion of the repairs to the 31 properties impacted by Hurricane Ike at costs that were lower than we estimated as of December 31, 2009. The estimated costs were sensitive to the scope requirements of our lenders and labor and material costs of our vendors, and the final costs incurred were more favorable than we anticipated. During the year ended December 31, 2009, we completed a settlement of our insurance claims related to our 31 properties damaged by Hurricane Ike. The settlement was \$7.0 million in its entirety, with \$6.5 million allocated to casualty claims and approximately \$0.5 million allocated to loss of rents claims. For the year ended December 31, 2009, the \$6.5 million in insurance proceeds allocated to casualty losses were offset by accrued repair costs of \$5.1 million resulting in a gain of \$1.4 million. The remaining \$0.1 million in involuntary conversion gain for the year ended December 31, 2009 was realized on an insurance settlement we completed during 2009 on a chiller unit at our Uptown Tower property in Dallas, Texas. Hurricane Ike-related repair costs of approximately \$0.4 million included in involuntary conversion loss during the year ended December 31, 2008.

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*Interest expense.* Interest expense for the year ended December 31, 2010 was \$5.6 million, a decrease of \$0.1 million over the same period in 2009. A decrease in our average outstanding notes payable balance of \$3.2 million accounted for the decrease in interest expense for the twelve months ended December 31, 2010 as compared to the same period in 2009.

**Results of Operations****Year Ended December 31, 2009 Compared to Year Ended December 31, 2008**

The following table provides a general comparison of our results of operations for the years ended December 31, 2009 and December 31, 2008 (dollars in thousands except per share and OP unit data):

|  | <b>Year Ended December 31,</b> |             |
|--|--------------------------------|-------------|
|  | <b>2009</b>                    | <b>2008</b> |
| Number of properties owned and operated                        | 36                             | 35          |
| Aggregate gross leasable area (sq. ft.)                        | 3,039,044                      | 2,990,892   |
| Ending occupancy rate operating portfolio <sup>(1)</sup>       | 82%                            | 84%         |
| Ending occupancy rate all properties                           | 82%                            | 84%         |
| Total property revenues  | \$ 32,685                      | \$ 31,201   |
| Total property expenses  | 12,991                         | 12,835      |
| Total other expenses   | 17,201                         | 19,600      |
| Provision for income taxes                                     | 222                            | 219         |
| Loss on disposal of assets                                     | 196                            | 223         |
| Income (loss) from continuing operations                       | 2,075                          | (1,676)     |
| Loss from discontinued operations                              |                                | (188)       |
| Gain from sale of properties from discontinued operations      |                                | 3,619       |
| Net income   | 2,075                          | 1,755       |
| Less: Net income attributable to noncontrolling interests      | 733                            | 621         |
| Net income attributable to Whitestone REIT                     | \$ 1,342                       | \$ 1,134    |
| Funds from operations <sup>(2)</sup>                           | \$ 8,618                       | \$ 4,236    |
| Dividends and distributions paid on common shares and OP Units | 6,926                          | 8,672       |
| Per Class A common share and OP Unit                           | 1.35                           | 1.74        |
| Dividends paid as a % of funds from operations                 | 80%                            | 205%        |

<sup>(1)</sup> 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.

<sup>(2)</sup> For a reconciliation of funds from operations to net income, see Funds From Operations below.

*Property revenues.* We had rental income and tenant reimbursements of approximately \$32.7 million for the year ended December 31, 2009 as compared to \$31.2 million for the year ended December 31, 2008, an increase of \$1.5 million, or 5%. The increase was primarily attributable to the addition of our Spoorlein Commons property during January 2009.

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*Property expenses.* Our property expenses were \$13.0 million for the year ended December 31, 2009, as compared to \$12.8 million for the year ended December 31, 2008, an increase of \$0.2 million, or 1%. The primary components of total property expenses are detailed in the table below (in thousands):

|                                | Year Ended December 31, |                  | Increase /<br>(Decrease) | % Increase<br>/<br>(Decrease) |
|--------------------------------|-------------------------|------------------|--------------------------|-------------------------------|
|                                | 2009                    | 2008             |                          |                               |
| Real estate taxes              | \$ 4,472                | \$ 3,973         | \$ 499                   | 13%                           |
| Utilities                      | 2,387                   | 2,679            | (292)                    | (11)%                         |
| Contract services              | 2,108                   | 2,138            | (30)                     | (1)%                          |
| Repairs and maintenance        | 1,408                   | 1,633            | (225)                    | (14)%                         |
| Bad debt                       | 877                     | 731              | 146                      | 20%                           |
| Labor and other                | 1,739                   | 1,681            | 58                       | 3%                            |
| <b>Total property expenses</b> | <b>\$ 12,991</b>        | <b>\$ 12,835</b> | <b>\$ 156</b>            | <b>1%</b>                     |

*Real estate taxes.* Increases during 2009 in real estate taxes of \$0.5 million, or 13%, were the result of increased assessed values on our properties and the addition of the Spoerlein Commons property during January 2009.

*Utilities.* Utilities decreased \$0.3 million, or 11%, during 2009. The majority of our utility expense is the electricity usage of our seven office buildings which were charged at a lower rate per kilowatt hour during the second half of 2009 due to our new contracts with our electricity provider for lower fixed rates in the Texas market.

*Repairs and Maintenance.* Repairs and maintenance decreases of \$0.2 million, or 14%, during 2009 were primarily attributable to decreases in hard surface and parking lot repair costs and the internalization of many maintenance functions.

*Bad debt.* Bad debt for the year ended December, 31 2009 was \$0.1 million, or 20%, more than in 2008. The increase in bad debt was driven by slower paying tenants and abandonments. We vigorously pursue past due accounts, but expect for collection of rents to continue to be challenging for the foreseeable future.

*Labor and other.* Increases of \$0.1 million, or 3%, in labor and other during 2009 were the result of increased travel and marketing costs.

*Other expenses.* Our other expenses were \$17.2 million for the year ended December 31, 2009, as compared to \$19.6 million for the year ended December 31, 2008, a decrease of \$2.4 million, or 12%. The primary components of other expenses, net are detailed in the table below (in thousands):

|                               | Year Ended December 31, |                  | Increase /<br>(Decrease) | % Increase<br>/<br>(Decrease) |
|-------------------------------|-------------------------|------------------|--------------------------|-------------------------------|
|                               | 2009                    | 2008             |                          |                               |
| General and administrative    | \$ 6,072                | \$ 6,708         | \$ (636)                 | (9)%                          |
| Depreciation and amortization | 6,958                   | 6,859            | 99                       | 1%                            |
| Involuntary conversion        | (1,542)                 | 358              | (1,900)                  | (531)%                        |
| Interest expense              | 5,749                   | 5,857            | (108)                    | (2)%                          |
| Interest income               | (36)                    | (182)            | 146                      | (80)%                         |
| <b>Total other expenses</b>   | <b>\$ 17,201</b>        | <b>\$ 19,600</b> | <b>\$ (2,399)</b>        | <b>(12)%</b>                  |

*General and administrative.* The decrease of \$0.6 million, or 9%, in general and administrative expense was primarily due to decreased legal fees related to litigation with our former CEO and our former external advisor, offset by share-based compensation that was incurred in 2009 but

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not in 2008. Legal fees were \$0.3 million for the year ended December 31, 2009, as compared to \$1.7 million for the same period in 2008. Share-based compensation was \$1.0 million and zero for the years ended December 31, 2009 and 2008, respectively.

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*Depreciation and amortization.* Depreciation and amortization increased \$0.1 million, or 1%, for the year ended December 31, 2009, as compared to the year ended December 31, 2008. During 2009 depreciation increased \$0.8 million, or 16%, while amortization decreased \$0.7 million, or 35%. The increase in depreciation expense is the result of tenant improvements placed in service and depreciation on our Pima Norte and Spoerlein Commons properties, which were placed in service in late 2008 and early 2009, respectively. The decrease in amortization expense is primarily attributable to the loan fees which were \$0.4 million during 2009 compared to \$1.1 million during 2008.

*Involuntary conversion.* Involuntary conversion was a gain of \$1.5 million for the year ended December 31, 2009, as compared to a loss of \$0.4 million during the same period in 2008. During the year ended December 31, 2009, we completed a settlement of our insurance claims related to our 31 properties damaged by Hurricane Ike. The settlement was \$7.0 million in its entirety, with \$6.5 million allocated to casualty claims and approximately \$0.5 million allocated to loss of rents claims. The \$6.5 million in insurance proceeds allocated to casualty losses were offset by accrued repair costs of \$5.1 million, resulting in a gain of \$1.4 million. The remaining \$0.1 million in involuntary conversion gain for the year ended December 31, 2009 was realized on an insurance settlement we completed during 2009 on a chiller unit at our Uptown Tower property in Dallas, Texas. Repair costs of \$0.4 million expensed during the twelve months ended December 31, 2008 related to Hurricane Ike are included in the 2008 involuntary conversion loss.

*Interest expense, net.* Interest expense for the year ended December 31, 2009 was \$5.7 million, a decrease of \$0.1 million over the same period in 2008. An increase in the average outstanding note payable balance of \$14.9 million accounted for approximately \$1.0 million in increased interest expense during 2009, while a lower effective interest rate of 1.0% per annum (excluding amortized loan fees) accounted for approximately \$1.1 million in decreased interest expense during 2009. The decrease in interest income of approximately \$0.1 million is primarily due to lower interest rates of return on our deposits.

*Discontinued operations.* Discontinued operations are comprised of the two properties known as Garden Oaks and Northeast Square. The two properties were transferred to our former CEO and our former external advisor as part of a legal settlement on May 30, 2008. Below is a summary of income from discontinued operations (in thousands):

|  | <b>Year Ended December 31,</b> |                 |
|--|--------------------------------|-----------------|
|  | <b>2009</b>                    | <b>2008</b>     |
| <b>Property Revenues</b>                                       |                                |                 |
| Rental revenues  | \$                             | \$ 333          |
| Other revenues   |                                | 225             |
| Total property revenues  |                                | 558             |
| <b>Property Expenses</b>                                       |                                |                 |
| Properties operation and maintenance                           |                                | 391             |
| Real estate taxes  |                                | 133             |
| Total property expenses  |                                | 524             |
| <b>Other expense</b>   |                                |                 |
| General and administrative                                     |                                |                 |
| Depreciation and amortization                                  |                                | 218             |
| Total other expense  |                                | 218             |
| <b>Loss before gain on disposal of assets and income taxes</b> |                                | <b>(184)</b>    |
| Gain on sale of properties                                     |                                | 3,619           |
| Provision for income taxes                                     |                                | (4)             |
| <b>Income from discontinued operations</b>                     | <b>\$</b>                      | <b>\$ 3,431</b> |





**Table of Contents****Index to Financial Statements****Funds From Operations and Funds From Operations Core**

NAREIT defines FFO as net income (loss) available to common shareholders computed in accordance with 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 GAAP net income alone as the primary measure of our operating performance. Historical cost accounting for real estate assets in accordance with 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 GAAP as an 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.

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, acquisition costs and certain costs paid as a result of our litigation with our former external manager. We define FFO-Core as FFO excluding these items.

Below is the calculation of FFO and FFO-Core and the reconciliation to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|  | Year Ended December 31, |                 |                 |
|--|-------------------------|-----------------|-----------------|
|  | 2010                    | 2009            | 2008            |
| Net income attributable to Whitestone REIT                         | \$ 1,105                | \$ 1,342        | \$ 1,134        |
| Depreciation and amortization of real estate assets <sup>(1)</sup> | 6,697                   | 6,347           | 5,877           |
| (Gain) loss on sale or disposal of assets <sup>(1)</sup>           | 160                     | 196             | (3,396)         |
| Net income attributable to noncontrolling interests                | 470                     | 733             | 621             |
| <b>FFO</b>   | <b>8,432</b>            | <b>8,618</b>    | <b>4,236</b>    |
| Acquisition costs  | 46                      | 75              |                 |
| (Gain) loss on insurance settlement <sup>(2)</sup>                 | (558)                   | (1,934)         | 358             |
| Litigation costs with our former external manager                  |                         |                 | 1,491           |
| <b>FFO-Core</b>  | <b>\$ 7,920</b>         | <b>\$ 6,759</b> | <b>\$ 6,085</b> |

<sup>(1)</sup> Including amounts for discontinued operations.

<sup>(2)</sup> \$392 included in rental revenue for the twelve months ended December 31, 2009.

**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



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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 a commonly used 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 gain or loss on sale or disposal of assets, the level of capital expenditures and leasing costs necessary to maintain the operating performance of the our properties.

The following is a reconciliation of our historical NOI to net income, which we believe is the most comparable GAAP financial measure (in thousands):

|   | Year Ended December 31 |               |               |
|---|------------------------|---------------|---------------|
|   | 2010                   | 2009          | 2008          |
| Net Income Attributable to Whitestone REIT              | \$ 1,105               | \$ 1,342      | \$ 1,134      |
| General and administrative expense                      | 4,992                  | 6,072         | 6,708         |
| Depreciation and amortization                           | 7,225                  | 6,958         | 6,859         |
| Involuntary conversion                                  | (558)                  | (1,542)       | 358           |
| Interest expense  | 5,620                  | 5,749         | 5,857         |
| Interest income   | (28)                   | (36)          | (182)         |
| Provision for income taxes                              | 264                    | 222           | 219           |
| Loss on disposal of assets                              | 160                    | 196           | 223           |
| Loss from discontinued operations                       |                        |               | 188           |
| Gain on sale of properties from discontinued operations |                        |               | (3,619)       |
| Net income attributable to noncontrolling interests     | 470                    | 733           | 621           |
| <br>NOI   | <br>\$ 19,250          | <br>\$ 19,694 | <br>\$ 18,366 |

**Taxes**

We elected to be taxed as a REIT under the Internal Revenue Code beginning with our taxable year ended December 31, 1999. As a REIT, we generally are not subject to federal income tax on income that we distribute to our shareholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate rates. We believe that we are organized and operate in 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. Consequently, increases due to inflation, as well as ad valorem tax rate increases, generally do not have a significant adverse effect upon our operating results.

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**Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of loss arising from adverse changes in market rates and prices. The principal market risk to which we are exposed is the risk related to interest rate fluctuations. Based upon the nature of our operations, we are not subject to foreign exchange or commodity risk. We are exposed to changes in interest rates as a result of our debt facilities that have floating interest rates. As of December 31, 2010, we had \$25.4 million of loans with floating interest rates. All of our financial instruments were entered into for other than trading purposes. As of December 31, 2010, we did not have a fixed rate hedge in place, leaving \$25.4 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 \$0.3 million, respectively.

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 try to 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.

**Off-Balance Sheet Arrangements**

We have no significant off-balance sheet arrangements as of December 31, 2010.

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**BUSINESS AND PROPERTIES**

**Our Company**

We are a fully integrated real estate company that owns and operates commercial properties in culturally diverse markets in major metropolitan areas. 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 define Community Centered Properties as visibly located properties in established or developing culturally diverse neighborhoods in our target markets. 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. We employ and develop a diverse group of seasoned professionals who understand the needs of our multicultural communities and tenants.

Our current portfolio is concentrated in Houston, with additional properties in the Phoenix, Chicago, Dallas and San Antonio metropolitan areas. According to the United States Census Bureau's *Estimates of Population Change for Metropolitan Statistical Areas and Rankings: July 1, 2008 to July 1, 2009*, Dallas and Houston ranked first and second, respectively, in population growth out of 366 metropolitan statistical areas, and Phoenix, Chicago and San Antonio ranked seventh, eighth and sixteenth, respectively. We believe the management infrastructure and capacity we have built can accommodate substantial growth in those markets. We also believe that those cities have expanding multi-cultural neighborhoods, providing us with excellent opportunities to execute our strategic plan in those markets.

We believe that over the next few years we will have opportunities to acquire quality properties at historically attractive prices. Many of these properties will be distressed due to over-leverage, mismanagement or the lack of liquidity in the financial markets. 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.

**Our Strengths**

We believe a number of factors differentiate us from other commercial real estate owners in our markets, including:

***Strong Occupancy Upside in Current Portfolio.*** As of December 31, 2010, 20 of our 38 properties had significant upside in occupancy with occupancy rates lower than 90%. We believe that through our:

Community Centered Property operating model,

focus on the fastest growing ethnic groups in our defined markets,

proactive marketing and leasing efforts, and

proven management team,

we will be able to increase occupancy in these properties to our individual property occupancy goals of 90% or higher. This occupancy upside provides the opportunity to increase property net operating income and funds from operations through leasing of vacant spaces at these properties. At our current average base rent of approximately \$10 per square foot and a total of approximately 3.2 million leasable square feet, each increase of 1% in occupancy will contribute approximately \$320,000 to our annual funds from operations.



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***Community Centered Property Investment Focus.*** We seek to invest in properties that are or can become Community Centered Properties from which our tenants deliver needed services to the surrounding community. We focus on niche properties with smaller rental spaces that present opportunities for attractive returns. We target properties that: (1) typically require relatively low capital investment, are management and leasing intensive and do not draw the interest of larger national real estate companies; (2) can be redeveloped at a low cost utilizing our internal management capabilities; and/or (3) can be Whitestone-branded and re-tenanted, resulting in lower tenant turnover and higher occupancy and rental rates, together with corresponding increases in tenant reimbursement of operating expenses.

***Multi-Cultural Community Focus.*** Our multi-cultural community focus sets us apart from traditional commercial real estate operators. We value diversity in our team and maintain in-house leasing, property management, marketing, construction and maintenance departments with culturally diverse and multi-lingual associates who understand the particular needs of our tenants and neighborhoods.

***Proactive Marketing and Leasing.*** Our proactive marketing and leasing programs are designed to utilize market research to determine the common and distinctive characteristics and needs of the neighborhood and attract tenants who meet those needs. Our in-depth local knowledge in each of our major markets and in-house research capabilities allow us to quickly access and analyze neighborhood demographics and cultural nuances, market rental trends and valuation metrics. Our streamlined and efficient leasing process allows us to attract tenants and to lease spaces quickly. We typically market and lease our properties to smaller tenants who rent on average less than 3,000 square feet. As of December 31, 2010, our average rent per square foot for our smaller tenants represents a 57% premium over rent paid by our larger tenants, or those tenants leasing more than 3,000 square feet.

***Extensive Pipeline of Acquisition Opportunities Generated through Relationships and Reputation.*** Our extensive pipeline of potential acquisitions has been developed over the last several years through our reputation in the markets in which we operate and our relationships with property owners, community banks, attorneys, title companies, and others in the real estate industry. The size of our pipeline of potential properties will allow us to be selective and close quickly on properties as single-asset or multi-asset purchases from various sellers.

***Proven Real Estate and Repositioning Track Record.*** Our nine-person senior management team, composed of James C. Mastandrea, John J. Dee, David K. Holeman, Daniel Nixon, Valarie King, Bradford Johnson, Gregory Belsheim, Charles M. Taylor and Anne Gregory, has more than 150 years of collective experience acquiring, developing, redeveloping, owning, managing and operating commercial real estate properties, portfolios and companies. Messrs. Mastandrea, Dee and Nixon each has over 30 years of experience and Mesdames King, Gregory and Messrs. Holeman, Johnson, Taylor and Belsheim each has 17, 3, 5, 29, 14 and 8 years of experience, respectively. Our senior management team has extensive national real estate contacts and investment expertise in our target markets. In particular, our management team has significant expertise in repositioning properties with complex problems. Our team executes a coordinated strategy, utilizing our corporate branding, philosophy and culture, operational systems and experience to renovate and re-tenant properties, with an intention to increase their net operating income and value.

**Our Growth Strategy**

Our primary business objective is to increase shareholder value by acquiring, owning and operating Community Centered Properties. The key elements of our strategy include:

***Strategically Acquiring Properties.***

***Seeking High Growth Markets.*** We seek to strategically acquire commercial properties in high-growth markets. Our acquisition targets are located in densely populated, culturally diverse neighborhoods, primarily in and around Phoenix, Chicago, Dallas, San Antonio and Houston, five of the top 20 markets in the United States in terms of population growth.





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*Diversifying Geographically.* Our current portfolio is concentrated in Houston. We believe that continued geographic diversification in markets where we have substantial knowledge and experience will help offset the economic risk from a single market concentration. We intend to continue to focus our expansion efforts on the Phoenix, Chicago, Dallas and San Antonio markets. We believe our management infrastructure and capacity can accommodate substantial growth in those markets. We may also pursue opportunities in other Southwestern and Western regions that are consistent with our Community Centered Property strategy.

*Capitalizing on Availability of Distressed Assets.* We believe that during the next few years there will be excellent opportunities in our target markets to acquire quality properties at historically attractive prices. We intend to acquire distressed assets directly from owners or financial institutions holding foreclosed real estate and debt instruments that are either in default or on bank watch lists. Many of these assets may benefit from our corporate strategy and our management team's experience in repositioning distressed properties, portfolios and companies. We have extensive relationships with community banks, attorneys, title companies, and others in the real estate industry with whom we regularly work to identify properties for potential acquisition.

*Maximizing Value by Redeveloping and Re-tenanting Existing Properties.* We reposition properties and seek to add value through renovating and re-tenanting our properties to create Whitestone-branded Community Centered Properties. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

*Recycling Capital for Greater Returns.* We seek to continually upgrade our portfolio by opportunistically selling properties that do not have the potential to meet our Community Centered Property strategy and redeploying the sale proceeds into properties that better fit our strategy. Some of our properties which were acquired prior to the tenure of our current management team may not fit our Community Centered Property strategy, and we may look for opportunities to dispose of these properties as we continue to execute our strategy.

*Orienting Our Capital Structure for Growth.* We intend to use the net proceeds of this offering to fund acquisitions and the selective redevelopment of existing properties. We do not have any debt maturities until October 2013, and we currently have 15 properties that are not mortgaged. We may seek to add mortgage indebtedness to existing and newly acquired unencumbered properties to provide additional capital for acquisitions. As a general policy, we intend to maintain a ratio of total indebtedness to undepreciated book value of real estate assets that is less than 60%. As of December 31, 2010, our ratio of total mortgage indebtedness to undepreciated book value of real estate assets was 49%. Assuming full deployment of the proceeds from this offering at 50% leverage in addition to our new revolving line of credit, we will have approximately \$            million available for investment in properties.

*Investing in People.* We believe that our people are the heart of our culture, philosophy and strategy. We continually focus on developing associates who are self-disciplined, motivated and display at all times a high degree of character and competence. We provide them with equity incentives to align their interests with those of our shareholders. We also focus on their training and development. Our annual in-house Real Estate Executive Development, or REED, program is designed to provide us with knowledgeable and well-trained associates to meet our strategic goals and provide continuity in our leadership and management. The 12-month REED program promotes in-depth understanding of all aspects of investing in, owning and operating commercial real estate by providing select associates with detailed training from real estate professionals from both within and outside Whitestone.

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**Our Opportunity**

*The Economic Opportunity*

The recent global recession has dramatically impacted the profitability of both large and small businesses, and many companies have declared bankruptcy. Additionally, the commercial real estate markets have experienced considerable distress, which we believe has greatly increased the number of quality properties available for acquisition. Furthermore, we believe that real estate companies with sufficient equity capital and experience repositioning assets are able to maximize the returns on these properties. 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.

Since the first quarter of 2008, the market for commercial mortgage-backed securities, or CMBS, has substantially contracted. Even though CMBS re-emerged in 2010, the volume of loans was only \$12 billion compared to a volume of \$96 billion in 2006.

Source: Commercial Mortgage Alert (March 24, 2011)

Although the loan markets were much improved in 2010, credit is not readily available as an ever-increasing number of mortgage defaults has reduced the willingness of traditional commercial mortgage lenders to extend credit.

Source: Mortgage Bankers Association

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In cases where they have provided financing, banks continue to tighten credit standards for commercial real estate loans.

Source: Federal Reserve Loan Officer Survey (January 2011)

These factors have resulted in a decrease in the amount of real estate investment capital available from traditional financing sources for commercial real estate acquisitions.

Source: Real Capital Analytics

Severe recession and tight credit have resulted in many commercial real estate developers being unable to finance tenant improvements necessary to lease their spaces and to meet or refinance current debt maturities. Institutional lenders who have extended mortgage credit to developers and owners are experiencing higher levels

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of payment and covenant defaults, are accumulating substantial inventories of commercial real estate from foreclosures, and are facing increased pressure from banking regulators to divest these assets. We believe these dynamics have created numerous opportunities to acquire distressed assets at prices at or below replacement cost of the underlying real estate.

The demand for basic goods and services such as specialty retail, grocery, and medical, educational and financial services remains strong, despite the recession, in neighborhoods throughout our Phoenix, Chicago, Dallas, San Antonio and Houston markets. These staple goods and services tend to be non-luxuries and are needed on an everyday basis. Many of these goods and services are provided by smaller, entrepreneurial businesses that have lower operating costs and require less commercial space. We believe that during the last cycle traditional real estate developers designed properties to accommodate larger national tenants requiring bigger spaces and that these types of properties have been harder hit by the credit and economic crises. We expect that many of these properties are currently, or will in the future be, distressed and can be re-positioned and re-tenanted into Community Centered Properties that better meet the needs of their surrounding neighborhoods.

*The Socio-Economic Opportunity*

According to the United States Census Bureau, all five of our target markets were in the top 10 largest United States cities as of July 1, 2009. In the Census Bureau's *Estimates of Population Change for Metropolitan Statistical Areas and Rankings: July 1, 2008 to July 1, 2009*, Dallas and Houston ranked first and second, respectively, in population growth out of 366 metropolitan statistical areas, and Phoenix, Chicago and San Antonio ranked seventh, eighth and sixteenth, respectively. Each of our markets except Chicago and Phoenix had population growth of at least two percent during this period and experienced better employment statistics than the national average during the current recession.

The following table shows that the unemployment rates in all of our five markets (Phoenix, Dallas, San Antonio and Houston) were less than or equal to the national average in each of the last three months of 2010.

|             | Jul   | Aug  | Sep  | Oct  | Nov  | Dec  |
|-------------|-------|------|------|------|------|------|
| National    | 9.7%  | 9.5% | 9.2% | 9.0% | 9.3% | 9.1% |
| Houston     | 8.8%  | 8.7% | 8.2% | 8.2% | 8.6% | 8.3% |
| Dallas      | 8.5%  | 8.4% | 7.9% | 8.0% | 8.2% | 8.0% |
| Chicago     | 10.5% | 9.8% | 9.4% | 9.0% | 9.0% | 8.7% |
| Phoenix     | 9.1%  | 9.1% | 8.9% | 8.5% | 8.5% | 8.5% |
| San Antonio | 7.7%  | 7.6% | 7.2% | 7.3% | 7.6% | 7.2% |

Source: Bureau of Labor Statistics

The Census Bureau in August 2008 forecasted that by 2042 minorities will become the majority of the United States population, and that by 2050 the Hispanic and Asian populations will nearly double as a percentage of the total United States population. We believe our primary markets represent some of the most culturally diverse cities in the United States and that Hispanic and Asian communities are prevalent in these cities. The following table shows changes in ethnic population in our primary markets:

| City        | 2005-2009 % Change in Population by Ethnicity |        |       |          |
|-------------|---|--------|-------|----------|
|             | White   | Black  | Asian | Hispanic |
| Chicago     | 1.3%  | (1.1%) | 9.7%  | 7.4%     |
| Houston     | 9.4   | 13.5   | 18.8  | 18.4     |
| Dallas      | 9.3   | 13.2   | 18.4  | 20.8     |
| San Antonio | 8.1   | 17.6   | 29.5  | 12.1     |
| Phoenix     | 10.8  | 35.5   | 33.3  | 23.0     |

Source: U.S. Census Bureau



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We believe that multicultural entrepreneurs will comprise a growing base of tenants for our Community Centered Properties. According to the United States Small Business Administration, or the SBA, immigrants are nearly 30% more likely to start a new business than non-immigrants. According to the SBA, between 1996 and 2007, immigrants represented nearly 17% of all new business owners in the United States. In Texas during this period, immigrants accounted for nearly 28% of new business owners, while in Arizona and Illinois, immigrants accounted for approximately 19% of new business owners. Each of these states was in the top 10 nationally for new business formations by immigrants.

**Our Acquisition Process**

***Commercial Real Estate***

We intend to continue acquiring properties that meet or can be repositioned to meet our criteria for Community Centered Properties in our target markets of Phoenix, Chicago, Dallas and San Antonio. Currently, we have an active acquisition pipeline exceeding \$300 million, comprised of over 75 properties from approximately 40 sources in our target markets. We believe that declining commercial real estate prices resulting from banks and other financial institutions and conduit lenders disposing of large numbers of commercial properties acquired between 2005 and 2009, combined with a shortage of affordable mortgage financing forcing distressed property owners to sell, will provide us with excellent opportunities in these markets to acquire quality properties. Once we acquire a property, we seek to reposition the property and add value through renovating and re-tenanting in order to create a Whitestone-branded Community Centered Property. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

We believe that over the next few years we will have opportunities to acquire quality properties at historically low prices. Many of these properties will be distressed due to over-leverage, mismanagement or the lack of liquidity in the financial markets. 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.

We target properties from 25,000 to 200,000 square feet in established or developing neighborhoods, generally resulting in acquisitions priced between \$3 million and \$30 million. In our experience, large institutional investors generally do not compete to purchase properties having values under \$30 million, thus limiting competition that would typically inflate the values of acquisition properties. We are not specifically limited by our governance documents, our management policies or the governance documents of our Operating Partnership in the number or size of properties we may acquire or the percentage of net proceeds of this offering that we may invest in a single property. The number and mix of properties we acquire will depend on real estate and market conditions existing at the time we acquire properties and the availability of debt and equity capital.

We have developed extensive research capabilities and utilize proprietary asset management and modeling tools that we believe help us to identify favorable property acquisitions, forecast growth and make estimates, at the time of the acquisition of a property, relating to disposition timing and sales price to maximize our return on investment. Using these tools in concert with our overall strategies, including individual market monitoring and ongoing analysis of macro- and micro-regional economic cycles, we expect to be better able to identify favorable acquisition targets. We believe our experience and investment discipline will enable us to maximize current returns and distributions to investors and maintain higher relative portfolio property values.

***Commercial Mortgage Loans***

We believe a significant opportunity currently exists to acquire distressed loans on quality commercial real estate at historically attractive prices with the intent to acquire the underlying property through foreclosure or

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deed in lieu of foreclosure within a short period of time. The global liquidity crisis has led to a repricing of risk, more dramatic and severe than other recent periods of distress. The market is demanding the continued de-leveraging of balance sheets of financial institutions in the face of rising loan maturities. We believe that unlike the Resolution Trust Corporation crisis of 1990 to 1992, distress today is affecting much higher quality assets where opportunities are created by excessive leverage and distressed sellers. Given the low interest rate environment, we believe many of these assets cover debt service, but the likelihood that they can be refinanced at maturity is in doubt. In light of this, we anticipate attractive investment opportunities in acquiring performing and non-performing loans from banks, investment banks or any other forced sellers due to margin calls, redemptions, capital adequacy concerns or capital requirements during the next year or two. We believe that our market knowledge, real estate expertise, geographic coverage and our ability to complete transactions quickly will enable us to succeed in these acquisitions. When we purchase debt, we intend to underwrite the underlying real estate in the same manner and method as we use to underwrite direct real estate acquisitions with a view toward ultimately acquiring the real estate securing the purchased debt.

### **Our Disposition Strategy**

We seek to continually upgrade our asset base by opportunistically selling properties that do not have the potential to meet our Community Centered Property strategy and redeploying the sale proceeds into properties that fit our strategy. Some of our properties were acquired prior to the tenure of our current management team and may not fit our Community Centered Property strategy, and we will look for opportunities to dispose of these properties as we continue to execute our strategy. A property may be sold before the end of the expected holding period if, in our judgment, the value of the property has reached its peak or may decline substantially or an opportunity has arisen to acquire other properties. We generally intend to hold our investments long-term; however, economic or market conditions may influence us to hold our investments for shorter periods of time.

The determination of whether a particular property should be sold or otherwise disposed of will be made after consideration of relevant factors, including prevailing economic conditions, with a view to achieving maximum capital appreciation. We cannot assure you that this objective will be realized. The selling price of a leased property will be determined in large part by the amount of net operating income of the property.

### **Development and Construction of Properties**

We do not currently intend to engage in the acquisition of raw land for development or the acquisition of existing improved property for tear-downs and rebuilding. However, we intend to engage in selective redevelopment of existing improved properties where such redevelopment will reposition the property and/or increase its earning capacity and long-term returns on invested capital. We reposition properties and add value through renovating and re-tenanting to create Whitestone-branded Community Centered Properties. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

### **Property Management, Leasing and Marketing**

We manage and lease what we own and retain the decision making authority and strategic planning responsibility for our properties. Our management team directly oversees our property portfolio and seeks to increase our operating cash flow through aggressive oversight of our leasing, property management and asset management functions. Our property management functions include the oversight of all day-to-day operations of our properties as well as the coordination and oversight of tenant improvements and building services. Property managers are required to communicate either in-person or via telephone with each tenant twice per quarter and more frequently for larger tenants on a property and for tenants close to a renewal period or at risk of default.



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Our current management team has implemented a number of operating strategies and reporting systems, which have been developed over their careers. Once we acquire a property we seek to aggressively manage the property in accordance with a strategic plan developed during pre-acquisition due diligence. Depending on the property, the strategic plan may seek to add value either through active property leasing efforts, investment in targeted capital improvement projects or the repositioning or redevelopment of certain properties. We intend to increase cash flows through cost efficient property operations and leasing strategies designed to capture market rental growth from the renewal of below-market leases at higher rates and/or recruitment of quality new tenants. We believe we have maintained both rigorous lessee underwriting and strong tenant relationships.

In implementing our Community Centered Property strategy, we strive to 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. We employ and develop a diverse group of seasoned professionals who understand the needs of our multicultural communities and tenants.

Marketing is an integral part of our leasing strategy. We deploy a multi-prong marketing effort as it focuses on mailings including post cards, e-mail distributions and door-to-door marketing for potential tenants in neighboring buildings. In addition, we outsource certain marketing functions for further penetration of the potential tenant market. We hold training seminars for our marketing employees and leasing agents specifically oriented towards the marketing process and other leasing principals.

We utilize large, conspicuous signage to advertise the availability of space at our vacant properties. We also actively communicate with tenant representatives in our markets in order to keep them continuously informed of our inventory of available space. We also utilize direct mail and telephone cold calls to find prospective tenants. Once a prospective tenant becomes interested in leasing from us, we provide our leasing agents with autonomy, within set parameters, to negotiate leases in order to fill vacant space. Leasing agents are allowed to use concessions to attract new tenants.

Our properties are marketed to smaller tenants, who rent on average less than 3,000 square feet. As of December 31, 2010, 561 of our 792 were smaller tenants (representing approximately 71% of our tenant base), and we have tailored our management and leasing approach to deal with the unique needs of these types and size tenants. For example, we have implemented a streamlined lease approval process, and we allow our trained representatives to make independent leasing decisions. Many competing properties often face a substantially more bureaucratic approval process, which could potentially inhibit a property from being fully leased. Our ability to act quickly allows us to capture those tenants that are unable or unwilling to wait a substantial period of time for a lease to be approved. We are able to examine the credit of a potential tenant during the lease negotiation process and quickly finalize the terms of the lease. Smaller tenants generally pay us a premium per square foot to occupy smaller spaces. As of December 31, 2010, this premium averaged 57% over what larger tenants pay on an average per square foot in our current portfolio.

We carefully monitor our property expenses and manage how we incur and bill expenses to our tenants. Because a significant amount of our leases are triple net leases, which means that the tenant is responsible for paying the cost of all maintenance and minor repairs, property taxes and insurance relating to its leased space, most operating expenses, such as insurance, taxes and common area maintenance, are reimbursed to us by our tenants. We also use gross leases and full service leases, which vary from our triple net leases. A gross lease typically includes the base or first year's property operating expenses, taxes and insurance in the rent. Any increases in the property operating expenses, taxes or insurance over the base year are generally reimbursed by the tenant. The cost of common area maintenance is also reimbursed by the tenant, as are utilities and other premises-specific costs. In a full service lease, all expenses, with the occasional exception of electricity and other utility costs, are included in the rent. Any increases in the expenses over the base year are generally reimbursed by the tenant. We have implemented collection and billing policies to assure we are collecting all expense

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reimbursements, and we plan our incurrence of such expenses so as to maximize recoverability in any given year, while minimizing the added cost to our tenants.

Leasing for our portfolio is generally performed internally and is a key component to our success. Members of our leasing team have developed strong relationships with the local tenant community in the respective markets. We aggressively seek to renegotiate and extend any existing leases that are below market at market rates. Although we maintain ongoing dialogue with our tenants, we will generally raise the issue of renewal 12 months prior to lease renewal often providing concessions for early renewal. We also aggressively pursue new tenants for any vacant space. As necessary, we will use third-party leasing agents in attracting tenants. Our use of third party brokerage firms is based on their demonstrated track record and knowledge of the sub-markets in which our properties are located.

### **Terms of Leases and Tenant Creditworthiness**

We typically lease our properties to a wide variety of tenants on a triple net basis. The terms and conditions of any lease that we enter into with our tenants may vary substantially from those we describe in this prospectus. Our leases range from terms of month-to-month to over 15 years with renewal options. However, we expect that a majority of our leases will be leases customarily used between landlords and tenants in the geographic area where the property is located and require the tenant to pay a pro rata share of building expenses, including real estate taxes and insurance. Under such typical leases, the landlord is directly responsible for all real estate taxes, sales and use taxes, special assessments, utilities, insurance and building repairs, and other building operation and management costs.

We execute new tenant leases and tenant lease renewals, expansions and extensions with terms that are dictated by the current sub-market conditions and the verifiable creditworthiness of each particular tenant. We use a number of industry credit rating services to determine the creditworthiness of potential tenants and any personal guarantor or corporate guarantor of each potential tenant. The reports produced by these services are compared to the relevant financial data collected from these parties before consummating a lease transaction. Relevant financial data from potential tenants and guarantors include income statements and balance sheets for the current year and for prior periods, net worth or cash flow statements of guarantors and other information we deem relevant. We have established leasing guidelines to use in evaluating prospective tenants and proposed lease terms and conditions.

### **Our Properties**

As of December 31, 2010, we owned 38 commercial properties, including

31 properties in Houston, Texas;

two properties in Dallas, Texas;

one property in Windcrest, Texas, a suburb of San Antonio;

one property in Scottsdale, Arizona;

one property in Carefree, Arizona;

one property in Phoenix, Arizona; and

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one property in Buffalo Grove, Illinois, a suburb of Chicago.

Our tenants consist of national, regional and local businesses. Our properties generally attract a mix of tenants who provide basic staples, convenience items and services tailored to the specific cultures, needs and preferences of the surrounding community. These types of tenants are the core of our strategy of creating Whitestone-branded Community Centered Properties. We also believe daily sales of these basic items are less sensitive to fluctuations in the business cycle than higher priced retail items. Our largest tenant represented 1.9% of total revenues for the year ended December 31, 2010.

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We directly manage the operations and leasing of our properties. Substantially all of our revenues consist of base rents received under leases that generally have terms that range from less than one year to 15 years. As of December 31, 2010, approximately 72% of our existing leases with terms greater than one year contained step up rental clauses that provide for increases in the base rental payments. The following table summarizes certain information relating to our properties as of December 31, 2010:

|  | No. of Properties | Leasable Square Feet | Average Occupancy as of 12/31/10 | Annualized Base Rental Revenue (in thousands) <sup>(1)</sup> | Average Annualized Base Rental Revenue Per Leased Sq. Ft. <sup>(2)</sup> | Average Net Effective Annual Base Rent per Leased Sq. Ft. <sup>(3)</sup> |
|--|-------------------|----------------------|----------------------------------|--|--|--|
| <b>Commercial Properties</b>                           |                   |                      |                                  |  |  |  |
| <b>Operating Portfolio:</b>                            |                   |                      |                                  |  |  |  |
| Retail   | 18                | 1,188,830            | 88%                              | \$ 9,843   | \$ 9.41  | \$ 10.60   |
| Office/Flex  | 11                | 1,201,672            | 88%                              | 7,670  | 7.25   | 7.16   |
| Office   | 7                 | 631,841              | 79%                              | 8,084  | 16.20  | 16.52  |
| <b>Subtotal Operating Portfolio</b>                    | <b>36</b>         | <b>3,022,343</b>     | <b>86%</b>                       | <b>25,597</b>  | <b>9.85</b>  | <b>10.35</b>   |
| <b>Redevelopment, New Acquisitions <sup>(4)</sup>:</b> |                   |                      |                                  |  |  |  |
| Retail   | 2                 | 139,677              | 40%                              | 612  | 10.95  | 11.65  |
| <b>Total</b>   | <b>38</b>         | <b>3,162,020</b>     | <b>84%</b>                       | <b>\$ 26,209</b>   | <b>\$ 9.87</b>   | <b>\$ 10.38</b>  |

<sup>(1)</sup> Calculated as the tenant's actual December 31, 2010 base rent (defined as cash base rents including abatements) multiplied by 12. Excludes vacant space as of December 31, 2010. Because annualized base rental revenue is not derived from historical results that were accounted for in accordance with GAAP, historical results differ from the annualized amounts. Total abatements for leases in effect as of December 31, 2010 equaled approximately \$125,000 for the month ended December 31, 2010.

<sup>(2)</sup> Calculated as annualized base rent divided by net rentable square feet leased at December 31, 2010. Excludes vacant space as of December 31, 2010.

<sup>(3)</sup> Represents (i) the contractual base rent for leases in place as of December 31, 2010, calculated on a straight-line basis to reflect changes in rental rates throughout the lease term and amortize free rent periods and abatements, but without regard to tenant improvement allowances and leasing commissions, divided by (ii) square footage under commenced leases as of December 31, 2010.

<sup>(4)</sup> Includes (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.

As of December 31, 2010, we had one property that accounted for more than 10% of total gross revenue. Uptown Tower is an office building located in Dallas, Texas and accounts for 12.0%, 11.9% and 12.8% of our total revenue for the years ended December 31, 2010, 2009 and 2008, respectively. Uptown Tower also accounts for 10.2%, 10.9% and 11.5% of our real estate assets, net of accumulated depreciation, for the years ended December 31, 2010, 2009 and 2008, respectively.

**Table of Contents****Index to Financial Statements****Location of Properties**

Of our 38 properties, 34 are located in Texas, with 31 being located in the greater Houston metropolitan statistical area. These 31 properties represent 76% of our revenue for the year ended December 31, 2010.

The Houston workforce is concentrated in energy, chemicals, information technology, aerospace sciences and medical sciences. According to the United States Census Bureau, Houston ranked 4th in the largest United States cities as of July 1, 2009. In the Census Bureau's *Estimates of Population Change for Metropolitan Statistical Areas and Rankings: July 1, 2008 to July 1, 2009*, Houston ranked second in population growth out of 366 metropolitan statistical areas. According to the Bureau of Labor of Statistics, the unemployment rate in Houston was less than the national average in each of the last six months of 2010.

|          | July | Aug. | Sept. | Oct. | Nov. | Dec. |
|----------|------|------|-------|------|------|------|
| National | 9.7% | 9.5% | 9.2%  | 9.0% | 9.3% | 9.1% |
| Houston  | 8.8% | 8.7% | 8.2%  | 8.2% | 8.6% | 8.3% |

Source: Bureau of Labor Statistics

**Table of Contents****Index to Financial Statements****General Physical and Economic Attributes**

The average total leasable area per property of our portfolio is 83,211 square feet. Currently, our portfolio is dispersed primarily among the sub-markets of the greater Houston metropolitan area, generally in high-traffic areas with good visibility and accessibility. Our portfolio provides our tenants with solid properties in preferred locations at competitive rental rates. As of December 31, 2010, our operating portfolio's average occupancy rate, or Operating Portfolio Occupancy Rate, was approximately 86%. The average base rental revenue per square foot for the retail, office/flex and office properties was \$9.41, \$7.25 and \$16.20, respectively. The following table sets forth certain information relating to each of our properties owned as of December 31, 2010.

| Property Name                  | Location    | Year Built/<br>Renovated | Leasable Square Feet | Percent Occupied at 12/31/10 | Annualized Base Rental Revenue (in thousands) <sup>(1)</sup> | Average Base Rental Revenue Per Leased Sq. Ft. <sup>(2)</sup> | Average Net Effective Annual Base Rent Per Leased Sq. Ft. <sup>(3)</sup> |
|--------------------------------|-------------|--------------------------|----------------------|------------------------------|--|---|--|
| <b>Retail Properties:</b>      |             |                          |                      |                              |  |   |  |
| Bellnott Square                | Houston     | 1982                     | 73,930               | 35%                          | \$ 266   | \$ 10.28  | \$ 10.86   |
| Bissonnet/Beltway              | Houston     | 1978                     | 29,205               | 95%                          | 256  | 9.23  | 11.10  |
| Centre South                   | Houston     | 1974                     | 39,134               | 82%                          | 312  | 9.72  | 9.75   |
| Greens Road                    | Houston     | 1979                     | 20,507               | 85%                          | 145  | 8.32  | 8.89   |
| Holly Knight                   | Houston     | 1984                     | 20,015               | 100%                         | 326  | 16.29   | 20.08  |
| Kempwood Plaza                 | Houston     | 1974                     | 101,008              | 100%                         | 876  | 8.67  | 8.70   |
| Lion Square                    | Houston     | 1980                     | 119,621              | 99%                          | 801  | 6.76  | 9.15   |
| Providence                     | Houston     | 1980                     | 90,327               | 99%                          | 786  | 8.79  | 8.58   |
| Shaver                         | Houston     | 1978                     | 21,926               | 98%                          | 239  | 11.12   | 11.40  |
| South Richey                   | Houston     | 1980                     | 69,928               | 94%                          | 548  | 8.34  | 10.77  |
| Spoerlein Commons              | Chicago     | 1987                     | 41,455               | 90%                          | 733  | 19.65   | 20.42  |
| SugarPark Plaza                | Houston     | 1974                     | 95,032               | 100%                         | 935  | 9.84  | 10.07  |
| Sunridge                       | Houston     | 1979                     | 49,359               | 89%                          | 429  | 9.77  | 9.86   |
| Torrey Square                  | Houston     | 1983                     | 105,766              | 88%                          | 694  | 7.46  | 9.63   |
| Town Park                      | Houston     | 1978                     | 43,526               | 100%                         | 758  | 17.41   | 17.44  |
| Webster Point                  | Houston     | 1984                     | 26,060               | 92%                          | 269  | 11.22   | 9.34   |
| Westchase                      | Houston     | 1978                     | 49,573               | 86%                          | 398  | 9.34  | 11.35  |
| Windsor Park                   | San Antonio | 1992                     | 192,458              | 76%                          | 1,072  | 7.33  | 9.82   |
|                                |             |                          | <b>1,188,830</b>     | <b>88%</b>                   | <b>\$ 9,843</b>  | <b>\$ 9.41</b>  | <b>\$ 10.60</b>  |
| <b>Office/Flex Properties:</b> |             |                          |                      |                              |  |   |  |
| Brookhill                      | Houston     | 1979                     | 74,757               | 89%                          | \$ 257   | \$ 3.86   | \$ 3.86  |
| Corporate Park Northwest       | Houston     | 1981                     | 185,627              | 70%                          | 1,373  | 10.57   | 10.87  |
| Corporate Park West            | Houston     | 1999                     | 175,665              | 92%                          | 1,471  | 9.10  | 9.02   |
| Corporate Park Woodland        | Houston     | 2000                     | 99,937               | 92%                          | 792  | 8.61  | 8.44   |
| Dairy Ashford                  | Houston     | 1981                     | 42,902               | 95%                          | 210  | 5.15  | (0.15)   |
| Holly Hall                     | Houston     | 1980                     | 90,000               | 100%                         | 689  | 7.66  | 8.09   |
| Interstate 10                  | Houston     | 1980                     | 151,000              | 95%                          | 693  | 4.83  | 4.79   |
| Main Park                      | Houston     | 1982                     | 113,410              | 100%                         | 660  | 5.82  | 6.15   |
| Plaza Park                     | Houston     | 1982                     | 105,530              | 74%                          | 650  | 8.32  | 8.18   |
| Westbelt Plaza                 | Houston     | 1978                     | 65,619               | 63%                          | 347  | 8.39  | 8.47   |
| Westgate                       | Houston     | 1984                     | 97,225               | 100%                         | 528  | 5.43  | 5.90   |
|                                |             |                          | <b>1,201,672</b>     | <b>88%</b>                   | <b>\$ 7,670</b>  | <b>\$ 7.25</b>  | <b>\$ 7.16</b>   |
| <b>Office Properties:</b>      |             |                          |                      |                              |  |   |  |
| 9101 LBJ Freeway               | Dallas      | 1985                     | 125,874              | 71%                          | \$ 1,462   | \$ 16.36  | \$ 15.98   |
| Featherwood                    | Houston     | 1983                     | 49,760               | 87%                          | 755  | 17.44   | 16.98  |
| Pima Norte                     | Phoenix     | 2007                     | 33,417               | 17%                          | 85   | 14.96   | 17.78  |
| Royal Crest                    | Houston     | 1984                     | 24,900               | 70%                          | 218  | 12.51   | 12.91  |
| Uptown Tower                   | Dallas      | 1982                     | 253,981              | 88%                          | 3,918  | 17.53   | 18.02  |
| Woodlake Plaza                 | Houston     | 1974                     | 106,169              | 89%                          | 1,215  | 12.86   | 13.30  |
| Zeta Building                  | Houston     | 1982                     | 37,740               | 77%                          | 431  | 14.83   | 16.21  |

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|                                  |         |      |                  |            |                  |                |                 |
|----------------------------------|---------|------|------------------|------------|------------------|----------------|-----------------|
|                                  |         |      | 631,841          | 79%        | \$ 8,084         | \$ 16.20       | \$ 16.52        |
| <b>Total Operating Portfolio</b> |         |      | <b>3,022,343</b> | <b>86%</b> | <b>\$ 25,597</b> | <b>\$ 9.85</b> | <b>\$ 10.35</b> |
| The Citadel                      | Phoenix | 1985 | 28,547           | 16%        | \$ 85            | \$ 18.61       | \$ 19.49        |
| Sunnyslope Village               | Phoenix | 2000 | 111,130          | 47%        | 527              | 10.09          | 10.76           |
|                                  |         |      | 139,677          | 40%        | 612              | 10.95          | 11.65           |
| <b>Grand Totals</b>              |         |      | <b>3,162,020</b> | <b>84%</b> | <b>\$ 26,209</b> | <b>\$ 9.87</b> | <b>\$ 10.38</b> |

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- (1) Calculated as the tenant's actual December 31, 2010 base rent (defined as cash base rents including abatements) multiplied by 12. Excludes vacant space as of December 31, 2010. Because annualized base rental revenue is not derived from historical results that were accounted for in accordance with generally accepted accounting principles, historical results differ from the annualized amounts. Total abatements for leases in effect as of December 31, 2010 equaled approximately \$125,000 for the month ended December 31, 2010.
- (2) Calculated as annualized base rent divided by net rentable square feet leased as of December 31, 2010. Excludes vacant space as of December 31, 2010.
- (3) Represents (i) the contractual base rent for leases in place as of December 31, 2010, calculated on a straight-line basis to reflect changes in rental rates throughout the lease term and amortize free rent periods and abatements, but without regard to tenant improvement allowances and leasing commissions, divided by (ii) square footage under commenced leases of December 31, 2010.

**Significant Tenants**

The following table sets forth information about our fifteen largest tenants as of December 31, 2010, based upon annualized rental revenues as of December 31, 2010.

| Tenant Name                                     | Location    | Annualized<br>Rental<br>Revenue<br>(in thousands) | Percentage of<br>Total<br>Annualized<br>Base<br>Rental<br>Revenues | Initial Lease<br>Date | Year<br>Expiring |
|---|-------------|---|--|-----------------------|------------------|
| Sports Authority                                | San Antonio | \$ 495  | 1.9%   | 1/1/2004              | 2015             |
| Compass Insurance                               | Dallas      | 367   | 1.4%   | 9/1/2005              | 2013             |
| Brockett Davis Drake Inc.                       | Dallas      | 365   | 1.4%   | 3/14/1994             | 2011             |
| Air Liquide America, L.P.                       | Dallas      | 363   | 1.4%   | 8/1/2001              | 2013             |
| Kroger  | Houston     | 265   | 1.0%   | 9/1/1999              | 2011             |
| X-Ray X-Press Corporation                       | Houston     | 262   | 1.0%   | 7/1/1998              | 2019             |
| Petsmart, Inc                                   | San Antonio | 255   | 1.0%   | 1/1/2004              | 2013             |
| Marshall's                                      | Houston     | 248   | 0.9%   | 5/12/1983             | 2013             |
| Rock Solid Images                               | Houston     | 243   | 0.9%   | 4/1/2004              | 2012             |
| Merrill Corporation                             | Dallas      | 234   | 0.9%   | 12/10/2001            | 2014             |
| Eligibility Services                            | Dallas      | 224   | 0.9%   | 6/6/2000              | 2012             |
| River Oaks L-M, Inc.                            | Houston     | 199   | 0.8%   | 10/15/1993            | 2011             |
| New Lifestyles, Inc.                            | Dallas      | 192   | 0.7%   | 5/5/1998              | 2013             |
| Landworks, Inc.                                 | Houston     | 178   | 0.7%   | 6/1/2004              | 2013             |
| The University of Texas Health Science Property | Houston     | 177   | 0.7%   | 7/1/2007              | 2017             |
|   |             | \$ 4,067  | 15.6%  |                       |                  |

**Lease Expirations**

Our leases range from terms of less than one year to over 15 years with renewal options. As a result of the length of our average lease term, we have, on average, leases for approximately 10% to 20% of our gross leasable area expiring on an annual basis. The following table sets forth a summary schedule of the lease expirations for the leases in place as of December 31, 2010 over the next ten years. Unless otherwise provided, the information set forth in the table assumes that tenants exercise no renewal options or early termination rights.

| Year | Number<br>of<br>Leases | Gross Leasable Area           |                     | Annualized Base Rent as<br>of December 31, 2010 |                     |
|------|------------------------|-------------------------------|---------------------|---|---------------------|
|      |                        | Approximate<br>Square<br>Feet | Percent of<br>Total | Amount<br>(in thousands)                        | Percent of<br>Total |



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|              |            |                  |              |                  |              |
|--------------|------------|------------------|--------------|------------------|--------------|
| 2011         | 251        | 670,660          | 21.2%        | \$ 6,641         | 25.3%        |
| 2012         | 159        | 460,412          | 14.6%        | 4,898            | 18.7%        |
| 2013         | 144        | 504,510          | 16.0%        | 5,394            | 20.6%        |
| 2014         | 94         | 327,413          | 10.4%        | 3,492            | 13.3%        |
| 2015         | 71         | 311,924          | 9.9%         | 3,026            | 11.5%        |
| 2016         | 39         | 127,213          | 4.0%         | 983              | 3.8%         |
| 2017         | 8          | 43,725           | 1.4%         | 407              | 1.6%         |
| 2018         | 9          | 55,581           | 1.8%         | 365              | 1.4%         |
| 2019         | 6          | 50,333           | 1.6%         | 569              | 2.2%         |
| 2020         | 3          | 37,907           | 1.2%         | 237              | 0.9%         |
| <b>Total</b> | <b>784</b> | <b>2,589,678</b> | <b>81.9%</b> | <b>\$ 26,012</b> | <b>99.3%</b> |

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*Uptown Tower, Dallas, Texas.* Uptown Tower accounts for 10.2% of our total assets. The Uptown Tower office property, which was built in 1982, consists of 253,981 rentable square feet located in the Uptown area of Dallas, Texas. We acquired the property in 2005. The average office space is approximately 2,900 square feet, and the typical tenants include professional services and non-profit organizations. As of December 31, 2010, the building was 88% leased to 77 tenants. Typical lease terms are generally gross lease where the tenant pays a monthly base rent and a reimbursement of operating expenses above its base year. These expense reimbursements include, but are not limited to, property taxes, insurance, security, utilities, landscaping and other common area maintenance items. Generally leased space has a term ranging from less than one year to over 15 years. The federal income tax basis for the Uptown Tower property is \$19,265,933 as of December 31, 2010.

No tenant occupied 10% or more of the property's rentable square footage as of December 31, 2010.

The following table sets forth the occupancy rate and average annual rent per leased rentable square foot for the Uptown Tower property at the end of each year indicated.

|      | <b>Occupancy<br/>Rate</b> | <b>Average Annual Base Rent<br/>per Leased Square<br/>Foot<sup>(1)</sup></b> | <b>Average Net Effective<br/>Annual Base Rent per<br/>Leased Square<br/>Foot<sup>(2)</sup></b> |
|------|---------------------------|--|--|
| 2006 | 80.5%                     | \$ 12.72   | \$ 16.58   |
| 2007 | 89.9%                     | \$ 14.35   | \$ 12.82   |
| 2008 | 89.8%                     | \$ 16.81   | \$ 17.14   |
| 2009 | 83.9%                     | \$ 16.82   | \$ 16.69   |
| 2010 | 87.7%                     | \$ 17.53   | \$ 18.02   |

(1) Calculated as annualized base rent divided by net rentable square feet leased at December 31, 2010. Excludes vacant space as of December 31, 2010.

(2) Represents (i) the contractual base rent for leases in place as of the dates indicated above, calculated on a straight line basis to reflect changes in rental rates throughout the lease term and amortize free rent periods and abatements, but without regard to tenant improvement allowances and leasing commissions divided by (ii) square footage under commenced leases as of the same date.

Depreciation on the Uptown Tower property is taken on a straight line basis over 6 to 39 years for book purposes, resulting in a depreciation rate of approximately 3% per year.

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## Lease Expiration Schedule Uptown Tower

| Year         | Number of Leases Expiring | Square Footage of Expiring Leases | Percentage of Property's Gross Leaseable Area | Annualized Base Rent of Expiring Leases <sup>(1)</sup> | Percentage of Property's Annualized Base Rent <sup>(2)</sup> |
|--------------|---------------------------|-----------------------------------|---|--|--|
| 2011         | 37                        | 57,858                            | 22.8%   | \$ 995,894   | 25.4%  |
| 2012         | 13                        | 38,672                            | 15.2%   | 791,467  | 20.2%  |
| 2013         | 12                        | 46,875                            | 18.5%   | 791,462  | 20.2%  |
| 2014         | 6                         | 36,070                            | 14.2%   | 650,309  | 16.6%  |
| 2015         | 4                         | 19,089                            | 7.5%  | 337,797  | 8.6%   |
| 2016         | 4                         | 18,787                            | 7.4%  | 250,559  | 6.4%   |
| 2017         |                           |                                   |   |  |  |
| 2018         |                           |                                   |   |  |  |
| 2019         | 1                         | 5,421                             | 2.1%  | 100,289  | 2.6%   |
| Thereafter   |                           |                                   |   |  |  |
| <b>Total</b> | <b>77</b>                 | <b>222,772</b>                    | <b>87.7%</b>                                  | <b>\$ 3,917,775</b>                                    | <b>100.0%</b>  |

<sup>(1)</sup> Calculated as the tenant's actual December 31, 2010 base rent multiplied by 12. Excludes vacant space as of December 31, 2010.

<sup>(2)</sup> Calculated as annualized base rent divided by net rentable square feet leased at December 31, 2010. Excludes vacant space at December 31, 2010.

We hold fee simple title to this property, which is subject to a mortgage loan, collateralized by this property and two others. The loan which has a principal balance, as of December 31, 2010, of approximately \$24.0 million, requires monthly interest-only payments for the first twelve months and has a 25 year amortization thereafter, bears interest at a fixed rate of 6.56% and matures on October 1, 2013. While prepayment of the loan is not restricted, prepayments are subject to a penalty provision. The outstanding balance at the time of maturity will be approximately \$22.8 million.

The property is held primarily for its income producing capabilities. Uptown Tower directly competes with other office buildings in the North Central Expressway corridor. There are no current plans for renovating this property. We believe the property to be adequately covered by insurance.

Real estate taxes for 2010 on the Uptown Tower property were approximately \$365,000, and the current real property tax rate with respect to the property is 2.66% of the assessed value.

**Indebtedness**

As a general policy, we limit our total indebtedness to 60% of the undepreciated book value of our real estate assets as of the date of any borrowing. The Board may, at any time, waive or change our borrowing policy. Moreover, the terms of certain mortgage loans and other credit facilities to which we may be a party may be more restrictive than our Board's policy. As of December 31, 2010, our total indebtedness is approximately 49% of the undepreciated book value of our real estate assets, and we were in compliance with all financial covenants in all loan documents to which we are a party.

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

| Description                                  | December 31,<br>2010 |
|--|----------------------|
| Fixed rate notes                             |                      |
| \$10.0 million 6.04% Note, due 2014          | \$ 9,498             |
| \$1.5 million 6.50% Note, due 2014           | 1,496                |
| \$11.2 million 6.52% Note, due 2015          | 10,908               |
| \$21.4 million 6.53% Notes, due 2013         | 20,142               |
| \$24.5 million 6.56% Note, due 2013          | 24,030               |
| \$9.9 million 6.63% Notes, due 2014          | 9,498                |
| \$0.5 million 5.05% Notes, due 2011 and 2010 | 13                   |
| Floating rate note                           |                      |
| \$26.9 million LIBOR + 2.86% Note, due 2013  | 25,356               |
|  | \$ 100,941           |

**Competition**

All of our properties are located in areas that include competing properties. The amount of competition in a particular area could impact our ability to acquire additional real estate, sell current real estate, lease space and the amount of rent we are able to charge. We may be competing with owners, including but not limited to, other REITs, insurance companies and pension funds, with access to greater resources than those available to us.

Many of our competitors have greater financial and other resources than us and may have more operating experience than us. Generally, there are other neighborhood and community retail centers within relatively close proximity to each of our properties. There is, however, no dominant competitor in the Houston, Dallas, San Antonio, Phoenix or Chicago metropolitan areas. Our retail tenants face increasing competition from outlet malls, internet discount shopping clubs, catalog companies, direct mail and telemarketing.

**Insurance**

We believe that we have adequate property and liability insurance with reputable, commercially rated companies. We also believe that our insurance policies contain commercially reasonable deductibles and limits, adequate to cover our properties. We expect to maintain this type of insurance coverage and to obtain similar coverage with respect to any additional properties we acquire in the near future. Further, we have title insurance relating to our properties in an aggregate amount that we believe to be adequate.

**Employees**

As of December 31, 2010 we had 53 full-time employees.

**Legal Proceedings**

From time to time, we may be party to a variety of legal proceedings arising in the ordinary course of our business. We are not a party to any material litigation or legal proceedings or, to the best of our knowledge, any threatened litigation or legal proceedings that, in the opinion of management, individually or in the aggregate, would have a material adverse effect on our results of operations or financial condition.

**Regulation*****Environmental Regulations***

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Our properties, as well as any other properties that we may acquire in the future, are subject to various federal, state and local laws, ordinances and regulations. They include, among other things, zoning regulations,

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land use controls, environmental controls relating to air and water quality, noise pollution and indirect environmental impacts such as increased motor vehicle activity. We believe that we have all permits and approvals necessary under current law to operate our properties.

All real property and the operations conducted on real property are subject to federal, state and local laws and regulations relating to environmental protection and human health and safety. These laws and regulations generally govern air and water quality, noise pollution and indirect environmental impacts such as increased motor vehicle activity, wastewater discharges, air emissions, the operation and removal of underground and above-ground storage tanks, the use, storage, treatment, transportation and disposal of solid and hazardous materials, and the remediation of contamination associated with disposals. Under these laws and regulations, a current or previous owner or operator of real property may be liable for the cost of removal or remediation of hazardous or toxic substances on, under or in such property. Some of these laws and regulations may impose joint and several liability on tenants, owners or operators for the costs of investigation or remediation of contaminated properties, regardless of fault or the legality of the original disposal and whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances.

Environmental laws also may impose restrictions on the manner in which property may be used or businesses may be operated, and these restrictions may require substantial expenditures. Environmental laws provide for sanctions in the event of noncompliance and may be enforced by governmental agencies or, in certain circumstances, by private parties. Certain environmental laws and common law principles could be used to impose liability for release of and exposure to hazardous substances, including asbestos-containing materials into the air, and third parties may seek recovery from owners or operators of real properties for personal injury or property damage associated with exposure to released hazardous substances. Additionally, concern about indoor exposure to mold has been increasing as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold at any of our properties could require us to undertake a costly remediation program to contain or remove the mold from the affected property, and could expose us to liability from our tenants, their employees and others. The cost of defending against claims of liability, of compliance with environmental regulatory requirements, of remediating any contaminated property, or of paying personal injury claims could materially adversely affect our business, assets or results of operations and, consequently, amounts available for payments of distributions to our shareholders. In addition, the presence of these substances, or the failure to properly remediate these substances, may adversely affect our ability to sell or rent such property or to use the property as collateral for future borrowing.

Some of these laws and regulations have been amended so as to require compliance with new or more stringent standards as of future dates. Compliance with new or more stringent laws or regulations or stricter interpretation of existing laws may require material expenditures by us. We cannot assure you that future laws, ordinances or regulations will not impose any material environmental liability, or that the current environmental condition of our properties will not be affected by the operations of the tenants, by the existing condition of the land, by operations in the vicinity of the properties, such as the presence of underground storage tanks, or by the activities of unrelated third parties. In addition, there are various local, state and federal fire, health, life-safety and similar regulations that we may be required to comply with, and which may subject us to liability in the form of fines or damages for noncompliance.

We will not purchase any property unless we are generally satisfied with the environmental status of the property. We may obtain a Phase I environmental site assessment, which includes a visual survey of the building and the property in an attempt to identify areas of potential environmental concerns, visually observing neighboring properties to assess surface conditions or activities that may have an adverse environmental impact on the property, and contacting local governmental agency personnel and performing a regulatory agency file search in an attempt to determine any known environmental concerns in the immediate vicinity of the property. A Phase I environmental site assessment does not generally include any sampling or testing of soil, groundwater or building materials from the property. Certain properties that we have acquired contain, or contained, dry-cleaning

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establishments utilizing solvents. Where believed to be warranted, samplings of building materials or subsurface investigations were undertaken with respect to these and other properties. To date, the costs associated with these investigations and any subsequent remedial measures taken have not been material to us.

We believe that our properties are in compliance in all material respects with all federal, state and local ordinances and regulations regarding the handling, discharge and emission of hazardous or toxic substances. During the re-financing of twenty-one of our properties in late 2008 and early 2009, Phase I environmental site assessments were completed at those properties. These assessments revealed that five of the twenty-one properties currently or previously had a dry cleaning facility as a tenant. Since release of chlorinated solvents can occur as a result of dry cleaning operations, a Phase II subsurface investigation was conducted at the five identified properties, and all such investigations revealed the presence of chlorinated solvents. Based on the findings of the Phase II subsurface investigations, we promptly applied for entry into the Texas Commission on Environmental Quality Dry Cleaner Remediation Program, or DCRP, for four of the identified properties and were accepted. We conducted subsequent testing on the fifth property and believe no further action is necessary at this time with respect to this property. Upon entry, and continued good standing with the DCRP, the DCRP administers the Dry Cleaning Remediation fund to assist with remediation of contamination caused by dry cleaning solvents. The response actions associated with the ongoing investigation and subsequent remediation, if necessary, have not been determined at this time. However, we believe that the costs of such response actions will be immaterial, and therefore no liability has been recorded to our financial statements. We have not been notified by any governmental authority, and are not otherwise aware, other than the five identified properties described above, of any material noncompliance, liability or claim relating to hazardous or toxic substances in connection with any of our present or former properties. We have not recorded in our financial statements any material liability in connection with environmental matters. Nevertheless, it is possible that the environmental assessments conducted thus far and currently available to us do not reveal all potential environmental liabilities. It is also possible that subsequent investigations will identify material contamination or other adverse conditions, that adverse environmental conditions have arisen subsequent to the performance of the environmental assessments, or that there are material environmental liabilities of which management is unaware.

***Americans with Disabilities Act of 1990***

Under the Americans with Disabilities Act, or ADA, all places of public accommodation are required to meet certain federal requirements related to access and use by disabled persons. Our properties must comply with the ADA to the extent that they are considered public accommodations as defined by the ADA. The ADA may require removal of structural barriers to access by persons with disabilities in public areas of our properties where such removal is readily achievable. We believe that our properties are in substantial compliance with the ADA and that we will not be required to make substantial capital expenditures to address the requirements of the ADA. In addition, we will continue to assess our compliance with the ADA and to make alterations to our properties as required.

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**POLICIES WITH RESPECT TO CERTAIN ACTIVITIES**

Our Board reviews our investment policies periodically to determine that the policies we follow are in the best interest of our shareholders. We acquire assets primarily for income and growth (value appreciation). The methods of implementing our investment policies also may vary as new investment techniques are developed. The methods of implementing our investment objectives and policies, except as otherwise provided in the organizational documents, may be altered by our Board without shareholder approval.

**Investments in Real Estate and Interests in Real Estate**

***Commercial Real Estate***

We intend to continue acquiring properties that meet or can be repositioned to meet our criteria for Community Centered Properties in our target markets of Phoenix, Chicago, Dallas and San Antonio. Currently we have an active acquisition pipeline exceeding \$300 million, comprised of over 75 properties from approximately 40 sources in our target markets. We believe that declining commercial real estate prices resulting from banks and other financial institutions and conduit lenders disposing of large numbers of commercial properties acquired between 2005 and 2010, combined with a shortage of affordable mortgage financing forcing distressed property owners to sell, will provide us with excellent opportunities in these markets to acquire quality properties. Once we acquire a property, we seek to reposition the property and add value through renovating and re-tenanting in order to create a Whitestone-branded Community Centered Property. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

We have extensive relationships with community banks, attorneys, title companies and others in the real estate industry with whom we regularly work to identify properties for potential acquisition. Due to the size and depth of our target markets, we believe we can continue our selective acquisition strategy in the future.

We target properties from 25,000 to 200,000 square feet in established or developing neighborhoods. In our experience, large institutional investors generally do not compete to purchase these types of properties, thus limiting competition that would typically inflate the values of acquisition properties. We are not specifically limited by our governance documents, our management policies or the governance documents of our Operating Partnership in the number or size of properties we may acquire or the percentage of our assets or the net proceeds of this offering that we may invest in a single property. The number and mix of properties we acquire will depend on real estate and market conditions existing at the time we acquire properties and the availability of debt and equity capital.

We have the capability to use OP units or common shares as currency along with a combination of cash and debt as consideration for our acquisitions. Our UPREIT structure is attractive to potential sellers because in addition to allowing sellers to defer taxable gains related to the sale of the property, it gives the seller an interest in a larger, more diversified pool of assets. It is possible that, in making future acquisitions in return for OP units, we may agree to restrictions on our ability, for a specified period of time following the acquisition, to dispose of the acquired properties in a taxable transaction.

Currently all of our properties are owned by our Operating Partnership or a wholly owned subsidiary of our Operating Partnership in fee simple title. We expect to continue to pursue our investment objectives through the direct ownership of properties. However, in the future, we may also participate with other entities (including non-affiliated entities) in property ownership, through joint ventures, limited liability companies, partnerships, co-tenancies or other types of common ownership. We may also consider entering into joint ventures with institutional partners to acquire properties in the future. Joint ventures generally entail the acquisition of



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properties in conjunction with an equity partner who, in most cases, provides the majority of the equity needed for the acquisition. We only anticipate using joint ventures for transactions in certain situations, such as where the property would be disproportionately larger than the other properties in our portfolio or would otherwise have a significantly higher risk profile than our other properties. We presently have no agreements to own any properties jointly with another entity or entities.

In addition, we may purchase properties and lease them back to the sellers of such properties. While we will use our best efforts to structure any such sale-leaseback transaction such that the lease will be characterized as a true lease so that we will be treated as the owner of the property for federal income tax purposes, we cannot assure you that the IRS will not challenge such characterization. In the event that any such sale-leaseback transaction is recharacterized as a financing transaction for federal income tax purposes, deductions for depreciation and cost recovery relating to such property would be disallowed.

Although we currently intend to continue acquiring Community Centered Properties in the Phoenix, Chicago, Dallas, and San Antonio metropolitan areas, our future acquisition or redevelopment activities are not limited to any geographic area or to a specified property use. We may invest in any geographic area and we may invest in other commercial properties such as manufacturing facilities, warehouse and distribution facilities in order to reduce overall portfolio risk, enhance overall portfolio returns, or respond to changes in the real estate market if our management determines that it would be advantageous to do so.

We have developed extensive research capabilities and utilize proprietary asset management and modeling tools that our management believes help it to identify favorable property acquisitions, forecast growth and make estimates at the time of the acquisition of a property, relating to disposition timing and sales price to maximize our return on investment. Using these tools in concert with our overall strategies, including individual market monitoring and ongoing analysis of macro- and micro-regional economic cycles, we expect to be better able to identify favorable acquisition targets. We believe our experience and investment discipline will enable us to maximize current returns and distributions to investors and maintain higher relative portfolio property values. We intend to execute timely dispositions at appropriate sales prices to enhance capital gains distributable to our investors.

When identifying particular properties as potential acquisitions, we consider relevant real estate property and financial factors, including:

the location of the property and visibility to high traffic areas;

the physical condition;

the property's historical operating use and any potential liabilities;

impediments to value identified from surveys, environmental reports, title reports and policies and similar materials;

current and pro forma financial information to determine a property's income-producing history and capacity, based on rent rolls and lease expiration format;

the repositioning prospects for transforming the property to a Whitestone-branded Community Centered Property;

the potential prospects for sale of the property when the transformed value is realized;

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market demographics and trends, along with unique needs within a community; and

income tax considerations.

Our obligation to purchase any property will generally be conditioned upon completion of due diligence including, where appropriate: plans and specifications; environmental reports; surveys; evidence of marketable title subject to such liens and encumbrances as are acceptable to us; financial statements and other data covering recent operations of properties having operating histories; and title and liability insurance policies.

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We will not purchase any property unless we are generally satisfied with the environmental status of the property. We may obtain a Phase I environmental site assessment, which includes a visual survey of the building and the property in an attempt to identify areas of potential environmental concerns, visually observing neighboring properties to assess surface conditions or activities that may have an adverse environmental impact on the property, and contacting local governmental agency personnel and performing a regulatory agency file search in an attempt to determine any known environmental concerns in the immediate vicinity of the property. A Phase I environmental site assessment does not generally include any sampling or testing of soil, groundwater or building materials from the property.

In purchasing, leasing and developing properties, we will be subject to risks generally incident to the ownership of real estate. See Risk Factors Risks Associated with Real Estate.

As a general policy, we intend to maintain a ratio of total indebtedness to undepreciated book value of real estate assets that is less than 60%, with flexibility to add higher leverage on a property-by-property basis where appropriate.

***Commercial Mortgage Loans***

Over the next few years, we anticipate a significant opportunity to acquire distressed loans on quality commercial real estate at historically attractive prices with the intent to acquire the underlying property through foreclosure or deed in lieu of foreclosure within a short period of time. The global liquidity crisis has led to a repricing of risk, more dramatic and severe than other recent periods of distress. The market is demanding the continued de-leveraging of balance sheets of financial institutions in the face of rising loan maturities. We believe that unlike the Resolution Trust Corporation crisis of 1990 to 1992, distress today is affecting much higher quality assets where opportunities are created by excessive leverage and distressed sellers. Given the low interest rate environment, we believe many of these assets cover debt service, but the likelihood that they can be refinanced at maturity is in doubt. In light of this, we anticipate attractive investment opportunities in acquiring performing and non-performing loans from banks, investment banks or any other forced sellers due to margin calls, redemptions, capital adequacy concerns or capital requirements during the next year or two. We believe that our market knowledge, real estate expertise, geographic coverage and our ability to complete transactions quickly will enable us to succeed in these acquisitions. When we purchase debt, we intend to underwrite the underlying real estate in the same manner and method as we use to underwrite direct real estate acquisitions with a view toward ultimately acquiring the real estate securing the purchased debt.

We will only make loans to other entities or other persons if they meet our underwriting and due diligence requirements. We will seek to obtain a customary lender's title insurance policy or commitment as to the priority of the mortgage or condition of the title.

As a general rule, we will not make mortgage loans if our total indebtedness would exceed 60% of the undepreciated book value of our real estate assets, unless we find substantial justification due to the presence of other underwriting criteria. We may find such justification in connection with the purchase of mortgage loans in cases in which we believe there is a high probability of our foreclosure upon the property in order to acquire the underlying assets and in which the cost of the mortgage loan investment does not exceed the appraised value of the underlying property.

In evaluating prospective mortgage loan investments, our management will consider factors such as the following:

the ratio of the amount of the investment in the loan to the value of the property by which it is secured;

the property's potential for capital appreciation;

expected levels of rental and occupancy rates;

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current and projected cash flow of the property;

potential for rental increases;

the degree of liquidity of the investment;

geographic location of the property;

the condition and use of the property;

the property's income-producing capacity;

the quality, experience and creditworthiness of the borrower;

general economic conditions in the area where the property is located;

potential impact on our REIT qualification; and

any other factors that our management believes are relevant.

We may purchase existing loans that were originated by other lenders. Our management will evaluate all potential mortgage loan investments to determine if the security for the loan and the loan-to-value ratio meets our investment criteria and objectives. We will inspect the property during the loan approval process. Most loans which we will consider for investment would provide for monthly payments of interest and some may also provide for principal amortization, although many loans of the nature which we will consider provide for payments of interest only and a payment of principal in full at the end of the loan term.

We do not have any policies directing the portion of our assets that may be invested in construction loans, loans secured by leasehold interests and second and wraparound mortgage loans. However, we recognize that these types of loans are riskier than first deeds of trust or first priority mortgages on income-producing, fee-simple properties, and expect to seek to minimize the amount of these types of loans in our portfolio, to the extent that we make or invest in mortgage loans. Our management will evaluate the fact that these types of loans are riskier in determining the rate of interest on the loans.

Our mortgage loan investments may be subject to regulation by federal, state and local authorities and subject to various laws and judicial and administrative decisions imposing various requirements and restrictions, including among other things, regulating credit granting activities, establishing maximum interest rates and finance charges, requiring disclosures to customers, governing secured transactions and setting collection, repossession and claims handling procedures and other trade practices. In addition, certain states have enacted legislation requiring the licensing of mortgage bankers or other lenders and these requirements may affect our ability to effectuate our proposed investments in mortgage loans. Commencement of operations in these or other jurisdictions may be dependent upon a finding of our financial responsibility, character and fitness. We may determine not to make mortgage loans in any jurisdiction in which the regulatory authority believes that we have not complied in all material respects with applicable requirements.

### ***Other Securities***

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While we intend to invest in commercial real estate, through acquisitions of properties and commercial mortgage loans, with the intent to own the assets, we may invest in other real estate related assets such as common and preferred stocks of public or private real estate companies.

Our management will have substantial discretion with respect to the selection of specific investments in other real estate related assets. Neither our declaration of trust, our bylaws, nor the governance documents of our Operating Partnership place any limit or restriction on:

the percentage of our assets that may be invested in any type of mortgage or in any single mortgage; or

the types of properties subject to mortgages in which we may invest.

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**Our Disposition Strategy**

Our general policy is to acquire properties primarily for generation of current income and long-term value appreciation. However, we seek to continually upgrade our asset base by opportunistically selling properties that do not have the potential to meet our Community Centered Property strategy and redeploying the sale proceeds into properties that fit our strategy. Some of our properties were acquired prior to our current management team and may not fit our Community Centered Property strategy, and we will look for opportunities to dispose of these properties as we continue to execute our strategy. A property may be sold before the end of the expected holding period if, in our judgment, the value of the property has reached its peak or might decline substantially or an opportunity has arisen to acquire other properties. We generally intend to hold our investments long-term; however, economic or market conditions may influence us to hold our investments for different periods of time.

The determination of whether a particular property should be sold or otherwise disposed of will be made after consideration of relevant factors, including prevailing economic conditions, with a view to achieving maximum capital appreciation. We cannot assure you that this objective will be realized. The selling price of a leased property will be determined in large part by the amount of net operating income of the property.

**Development and Construction of Properties**

We do not currently intend to engage in the acquisition of raw land for development or the acquisition of existing improved property for tear-downs and rebuilding. However, we intend to engage in selective redevelopment of existing improved properties where such redevelopment will reposition the property and/or increase its earning capacity and long-term returns on invested capital. We reposition properties and add value through renovating and re-tenanting to create Whitestone-branded Community Centered Properties. We seek to accomplish this by (1) stabilizing occupancy, with per property occupancy goals of 90% or higher; (2) adding leasable square footage to existing structures; (3) developing and building on excess land; (4) upgrading and renovating existing structures; and (5) investing significant effort in recruiting tenants whose goods and services meet the needs of the surrounding neighborhood.

**Borrowing Policies**

As of December 31, 2010, 15 of our 38 properties were not subject to mortgages. If we acquire a property for cash in the future, we will most likely fund a portion of the purchase price with debt. By operating and acquiring on a leveraged basis, we will have more funds available for investment in properties. We expect that initially we will purchase assets with cash, and subsequently obtain debt financing. This will allow us to make more investments than would otherwise be possible, resulting in a more diversified portfolio of assets and higher returns. However, this also subjects us to risks associated with borrowing. For example, our ability to increase our diversification through borrowing could be adversely impacted if banks and other lending institutions reduce the amount of funds available for loans secured by real estate. See Risk Factors Risks Associated with Our Indebtedness and Financing. When interest rates on mortgage loans are high or financing is otherwise unavailable on a timely basis, we may purchase certain properties for cash with the intention of obtaining a mortgage loan for a portion of the purchase price at a later time.

As a general policy we intend to maintain a ratio of total indebtedness to undepreciated book value of our real estate assets that is less than 60%. Concurrently with the completion of this offering, we intend to enter into a revolving credit facility which would be subject to our 60% leverage policy. As of December 31, 2010, our ratio of total indebtedness to undepreciated book value of our assets was 49%. We cannot assure you that we will be able to continue to achieve this objective.

By operating on a leveraged basis, we expect that we will have more funds available for investment in properties and other investments. This will allow us to make more investments than would otherwise be possible, resulting in a more diversified portfolio. Although we expect our liability for the repayment of indebtedness to be

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limited to the value of the property securing the liability and the rents or profits derived therefrom, our use of leveraging increases the risk of default on the mortgage payments and a resulting foreclosure of a particular property. See Risk Factors Risks Associated with Real Estate. To the extent that we do not obtain mortgage loans on our properties, our ability to acquire additional properties will be restricted. We will use our best efforts to obtain financing on the most favorable terms available to us. Lenders may have recourse to assets not securing the repayment of the indebtedness.

We may reevaluate and change our debt policy in the future without a shareholder vote. Factors that we would consider when reevaluating or changing our debt policy include then-current economic conditions, the relative cost of debt and equity capital, any acquisition opportunities, the ability of our properties to generate sufficient cash flow to cover debt service requirements, the appreciation of the market value of the property and other similar factors. Further, we may increase or decrease our ratio of debt to undepreciated book value of our real estate assets in connection with any change of policy.

We may refinance properties during the term of a loan in limited circumstances, such as when a decline in interest rates makes it beneficial to prepay an existing mortgage, when an existing mortgage matures or if an attractive investment becomes available and the proceeds from the refinancing can be used to purchase such investment. The benefits of the refinancing may include an increased cash flow resulting from reduced debt service requirements, an increase in dividend distributions from proceeds of the refinancing, and an increase in property ownership if refinancing proceeds are reinvested in real estate.

**Securities of or Interests in Persons Primarily Engaged in Real Estate Activities and Other Issuers**

We may acquire securities of entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities and investing in other companies or funds owning securities. However, all acquisitions of securities of such entities will be subject to the percentage ownership limitations and gross income tests necessary for REIT qualification. We refer you to the Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT section of this prospectus for a discussion of these tests. We may acquire all or substantially all of the securities or assets of REITs or similar entities where such investments would be consistent with our investment policies. We anticipate that we will only acquire securities or other interests in issuers engaged in commercial real estate activities involving retail, office or mixed retail-office properties. We may also invest in entities owning undeveloped acreage. Neither our declaration of trust nor our bylaws place any limit or restriction on the percentage of our assets that may be invested in securities of or interests in other issuers. The governance documents of our Operating Partnership also do not contain any such restrictions.

**Equity Capital Policies**

In the event that our Board determines to raise additional equity capital, it has the authority, without shareholder approval, to issue additional common shares or preferred shares of beneficial interest. Additionally, our Board could cause our Operating Partnership to issue OP units which are convertible into our common shares. Subject to limitations contained in the organizational and governance documents of our Operating Partnership and us, our Board could issue, or cause to be issued, such securities in any manner (and on such terms and for such consideration) it deems appropriate, including in exchange for real estate. We have issued securities in exchange for real estate and we expect to continue to do so in the future. Existing shareholders have no preemptive right to purchase such shares in any offering, and any such offering might cause a dilution of a shareholder's initial investment.

**Other Policies and Investments**

We continually review our investment activity to attempt to ensure that we do not come within the application of the Investment Company Act of 1940, as amended, or the Investment Company Act. Among other

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things, the Board will monitor the proportion of our portfolio that is placed in various investments so that we do not come within the definition of an investment company under the Investment Company Act. We generally do not intend to:

invest in the securities of other issuers for the purpose of exercising control over an issuer (except as described above);

underwrite securities of other issuers; or

actively trade in loans or other investments.

Subject to certain restrictions we are subject to in order to qualify to be taxed as a REIT, we may make investments other than as previously described, although we do not currently intend to do so. We have authority to purchase or otherwise reacquire our common shares or any of our other securities. We have no present intention of repurchasing any of our common shares, and we would only take such action in conformity with applicable federal and state laws and the requirements for qualifying as a REIT under the Code.

Other than as disclosed elsewhere in this document relative to transactions with related parties, we have not made any material loans to third parties and we have no present intention to do so. However, we may in the future make loans to third parties, including, without limitation, loans to joint ventures in which we participate. We have not engaged in the trading, underwriting or agency distribution or sale of securities of other issuers, and we do not intend to do so in the future.

We are subject to the full information reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Pursuant to these requirements, we file periodic reports, proxy statements and other information, including certified financial statements, with the Securities and Exchange Commission, or the SEC. See [Where You Can Find More Information](#).



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We operate under the direction of our Board. Our Board is responsible for the management of our business and affairs. Our declaration of trust provides that the number of trustees may be determined pursuant to our bylaws, and our bylaws provide that such number may be established, increased or decreased by a majority of our entire Board. However, under our bylaws, our Board must always have at least one member and no more than fifteen members. Our Board is divided into three classes, with each trustee holding office for three years and until his successor is duly elected and qualifies. We currently have a total of five members on our Board. We believe a majority of our Board meets the independence requirements of the NYSE Amex. Our executive officers serve one-year terms at the pleasure of our Board. The following sets forth certain information about our trustees, executive officers and certain other officers:

| <b>Name</b>          | <b>Age</b> | <b>Position(s)</b>  |
|----------------------|------------|---|
| James C. Mastandrea  | 67         | Chairman of our Board of Trustees and Chief Executive Officer |
| John J. Dee          | 60         | Chief Operating Officer                                       |
| David K. Holeman     | 47         | Chief Financial Officer                                       |
| Valarie L. King      | 49         | Sr. Vice President Regional Director                          |
| Daniel E. Nixon, Jr. | 62         | Sr. Vice President Regional Director                          |
| Gregory J. Belsheim  | 65         | Sr. Vice President Human Resources                            |
| Bradford D. Johnson  | 52         | Director of Acquisitions and Dispositions                     |
| Charles M. Taylor    | 55         | Corporate Counsel   |
| Anne Gregory         | 53         | Vice President, Marketing and Investor Relations              |
| Daryl J. Carter      | 55         | Trustee   |
| Daniel G. DeVos      | 53         | Trustee   |
| Donald F. Keating    | 78         | Trustee   |
| Jack L. Mahaffey     | 79         | Trustee   |

*James C. Mastandrea* has been our Chairman and Chief Executive Officer since October 2006. Mr. Mastandrea has over 35 years of experience in the real estate industry and 17 years serving in high level positions of publicly traded companies. He has also served since 2003 as the President, Chief Executive Officer and Chairman of the Board of Trustees of Paragon Real Estate Equity and Investment Trust, a real estate company currently focused on value-added real estate and investments in shares of publicly-traded real estate investment trusts, and a publicly traded company on the former American Stock Exchange until 2006. Mr. Mastandrea has also served since 1978 as the Chief Executive Officer/Founder of MDC Realty Corporation, a privately held residential and commercial real estate development company. From 1999 to 2002, Mr. Mastandrea served as Chief Executive Officer of Eagle's Wings Aviation Corporation, an entity formed to purchase a troubled aviation services business. At the time of the purchase, the business was in default on debt obligations. Following the September 11, 2001 terrorist attacks, the business was further adversely affected and in March 2002, Eagle's Wings Aviation Corporation filed for protection under Chapter 11 of the federal bankruptcy laws. From 1994 to 1998, Mr. Mastandrea served as Chairman and Chief Executive Officer of First Union Real Estate Investments, a NYSE-listed real estate investment trust. Mr. Mastandrea also served in the U.S. Army as a Military Police Officer. Mr. Mastandrea currently is a director of Cleveland State University Foundation Board and a member of the investment committee, a director of University Circle Inc. Board, Cleveland, Ohio, and a member of the real estate committee, and a director of the Calvin Business Alliance Board of Calvin College, Grand Rapids, Michigan. Mr. Mastandrea regularly lectures to MBA students at the University of Chicago and Rice University and also regularly presents to institutional investors in the U.S. and Europe.

*John J. Dee* has served as our Chief Operating Officer since 2006. Mr. Dee has also served since 2003 as the Senior Vice President, Chief Financial Officer and member of the Board of Trustees of Paragon Real Estate Equity and Investment Trust. Prior to joining us, Mr. Dee served from 2002 to 2003 as Senior Vice President and

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Chief Financial Officer of MDC Realty Corporation, a privately held residential and commercial real estate development company. From 2000 to 2002, he also served as Director of Finance and Administration for Frantz Ward, LLP. From 1978 to 2000, he held several management positions at First Union Real Estate Investments, a NYSE-listed REIT, and most recently served as Senior Vice President and Chief Accounting Officer.

*David K. Holeman* is our Chief Financial Officer and has served in this capacity since 2006. Mr. Holeman also served as the Chief Financial Officer of our former external advisor. Prior to joining us, Mr. Holeman served as Vice President and Chief Financial Officer of Gexa Energy, a NASDAQ listed retail electricity provider from 2004 to 2006, and as Controller and Chief Financial Officer of Houston Cellular Telephone Company from 1994 to 2003.

*Valarie L. King* is our Senior Vice President of Property Management and has served in this capacity since 2006. From 2000 to 2006, Ms. King also held several management positions, and most recently served as Vice President of Property Management for our former external advisor. Ms. King has over 15 years of property management experience in Houston, Texas. From 1986 until 1989, she was Property Manager at Helmsley Spear National Realty, a New York-based company, where she was responsible for running the Houston office, including property management, leasing and construction.

*Daniel E. Nixon, Jr.* is our Senior Vice President of Leasing and Redevelopment and has served in this capacity since 2007. Prior to joining us, Mr. Nixon served as the Executive Vice President for Hull Storey Retail Group, LLC, owner of 17 enclosed malls, totaling 11 million square feet from 2000 to 2007. He also held several management positions and most recently Executive Vice President, Director of Retail at First Union Real Estate Investments, a NYSE-listed REIT, from 1978 until 1999.

*Gregory J. Belsheim* is our Sr. Vice President of Human Resources. Mr. Belsheim joined us in 2006 and has more than 25 years of human resources management experience in the retail, wholesale and manufacturing industries. From 1997 to 2005, Mr. Belsheim was Vice President of Human Resources of Rice Epicurean Markets, the oldest family-owned supermarket chain in Houston.

*Bradford D. Johnson* is our Director of Acquisitions and Dispositions. Mr. Johnson joined us in November 2010 and has over 25 years of commercial real estate experience and has previously held executive and management positions with other REITs and real estate development companies. Most recently, he served as Vice President of Acquisitions and Development with Campus Living Villages Funds Management REIT in Houston. His background includes extensive experience in real estate financial analysis related to acquisitions, redevelopment and dispositions. Mr. Johnson is a graduate of Baylor University, where he earned his B.A. in Business Administration.

*Charles M. Taylor* is our Corporate Counsel. He joined us in 2009 and is responsible for supervising and directing our corporate legal functions. Mr. Taylor has over 25 years of broad-based experience in the legal, financial and commercial real estate fields. Prior to joining Whitestone REIT, Mr. Taylor served as General Counsel of AmREIT, a real estate investment trust based in Houston, Texas. Between 1993 and 2001 Mr. Taylor served as Assistant General Counsel and then Senior Vice President of Administration for Bank United, Houston Texas. During his tenure at Bank United, Mr. Taylor directed a corporate reorganization and technology project and negotiated the acquisition of over \$20 billion in mortgage servicing rights. Mr. Taylor is a member of the Texas and Mississippi Bars and is a licensed Texas Real Estate Broker. He is a graduate of the University of Mississippi with a Bachelors degree in English with a minor in accounting and a Juris Doctorate degree from the University of Mississippi School of Law.

*Anne Gregory* is our Vice President of Marketing and Investor Relations. Ms. Gregory joined us in 2008. With over 25 years of management experience in corporate communications, she has directed marketing and employee communications, media and public relations initiatives, as well as investor relations for both public and privately held companies.

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*Daryl J. Carter* has been a member of our Board since February 2009. Mr. Carter founded and since 2007 has served as Chairman and CEO of Avanath Capital Partners, LLC, an investment firm focused on urban-themed real estate and mortgage investments. From 2005 to 2007, Mr. Carter was an Executive Managing Director of Centerline Capital Group, or Centerline, a subsidiary of Centerline Holding Company (NYSE), and head of the Commercial Real Estate Group. From 2005 to 2007, he was also the President of American Mortgage Acceptance Corporation, a publicly-held, commercial mortgage lender (AMEX) that was externally managed by Centerline. Mr. Carter became part of Centerline when his company, Capri Capital Finance, or CCF, was acquired by Centerline in 2005 and stayed with Centerline until 2006. Mr. Carter co-founded and served as Co-Chairman of both CCF and Capri Capital Advisors in 1992. He was instrumental in building Capri to a diversified real estate firm with \$8 billion in real estate equity and debt investments under management. Prior to Capri, Mr. Carter was Regional Vice President at Westinghouse Credit Corporation in Irvine and a Second Vice President at Continental Bank in Chicago. Since 2003, Mr. Carter has served as a trustee of Paragon Real Estate Equity and Investment Trust, traded on the former American Stock Exchange until 2006, Trustee of the Urban Land Institute, Treasurer and Executive Committee Member of the National Multifamily Housing Association. He has also served as Chairman of the Commercial Board of Governors of the Mortgage Bankers Association. Mr. Carter serves on the Dean's Advisory Council of the M.I.T. Sloan School of Management.

*Daniel G. DeVos* has been a member of our Board since February 2009. Since 1993, Mr. DeVos has served as Chairman of the Board and Chief Executive Officer of DP Fox Ventures, LLC, a diversified management enterprise with investments in real estate, transportation, and sports teams. Since 1999, Mr. DeVos has served as the President and Chief Executive Officer of Fox Motors, based in Grand Rapids, Michigan, majority owner of the Grand Rapids Griffins (AHL) and has an ownership interest in the Orlando Magic (NBA). Mr. DeVos has served as Vice Chairman of the RDV Corporation Board since 2009 and as a director since 1991, and since 1990 has served as a director and currently serves on the Audit Committee of Alticor, Inc., the parent of Amway Corporation, located in Ada, Michigan. Since March 2003, Mr. DeVos has served as a trustee of Paragon Real Estate Equity and Investment Trust, traded on the former American Stock Exchange until 2006, and served as a trustee of First Union Real Estate Investments, an NYSE-listed REIT, from 1994 to 1998.

*Donald F. Keating* has been a member of our Board since 2008. Mr. Keating was formerly the Chief Financial Officer of Shell Mining Company. Mr. Keating retired from Shell Mining Company in 1992 and continued to provide consulting services to Shell Oil until 2002. Since 2002, Mr. Keating has managed his personal investments. Mr. Keating graduated from Fordham University with a Bachelor of Science Degree in Finance and served in the United States Marine Corps as infantry company commander. He is a former board member of Billiton Metals Company, R & F Coal Company and Marrowbone Coal Company.

*Jack L. Mahaffey* has served on our Board since 2000. Mr. Mahaffey was formerly the President and Chief Executive Officer of Shell Mining Company. Since retiring from Shell Mining Company in 1991, Mr. Mahaffey has managed his personal investments. Mr. Mahaffey served in the United States Air Force and is a former board member of the National Coal Association and the National Coal Counsel.

**Qualifications of Trustees**

When considering whether our trustees have the experience, qualifications, attributes and skills, taken as a whole, to enable our Board to satisfy its oversight responsibilities effectively in light of our operational and organizational structure, the Nominating and Corporate Governance Committee and the Board focused primarily on the information discussed in each of the individual biographies set forth above and on the following particular attributes:

Mr. Carter: The Board considered his management experience with a number of financial and real estate entities and determined that his extensive financial background and demonstrated leadership skills provide exceptional qualification to perform oversight functions as a member of our Audit Committee and as a member of our Board.

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Mr. DeVos: The Board considered his extensive and diverse business experience within and outside the real estate industry and concluded that his leadership skills in business and non-profit management make him exceptionally qualified to serve in the capacity of Chairman of the Nominating and Corporate Governance Committee and as a member of the Compensation Committee and our Board.

Mr. Keating: The Board considered his educational and professional experience in the field of finance and accounting as well as supervisory roles in the accounting industry and determined that his experience and skills in these industries facilitate his oversight and administration of our accounting and financial reporting practices, risk management efforts and compliance with applicable regulatory standards in the capacity of Chairman of the Audit Committee, as a member of our Nominating and Corporate Governance and Compensation Committees.

Mr. Mahaffey: The Board considered his demonstrated ability of oversight and decision-making functions during his tenure within the petroleum industry and his experience in managing investments and determined that his expertise in these areas enhances his oversight and administration of our compensation programs in the capacity of Chairman of the Compensation Committee and as a member of our Nominating and Governance Committee, Audit Committee and our Board.

Mr. Mastandrea: The Board considered his prior service to Whitestone as its Chairman and Chief Executive Officer, his thirty-five years of experience in the commercial real estate industry, and his seventeen years serving in high level positions of publicly traded companies, and determined that his intimate knowledge of Whitestone, his extensive experience and familiarity with the commercial real estate industry and public companies are critical to the oversight of our strategic initiatives and the evaluation of our operational performance in his capacity as Chief Executive Officer and Chairman of our Board.

**Corporate Governance Profile**

We have structured our corporate governance in a manner we believe closely aligns our interests with those of our shareholders. The corporate governance initiatives that we have enacted include the following:

our Board is staggered, with two of our trustees subject to election every year and each of our trustees subject to re-election every three years;

of our five trustees, four have been determined by us to be independent pursuant to the NYSE Amex's listing standards;

we have opted out of the Maryland business combination statute; and

we do not have a shareholder rights plan.

**Committees of the Board of Trustees**

Our entire Board considers all major decisions concerning our business, including any property acquisitions. However, our Board has established committees so that certain functions can be addressed in more depth than may be possible at a full board meeting. Our Board has established three permanent committees, each comprised solely of independent trustees: the Audit Committee, the Nominating and Corporate Governance Committee and the Compensation Committee. The charter for each of these committees is posted on the Corporate Governance section of our website at [www.whitestonereit.com](http://www.whitestonereit.com).

***Audit Committee***

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Our Audit Committee consists of Daryl J. Carter, Donald F. Keating and Jack Mahaffey with Mr. Keating serving as chairman. Our Board has determined that Mr. Keating, chairman and a former chief financial officer, is an audit committee financial expert, as defined by the rules of the SEC. Each member of the committee is independent under the NYSE Amex listing standards and applicable SEC rules.

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The primary purposes of our Audit Committee are:

overseeing our accounting and financial reporting process, the audits of our financial statements; and

assisting our Board in monitoring the following:

the integrity of our financial statements and financial reporting processes and systems of internal controls;

the qualifications and independence of our independent accountants;

the performances of our independent accountants; and

our compliance with legal and regulatory requirements.

The committee also prepares a report each year for inclusion in our annual proxy statement in accordance with the rules of the SEC.

***Nominating and Corporate Governance Committee***

The committee currently consists of Daniel G. DeVos, Donald F. Keating and Jack L. Mahaffey, with Mr. DeVos serving as chairman. Each member of the committee is independent under the NYSE Amex listing standards and applicable SEC rules.

The primary purposes of the Nominating and Corporate Governance Committee are:

identifying individuals qualified to become trustees;

recommending nominees for committees of our Board; and

overseeing matters concerning corporate governance practices.

***Compensation Committee***

The committee currently consists of Daniel G. DeVos, Donald F. Keating and Jack L. Mahaffey, with Mr. Mahaffey serving as chairman. Each member of the committee is independent under the NYSE Amex listing standards and applicable SEC rules. The primary purposes of our Compensation Committee are:

assisting our Board in discharging the Board's responsibilities relating to compensation and our overall compensation and benefit structure; and

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producing an annual report on executive compensation for inclusion in our annual meeting proxy statement in accordance with SEC rules.

### **Code of Business Conduct and Ethics**

Our Board has adopted a code of business conduct that is applicable to all members of our Board, our executive officers and our employees. We have posted our Code of Business Conduct and Ethics on the Corporate Governance section of our website at [www.whitestonereit.com](http://www.whitestonereit.com).

### **Board Leadership Structure**

Our Board believes that our Chief Executive Officer is best situated to serve as Chairman because he is the trustee most familiar with the company's business and industry, and most capable of effectively identifying strategic priorities and leading the discussion and execution of strategic initiatives. Independent trustees and management have different perspectives and roles in strategy development. Our independent trustees bring experience, oversight and expertise from outside our company and industry, while the Chief Executive Officer

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brings company-specific experience and expertise. We believe that consolidating our leadership structure without a lead independent trustee provides an efficient and effective management model which fosters direct accountability, effective decision-making and alignment of corporate strategy between our Board and management.

One of the key responsibilities of the Board is to develop strategic direction and hold management accountable for the execution of strategy once it is developed. The Board believes the combined role of Chairman and Chief Executive Officer is in the best interest of shareholders because it provides the appropriate balance between strategy development and independent oversight of management.

**Risk Management**

Our Board has an active role, as a whole and also at the committee level, in overseeing management of our risks. Our Board regularly reviews information regarding our credit, liquidity and operations, as well as the risks associated with each. Our Compensation Committee is responsible for overseeing the management of risks relating to our executive compensation plans and arrangements, as more fully described in Executive Compensation Compensation Discussion and Analysis Compensation Related Risk Management. Our Audit Committee oversees management of financial risks. Our Nominating and Corporate Governance Committee manages risks associated with the independence of the Board and potential conflicts of interest. While each committee is responsible for evaluating certain risks and overseeing the management of such risks, the entire Board is regularly informed through committee reports about such risks. Specific actions that have been taken by the Board include:

A limitation on expenditures of \$1.0 million without Board approval.

A Board-level Investment Committee that reviews and approves all acquisition decisions.

A limitation on base salary to \$100,000 for any employee hired unless our Board approves a greater amount.

The absence of golden parachute agreements with any named executive officer to help reduce influence of a potential merger or venture decision.

Compliance policy (in place since 2007) regarding insider information, disclosure of non-public information, and limitation on employee and trustee transactions of our shares.

**Compensation Committee Interlocks and Insider Participation**

Our Compensation Committee is currently comprised of Messrs. DeVos, Keating, and Mahaffey. None of the members of our Compensation Committee during 2010 is or has served as an officer or employee for us and none of our executive officers has served on the board of directors of compensation committee of any company whose executive officers served on our Compensation Committee or our Board.



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**EXECUTIVE COMPENSATION**

**Compensation Discussion and Analysis**

**Introduction**

This Compensation Discussion & Analysis, or CD&A, focuses on our Chief Executive Officer, Chief Financial Officer and our three other most highly compensated executive officers, which we refer to as the named executive officers, or NEOs, about important information and summary material regarding the compensation levels, incentive programs, incentive awards, compensation policy and governance. The CD&A presents the philosophy, methods and processes that our Compensation Committee, or the Committee, uses to make decisions regarding NEO compensation.

The Committee believes that the information presented herein demonstrates that our NEO team has accomplished significant goals on behalf of our shareholders in 2010, and has done so without cash incentives and with below market salaries. The NEOs' willingness to voluntarily reduce their base salaries to reduce costs, and expand their responsibilities to maintain efficient operations with reduced manpower, is a powerful statement of commitment to the long term success of our company and our shareholders. Further, we believe the interests of the NEOs are strongly aligned with those of our shareholders, as our Long-Term Equity Incentive Ownership Plan, or the Plan, approved by shareholders in 2008, which provides for long-term performance-based vesting of our shares, is currently the primary component of our incentive-based compensation. We believe the information in this CD&A also demonstrates that our compensation governance program is commensurate with our company's growth and follows the best practices in the industry.

The Committee's charter specifies responsibility for establishing, implementing and continually monitoring our executive compensation programs. Additionally, the Committee is responsible for the assessment of executive compensation relative to our performance, the rationale in ensuring that the application of our compensation plans to specific executive incentive awards is justifiably appropriate, and making all compensation-related recommendations to our Board.

The material presented in this CD&A relates to: (1) all compensation components for our five NEOs, and (2) to the extent required, an understanding of our executive compensation and Committee activities, responsibilities and decisions, and provides summary information on the following:

our overall compensation programs and characteristics;

performance evaluation methodology and results;

compensation plans adopted and that may be considered in the future; and

comparative market compensation assessment.

Throughout this discussion, James C. Mastandrea, our Chairman and Chief Executive Officer, John J. Dee, our Chief Operating Officer, David K. Holeman, our Chief Financial Officer, Valarie L. King, our Senior Vice President - Regional Director (Southwest) and Daniel E. Nixon, Jr., our Senior Vice President - Regional Director (Texas and Central) are the executives referred to as NEOs.

**Highlights and Summary**

2010 was a challenging yet successful year for our company because we achieved one of our major goals of having our shares become publicly traded through a public offering and concurrent listing of our Class B common shares on a stock exchange. This allowed for a broader shareholder base, institutional investor interest, shareholder liquidity and a market-based indication of value.



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Executive compensation for 2010 reflected many of the policy actions initiated in 2009 to reduce costs during the economic downturn. The highlights of 2010 include:

Base salaries remained at the reduced levels of October 2009 when the NEOs voluntarily agreed to reduce their base salaries by 12.5%.

No bonus payments were made for 2010 performance, except to the CFO recognizing his contributions in the successful public offering.

Increased FFO in 2009, attained through both focused operations management and acquisitions, triggered in March 2010 the vesting of the first 10% of long-term incentive awards granted pursuant to the Plan.

All perquisites and miscellaneous expenses that were reduced or eliminated in 2009 remained even in 2010.

No additional incentive or compensation programs were adopted in 2010.

No changes to our existing incentive program were made.

The NEOs, as well as all other participants in the Plan, elected to return a portion of the shares that vested in March 2010 to pay their estimated tax obligations and were granted an equal number of restricted shares to replace the shares returned to the company, which will vest equally over three years.

We believe the actions of the company and the Committee in 2010 reflect not only the best interests of the shareholders but also many of the industry best practices in compensation governance, including:

A general policy of pay-for-performance and an alignment of the interests of our NEOs with the economic interests of our shareholders.

Three levels of compensation – base salary and two levels of variable compensation, comprised of a short-term annual bonus program and a long-term incentive program earned over many years.

Elimination of cash bonuses during a period of downward economic and operating pressure.

Salary reductions for NEOs, as well as other employees, to reduce general and administrative expenses.

Reorganization of operating functions and combining of responsibilities.

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No reinstatement of base salaries to pre-reduction levels of 2009, although many companies in the industry did increase salaries in 2010.

Continuous oversight, evaluation and monitoring of general economic conditions, the markets associated with our assets, our tenant base, and general operating and financial policies to determine if the actions/decisions which drive incentive compensation would involve any unnecessary or excessive risk.

### **Compensation Strategy and Philosophy**

Total compensation for our NEOs is highly weighted to long-term incentive opportunity and highly correlated with increasing shareholder value, consistent with the overall philosophy and compensation strategy adopted by the Committee.

The Committee believes that the most effective executive compensation strategy is one that encourages entrepreneurship, which is a core driver of creating real estate value and is designed to target specific annual and long-term goals defined by management and approved by our Board, and aligns the economic interests of company associates with shareholders. This strategy is designed to reward the achievement of performance above established goals that contribute to increased shareholder value.

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The Committee believes that an effective executive compensation strategy has several components aimed at specific objectives and timeframes.

*Base Salary.* The Committee believes the base salary should be reflective of position, responsibility and experience, and correlated with market-based salary levels for similar positions with competitor companies. The Committee believes that the 50th percentile level of our competitive market is the appropriate benchmark to target for base salary at this time for our growth and size, however members of our senior management, including our Chief Executive Officer, Chief Operating Officer and Chief Financial Officer, fall below that level.

*Annual Incentive Bonus.* A bonus provides an opportunity for selected employees (and potentially all employees) to receive an annual cash (or potentially cash and shares) award based on the achievement of specific organization, operating and financial goals and objectives at three levels during any fiscal year of our operation:

corporate performance;

business unit (functional area) performance; and

individual performance.

Currently, we have not formalized an annual bonus incentive plan, but may design a plan in the future. The Committee believes that any design of an annual incentive plan should establish a threshold, target and maximum incentive opportunity for participants. Additionally, the annual incentive plan should be designed to provide an effective weighting and performance measurement system for corporate, business unit (functional), and individual objectives, and be flexible to adapt to our changing needs and circumstances. Because of the current economic conditions, annual incentive bonuses were generally eliminated subsequent to March 2008.

*Long-Term Equity Incentive Plan.* In July 2008, our shareholders approved the Plan to provide equity-based grants as incentive compensation to our employees. A long-term incentive plan is an opportunity for our employees to receive grants of equity (restricted shares and restricted share units) that vest upon the achievement of long-term incremental value for the company and our shareholders. This plan is designed to encourage entrepreneurship and align the interests of our employees with our long-term strategy and is expected to be an important component of total compensation and key retention of participants.

*Benefits and Other Perquisites.* We provide the NEOs, as well as all other employees, a full range of benefits related to insurances for health and security. These benefit plans, and other perquisites to key employees, are consistent with our competitors for experienced executives and are an important component of retention.

The Committee charter outlines the Committee's key objectives in the governance of compensation plan development and award decisions, including its major responsibilities to evaluate our performance and executive compensation and the relationship between them in any year and over time, one of the fundamental rationales for incentive compensation. Additionally, the Committee must ensure to the extent possible that we maintain our ability to attract and retain employees in key positions and that compensation opportunities to key employees remain competitive relative to those of similarly situated executives of our peer companies. To that end, the Committee believes executive compensation packages currently provided and to be developed will reflect the elements outlined above and have specific performance measurement and accountability procedures to correlate with incentive awards.

**Compensation Objectives**

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In association with the overall compensation strategy and philosophy outlined above, the Committee defines its core values and fundamental guiding principles relating to executive compensation as follows:

*Compensation is linked to performance.* Executive pay is linked to the company's performance and performance of the NEOs. NEOs should be rewarded for achieving annual strategic, operating, and

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financial goals. Goals should be defined and directed by our strategic plan. Long-term compensation should promote retention and align the interests of management and employees with the long-term interests of shareholders.

*Compensation elements should be appropriately balanced.* The mix of compensation elements will vary with respect to each NEO's position and the company's circumstances. Base salary and benefits are designed to attract and retain experienced key personnel. Annual incentives emphasize annual objectives, while long-term compensation emphasizes growth in profitability and shareholder value. The proportion of guaranteed and at risk (incentive) compensation should be structured by position consistent with responsibility, target total compensation level and market benchmarks. Additionally, a severance benefits program is appropriate to encourage retention and objectivity in connection with events that may trigger a change in control of us or other circumstances of separation. We do not currently have a general severance benefits program, but may develop one in the future.

*Compensation should be fair and competitive.* The Committee strives to establish fair and competitive compensation for the NEOs (and other management), and does so by the process and assessment methods as described in the Committee charter.

*Executive stock ownership is expected.* The Committee believes that all executive officers (and to the extent possible, all employees) should also be our shareholders. The Committee, as well as the NEOs, expect compensation in the form of awards pursuant to the Plan to help achieve this objective.

*The Committee and Board exercise independent judgment.* On behalf of our shareholders, the Committee and our Board ensure that executive compensation is appropriate and effective, and that all assessments, engagement of advisors, analysis, discussion, rationale and decision making are through the exercise of independent judgment.

*Compensation may be structured to meet corporate tax and accounting rules.* We generally structure the NEO compensation so that all elements of pay are tax deductible to us. Section 162(m) of the Code limits the amount of compensation we may deduct in any fiscal year. Compensation above these limits can be deducted if it is awarded under a shareholder approved performance-based incentive compensation plan. Under an annual incentive plan, awards which would limit the deductibility of compensation by us may (upon approval of the Committee) be delayed until a period where the deduction can be taken. We adhere to all FASB requirements related to the accounting treatment and reporting of compensation expense and valuation.

**Roles and Responsibilities in Compensation Decisions**

The Committee is specifically responsible for compensation decisions related to the Chairman and Chief Executive Officer.

The Committee reviews, assesses and approves recommendations from the Chairman and Chief Executive Officer regarding any determination of base salary and bonuses to all officers, including the other NEOs. The Committee's philosophy and strategy, and the programs adopted by our Board, establish the general parameters within which the Chairman and Chief Executive Officer determines the recommended compensation for the other NEOs.

James C. Mastandrea, Chairman and Chief Executive Officer, and John J. Dee, Chief Operating Officer, annually review the performance of our other executive officers. The conclusions reached and recommendations made based on these reviews, including base salary adjustments as well as bonuses, are presented to the Committee. The Committee can exercise its discretion in modifying any recommended salary adjustment or bonus award. The Committee also evaluates the performance of our NEOs.

The Committee hires an independent outside compensation consultant familiar with the real estate industry, generally, and our competitors, specifically, for use in the assessment of market compensation for the NEOs and

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the general market conditions as related to compensation policy and practices in the industry and among our competitors. This information is used by the Committee to judge industry performance as it relates to the company and to address questions related to effective compensation plans and associate retention.

The Chairman and Chief Executive Officer and Chief Operating Officer may also hire independent compensation advisors (other than those hired by the Committee) in conjunction with the Committee to provide the Committee with additional information for compensation levels and programs for the Committee's consideration, but did not do so in 2010.

**Setting Executive Compensation**

Based on the strategy and philosophy described above, the Committee has structured our annual and long term executive compensation to motivate the executive officers to achieve our business goals and reward the executive officers for achieving those goals. In 2008, the Committee engaged CEL & Associates, Inc., or CEL, an independent executive compensation consulting firm with specific expertise in the real estate industry, to conduct a review and benchmarking of total compensation levels for our executive officers. The Committee again engaged CEL in 2011, both to review and analyze our 2010 NEO compensation, as well as to assist the Committee in setting compensation for 2011. See 2011 Compensation Actions. CEL provided the Committee with relevant market data and benchmarking recommendations for consideration by the Committee. In addition to market benchmarking, CEL has previously provided annual and long-term plan alternatives to consider when designing and adopting compensation programs for our NEOs. The Committee also independently reviews public disclosures made by companies in the real estate industry and published surveys with particular focus on companies of similar size within our industry.

As a part of the compensation decision making process, the Committee compares each element comprising total compensation for our NEO positions against similar positions in a peer group of other REITs, or the Compensation Peer Group. The Compensation Peer Group, which is periodically reviewed and updated by the Committee, consists of companies with which we believe we compete for talent, investment opportunity, and shareholder investment.

In 2008, the Committee utilized the CEL analysis to set 2008 compensation, which remained unchanged in 2009. In October 2009, the NEOs voluntarily agreed to reductions in their base salaries of 12.5%. The NEOs voluntarily agreed to continue the salary reductions in 2010. Therefore, based upon economic conditions, our performance goals and the recommendations of the NEOs, the Committee made no changes to the reduced compensation levels in setting 2010 executive compensation.

The 2008 analysis included a total of seventeen (17) public companies and nine (9) private companies. The public companies included the following, though some of them have since been acquired or merged:

|                                   |                                   |
|-----------------------------------|-----------------------------------|
| Acadia Realty Trust               | Marcus Corporations               |
| AmREIT                            | PS Business Parks, Inc.           |
| Capital Lease Funding, Inc        | Ramco-Gershenson Properties Trust |
| Cedar Shopping Centers, Inc.      | Republic Property Trust           |
| Columbia Equity Trust             | Saul Centers, Inc.                |
| First Potomac Realty Trust        | Spirit Finance Corporation        |
| Government Properties Trust, Inc. | Thomas Properties Group, Inc.     |
| Kite Realty Group Trust           | Urstadt Biddle Properties, Inc.   |
|                                   | Winthrop Realty Trust             |

We compete with many companies for experienced executives, and the Committee generally has set compensation for the NEOs relative to the range of compensation paid to similarly situated executives of the companies comprising the Compensation Peer Group. Variations to this objective may occur as dictated by the experience level of the individual, market factors, and circumstances particular to us.



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The philosophy of the Committee is to provide programs that offer a significant percentage of total compensation from performance-based incentives. Alignment of key management and employees with our growth and the creation of value is the guiding principle of our compensation program. Currently, given our limited operating history as an internally managed REIT, policies, specific incentive compensation targets and the mix between cash and equity incentives for key employees will continue to evolve.

The Committee will continue to review a variety of information, including that provided by CEL, to determine the appropriate level and mix of incentive compensation. Income from incentive compensation is realized as a result of our performance and that of individual performance, measured against established goals. The Committee believes that our NEOs must think and act like owners to create value, and therefore a significant portion of total compensation to our NEOs should be in the form of share-based long-term incentive compensation. A comprehensive incentive compensation program is a key strategic plan element for us. With the implementation of the Plan in 2009, the Committee believes the NEOs have a long-term equity program that meets the philosophy of the Committee to link executive compensation to our increased value. The Committee and management continue to evaluate annual incentive plans as part of the comprehensive compensation program.

**Compensation Related Risk Management**

Incentive compensation plans and other opportunities for additional compensation are triggered by financial and operating results and achieved by the behavior and decisions of management. As a part of compensation governance, the Committee must take an oversight role to monitor the actions of management and the opportunities in compensation presented to management to ensure that incentive programs are not creating an environment of excessive risk taking which could be detrimental to shareholders. This risk management aspect of the Committee's responsibility is an evolving industry responsibility and focus. The Committee has taken certain steps to establish policies that will limit and manage the risk of management actions as well as measure and monitor business activities that can indicate risk and risk management needs. The relatively smaller size of our company at this time makes these risk management policies easier to manage. However, as the company grows, the Committee will consider and adopt policies as needed to continue to ensure that decisions associated with incentive compensation opportunity do not exceed the intended risk level for the company.

**Equity Compensation Plans**

At our annual meeting of shareholders held on July 29, 2008, our shareholders approved the Plan. The purpose of the Plan is to promote our interests and the interests of our subsidiaries and our shareholders by (i) attracting and retaining key officers with strong leadership, employees, and trustees of, and consultants to, us and our subsidiaries and affiliates; (ii) motivating these individuals by means of performance-related incentives to achieve long-range performance goals; (iii) enabling these individuals to participate in our long-term growth and financial success; (iv) encouraging ownership in our equity by these individuals; and (v) linking their compensation to our long-term interests and the interests of our shareholders. The Plan will be interpreted in a manner consistent with the requirements of performance-based compensation under Section 162(m) of the Code for any awards granted under the Plan that are intended to comply with the requirements of that particular section.

Under the Plan, as amended, awards may be made in our Class B common shares or OP units, which may be redeemed for cash or, at our option, our Class A common shares. The Plan initially authorized awards in respect of an aggregate of 687,961 Class A common shares. In December 2010, our Board amended the Plan to authorize the issuance of our Class B common shares. As amended, only grants in respect of Class B common shares may be made pursuant to the Plan. The maximum aggregate number of Class B common shares that may be issued pursuant to the Plan is increased upon each issuance of Class B common shares by us so that at any time the maximum number of Class B common shares that may be issued under the Plan will equal 12.5% of the aggregate number of Class A and Class B common shares and units of our Operating Partnership issued and outstanding (other than units issued to or held by us).

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If any common shares covered by an award under the Plan are forfeited or if any such award otherwise terminates, expires unexercised or is cancelled, those common shares will again become shares with respect to which awards can be made under the Plan. Class B common shares issued under the Plan may be either newly issued Class B common shares or Class B common shares that have been reacquired by us. In addition, shares that are canceled, tendered or withheld in payment of all or part of the exercise price of an award or in satisfaction of withholding tax obligations, and shares that are reacquired with cash tendered in payment of the exercise price of an award, will be included in or added to the number of Class B common shares available for grant under the Plan. Class B common shares issued by us as substitute awards granted solely in connection with the assumption of outstanding awards previously granted by a company acquired by, or with which we combine, or substitute awards, do not reduce the number of shares available for awards under the Plan.

In addition, the Plan imposes individual limitations on the amount of certain awards in order to comply with Section 162(m) of the Code. Under these limitations, no single participant may receive options or share appreciation rights, or SARs, in any calendar year that, taken together, relate to more than 166,166 Class B common shares, subject to adjustment in certain circumstances. In addition, the maximum number of Class B common shares that may be issued by options intended to be incentive share options will be limited in total to 12.5% of the outstanding Class A and Class B common shares and OP units, during the life of the Plan.

With certain limitations, awards made under the Plan will be adjusted by the Committee to prevent dilution or enlargement of benefits or potential benefits intended to be made available under the Plan in the event of any share dividend, reorganization, recapitalization, share split, combination, merger, consolidation, change in laws, regulations or accounting principles or other relevant unusual or nonrecurring event affecting us.

*Eligibility and Administration.* Current and prospective officers, employees and trustees of, and consultants to, us or our subsidiaries or affiliates are eligible to be granted awards under the Plan. The Committee will administer the Plan, except with respect to awards to non-employee trustees, for which the Plan will be administered by the our Board. Subject to the terms of the Plan, the Committee is authorized to select participants, determine the type and number of awards to be granted, determine and later amend (subject to certain limitations) the terms and conditions of any award, interpret and specify the rules and regulations relating to the Plan, and make all other determinations which may be necessary or desirable for the administration of the Plan.

*Share Options and Share Appreciation Rights.* The Committee is authorized to grant share options, including both incentive share options, which can result in potentially favorable tax treatment to the participant, and non-qualified share options. The Committee may specify the terms of these grants subject to the terms of the Plan. The Committee is also authorized to grant SARs, either with or without a related option. The exercise price per share subject to an option is determined by the Committee, but may not be less than the fair market value of a common share on the date of the grant, except in the case of substitute awards. The maximum term of each option or SAR, the times at which each option or SAR will be exercisable, and the provisions requiring forfeiture of unexercised options at or following termination of employment generally are fixed by the Committee, except that no option or SAR relating to an option may have a term exceeding 10 years. Incentive share options that are granted to holders of more than 10% of our voting securities are subject to certain additional restrictions, including a five-year maximum term and a minimum exercise price of 110% of fair market value.

*Restricted Common Shares and Restricted Common Share Units.* The Committee is authorized to grant restricted Class B common shares and restricted Class B common share units. Restricted Class B common shares and units are Class B common shares subject to transfer restrictions as well as forfeiture upon certain terminations of employment prior to the end of a restricted period or other conditions specified by the Committee in the award agreement. Restricted Class B common shares and units may also be subject to restrictions on voting rights and receipt of dividends. None of the restricted common shares or units may be transferred, encumbered or disposed of during the restricted period or until after fulfillment of the restrictive conditions.

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*Restricted Unit Award.* The Committee is authorized to grant units in our Operating Partnership, subject to the terms of the limited partnership agreement of our Operating Partnership. The units are represented by a restricted unit award agreement. A participant who receives a restricted unit award agreement has immediate rights of ownership in the units underlying the award, but these units are subject to restrictions in accordance with the terms and provisions of the Plan and the limited partnership agreement of our Operating Partnership, as amended, and may be subject to additional restrictions in accordance with the terms of a restricted unit award agreement, including provisions causing the units to be subject to forfeiture by the individual until the earlier of (a) the time these restrictions lapse or are satisfied, or (b) the time these shares are forfeited, pursuant to the terms and provisions of any award agreement pertaining to the award.

*Performance Awards.* A performance award consists of a right that is denominated in cash or Class B common shares, valued in accordance with the achievement of certain performance goals during certain performance periods as established by the Committee, and payable at a time and in a form as the Committee will determine. Performance awards may be paid in a lump sum or in installments following the close of a performance period or on a deferred basis, as determined by the Committee. Termination of employment prior to the end of any performance period, other than for reasons of death or total disability, will result in the forfeiture of the performance award. A participant's rights to any performance award may not be transferred, encumbered or disposed of in any manner, except by will or the laws of descent and distribution or as the Committee may otherwise determine.

*Other Share-Based Awards.* The Committee is authorized to grant any other type of awards that are denominated or payable in, valued by reference to, or otherwise based on or related to our Class B common shares. The Committee will determine the terms and conditions of these awards, consistent with the terms of the Plan.

*Non-Employee Trustee Awards.* Subject to applicable legal requirements, our Board may provide that all or a portion of a non-employee trustee's annual retainer and/or retainer fees or other awards or compensation as determined by our Board be payable in non-qualified Class B common share options, restricted shares, restricted share units and/or other share-based awards, including unrestricted Class A common shares, either automatically or at the option of the non-employee trustees. Our Board will determine the terms and conditions of any of these awards, including those that apply upon the termination of a non-employee trustee's service as a member of our Board. Non-employee trustees are also eligible to receive other awards pursuant to the terms of the Plan, including options and SARs, restricted shares and restricted share units, and other share-based awards upon terms as the Committee may determine; provided, however, that with respect to awards made to members of the Committee, the Plan is administered by our Board.

*Termination of Employment.* The Committee will determine the terms and conditions that apply to any award upon the termination of employment with us, our subsidiaries and affiliates, and provide the terms in the applicable award agreement or in our rules or regulations.

*Change in Control.* The Committee may specify in the applicable award agreement at or after grant, or otherwise by resolution prior to a Change in Control (as defined in the Plan), that all or a portion of the outstanding awards under the Plan will vest, become immediately exercisable or payable and have all restrictions lifted upon a Change in Control.

*Amendment and Termination.* Our Board may amend, alter, suspend, discontinue or terminate the Plan or any portion of the Plan at any time, provided that none of these amendments, alterations, suspensions, discontinuations or terminations will be made without shareholder approval if (a) approval is necessary to comply with any tax or regulatory requirement for which or with which our Board deems it necessary or desirable to comply or (b) if the amendment, alteration, suspension, discontinuation or termination constitutes a material revision to the Plan. Among other things, a material revision includes: (i) a material increase in the number of shares subject to the Plan (other than the Share Increase, as defined in the Plan, (ii) an expansion of

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the types of awards under the Plan; (iii) a material expansion of the class of employees, trustees or other participants eligible to participate in the Plan; (iv) a material extension of the term of the Plan; (v) a material change to the method of determining option price under the Plan; and (vi) an amendment to the section regarding the pricing of options.

A material revision does not include any revision that curtails rather than expands the scope of the Plan. Subject to certain restrictions in the Plan, the Committee may waive any conditions or rights under, amend any terms of, or alter, suspend, discontinue, cancel or terminate any award, either prospectively or retroactively. The Committee does not have the power, however, to amend the terms of previously granted options to reduce the exercise price per share subject to those options or to cancel those options and grant substitute options with a lower exercise price per share than the cancelled options. The Committee also may not materially and adversely affect the rights of any award holder without the award holder's consent.

*Other Terms of Awards.* We may take action, including the withholding of amounts from any award made under the Plan, to satisfy withholding and other tax obligations. The Committee may provide for additional cash payments to participants to defray any tax arising from the grant, vesting, exercise or payment of any award.

*Shares Authorized.* The following table provides information regarding our equity compensation plans as of December 31, 2010:

| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|--|---|---|--|
| Equity compensation plans approved by security holders     | (1)   | \$  | 473,814 <sup>(2)</sup>   |
| Equity compensation plans not approved by security holders |   |   | (3)  |
| <b>Total</b>   |   | <b>\$</b>   | <b>473,814</b>   |

(1) Excludes 632,589 Class A common shares subject to outstanding restricted common share units granted pursuant to our Plan.

(2) Pursuant to our Plan, as amended, the maximum aggregate number of Class B common shares that may be issued under the Plan will be increased upon each issuance of Class A and Class B common shares by the company so that at any time the maximum number of shares that may be issued under the Plan shall equal 12.5% of the aggregate number of Class A and Class B common shares of the company and OP units issued and outstanding (other than treasury shares and/or units issued to or held by the company).

(3) Excludes 8,333 restricted Class A common shares issued to trustees outside the Plan. See Note 14 of the accompanying Consolidated Financial Statements for more information.

**Employment Agreements; Payments Upon Change of Control**

We have not entered into employment agreements with any of our executive officers. However, the Plan provides for certain vesting for all participants in the event of a change in control. The following summarizes the compensation payable to each NEO in the event of a termination of the executive's employment.

*Payments Made Upon Any Termination.* In all events, we are obligated to pay all salary and benefits accrued to the executive through and including the date of termination.

*Payments Made Upon Voluntary Termination.* In the event of an employee voluntary separation, we are obligated to pay all salary and benefits accrued to the executive through and including the date of termination, but no incentive compensation. Acceleration of the vesting of restricted shares or restricted share units will not occur in this circumstance.



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*Payments Made Upon Death or Disability.* In the event of the employee's death or disability, any unvested restricted common shares or unvested restricted common share units shall immediately vest.

*Award Vesting Acceleration.* In the event of a Change in Control, as defined below, any unvested restricted common shares or restricted common share units granted pursuant to the Plan will automatically vest prior to the consummation of such Change in Control. In addition, if there are any restricted common share units which have been allocated but not yet granted and the employee remains employed with the acquiring or successor entity, then the employee must receive an award of a comparable value covering shares of a successor corporation.

Change in Control means, unless otherwise defined in the applicable award agreement, any of the following events:

any person or entity, including a group as defined in Section 13(d)(3) of the Exchange Act, other than us or one of our wholly-owned subsidiaries or any employee benefit plan of us or any of our subsidiaries, becomes the beneficial owner of 35% or more of the combined voting power of our outstanding securities that may be cast for the election of our trustees;

as the result of, or in connection with, any cash tender or exchange offer, merger or other business combination or contested election, less than a majority of the voting power of our outstanding securities or any successor company or entity entitled to vote generally in the election of our trustees or other corporation or entity after such transaction is held in the aggregate by our security holders entitled to vote generally in the election of our trustees immediately prior to such transaction;

during any period of two consecutive years, individuals who at the beginning of that period constitute our Board cease for any reason to constitute at least a majority thereof, unless the election, or the nomination for election by our shareholders, of each of our trustees first elected during that period was approved by a vote of at least two-thirds (2/3rds) of our trustees then still in office who were (a) our trustees at the beginning of that period, and (b) not initially (1) appointed or elected to office as result of either an actual or threatened election and/or proxy contest by or on behalf of a person other than our Board, or (2) designated by a person who has entered into an agreement with us to effect a transaction described in (1) or (2) above or (4) or (5) below;

our complete liquidation or dissolution;

the sale or other disposition of all or substantially all of our assets to any person; or

with respect to award agreements for James C. Mastandrea, as Chairman and Chief Executive Officer, John J. Dee, the Chief Operating Officer, and David K. Holeman, the Chief Financial Officer, only, a termination of our Chief Executive Officer without cause, excluding non-appealable determinations by a court of law for fraud, gross negligence, or willful neglect, which would be considered termination for cause.

**2010 Executive Compensation Elements**

A description of Whitestone's compensation elements during 2010 are presented below.

**Base Salary.** The NEOs receive a base salary established by an assessment of the responsibilities, skills and experience related to their respective positions, and an evaluation of the base salary of comparable positions in peer companies in the market in general. Other factors considered in base salary determinations are individual performance, the success of each business unit (functional area), the competitiveness of the executive's total compensation, our ability to pay an appropriate and competitive salary, and grants under our Plan. In the past, the NEOs were eligible for annual increases in their base salary as a result of: individual performance; their salary relative to the compensation paid to similarly situated executives in companies comprising our Compensation Peer Group; cost of living considerations; and the time interval and changes in responsibility since the last salary increase. Our Board implemented a salary freeze in March 2008 for the salary of all employees

above the Assistant Vice President level, which includes all of our NEOs. Because of the difficult economic times during

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2009 and 2010, no employee received an annual raise. Additionally, in October 2009, the NEOs voluntarily agreed to reductions in their base salaries by 12.5% as part of a corporate realignment program to reduce overhead, which included making salary reductions for other employees, eliminating positions and combining job responsibilities throughout the company.

**Annual Bonus.** At this time, we do not have an annual cash incentive plan, though the Committee may adopt one and may, in accordance with that plan, award annual bonuses to an executive for the achievement of specific operating and financial goals by us, the individual's business unit or functional area, and the individual's personal achievements and performance. Because of the difficult economic times, no bonuses were paid in 2009. In 2010, we only paid a bonus to our CFO to recognize his contributions to our successful public offering.

**Long-Term Equity Incentive Compensation.** The Committee made initial grants under the Plan in January 2009. Because the majority of the NEOs' annual salaries have been below the Committee's goal of the 50th percentile of our Compensation Peer Group, and because the Plan had been under discussion, review, and development since 2007, the value of the grants from the Plan are a significant portion of compensation compared to annual cash compensation, which was intended to provide a meaningful incentive to create value for our shareholders by growing our company and getting listed on a national securities exchange.

The grants may provide significant value for the NEOs, but because the grants are 100% performance-based, the NEOs will only receive that value by achieving financial goals for the company. The Committee believes the NEOs are truly shoulder-to-shoulder with the shareholders and motivated to achieve extraordinary operating results to have the grants vest and the restrictions removed.

The January 2009 awards consisted of restricted Class A common shares and Class A common share units that vest incrementally upon achievement of five increasing levels of FFO. The first of five goals was achieved in 2009 when the company reported FFO of \$8.6 million, which was more than double the FFO of 2008. In order for all of the grants to vest, FFO must exceed \$43 million, an increase of more than ten times the 2008 FFO when the goals were established.

The 10% vesting of granted restricted shares and restricted share units in 2009 created a tax obligation to the recipients for 2010. Under normal circumstances, this tax obligation is anticipated by the recipient because there is no associated cash compensation with which to pay the taxes. Because the NEOs agreed to reduce their base salary by 12.5% and because there was no annual bonus compensation, the Committee recognized that the tax payment was indeed a special hardship at this point in time after achieving the first milestone of the performance-based Plan.

To accommodate the tax obligation needs of the NEOs, the Committee allowed the NEOs, as well as all participants, to return to the company a portion of their vested shares sufficient to cover their estimated tax liability. In return, the Committee granted replacement restricted shares to the NEOs, as well as all participants, in an equal number with a three year ratable vesting period (non-performance-based as they had already achieved a successful performance vesting within the Plan).

The following table reflects the restricted common shares granted to the NEOs in 2010 to replace the return of vested shares for the estimated tax obligation of the vesting in 2010.

|                      | <b>Grant Date</b> | <b>Number of<br/>Shares <sup>(1)</sup></b> | <b>Award Type</b>     |
|----------------------|-------------------|--|-----------------------|
| James C. Mastandrea  | 4/19/2010         | 5,172                                      | Class A Common Shares |
| John J. Dee          | 4/19/2010         | 4,074                                      | Class A Common Shares |
| David K. Holeman     | 4/19/2010         | 1,415                                      | Class A Common Shares |
| Valarie L. King      | 4/19/2010         | 1,197                                      | Class A Common Shares |
| Daniel E. Nixon, Jr. | 4/19/2010         | 1,314                                      | Class A Common Shares |

<sup>(1)</sup> The restricted Class A common shares vest 1/3<sup>rd</sup> on April 19, 2011, 1/3<sup>rd</sup> on April 19, 2012 and 1/3<sup>rd</sup> on April 19, 2013.



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**Perquisites and Other Personal Benefits.** We provide our NEOs with benefits and other personal perquisites that we deem reasonable and consistent with our overall compensation program. Such benefits enable us to attract and retain superior employees for key positions. The Committee periodically reviews our overall compensation program and specific perquisites provided to the NEOs.

Three of our NEOs (James C. Mastandrea, John J. Dee, and Daniel E. Nixon, Jr.) have relocated to the Houston area. We have agreed to pay for all reasonable relocation costs including, but not limited to, temporary living expenses, all costs associated with moving household items and personal cars, necessary roundtrip air travel, the costs associated with selling homes, including the cost of preparing the houses for sale, sales consultation costs, reimbursement of realtor's commission upon sale, and other selling costs. The Committee has also negotiated and approved an agreement between the company and Mr. Mastandrea regarding the disposition of his home in Cleveland, Ohio. The details of this transaction are more fully described under the section Certain Relationships and Related Transactions, and involves the hiring of a professional relocation firm to market the home, and reimbursement of Mr. Mastandrea for losses not to exceed \$700,000 plus tax on the amount of such payment at the maximum federal income tax rate. The first \$450,000 of any such payment is to be paid in cash and the excess, if any, to be paid in common shares in equal amounts over four quarters. Any payment related to the relocation will include the tax at the maximum federal income tax rate. Additionally, the agreement calls for the continued reimbursement of the Mastandrea family housing, and other expenses incident to their ownership of the home.

**2011 Compensation Actions**

Following our public offering and the listing of our Class B common shares on the NYSE Amex in August 2010, the Committee engaged CEL in January 2011 to review and analyze our current compensation levels and to advise the Committee with respect to the compensation of our NEOs as compared to other real estate companies. In its 2011 engagement, CEL conducted a review of the 2008 peer group due to changes in the financial condition of many of the companies formerly in the peer group, the merger and privatization of several firms, and to be certain that the range of peer companies best represent the company, taking into consideration our public offering and the listing of our shares in 2010. The companies comprising the Compensation Peer Group in 2011 include firms based primarily on the following criteria:

Public real estate companies structured as equity REITs that own, invest, manage and develop real estate assets similar to us through an integrated and self-managed operating platform;

Real estate firms which focus on shopping centers, retail assets, and related community based property types consistent with our strategy of creating communities including office, healthcare and diversified categories;

Firms of similar size as us measured by market capitalization (implied market cap, and total capitalization), gross leasable area (square feet), number of properties, and number of employees; and

Firms which report executive compensation data and a range of performance results (FFO and FFO per share) which correlates with that of the company.

A total of 12 public companies were used in the CEL analysis in 2011 and are listed below with their respective exchange ticker symbol.

Agree Realty Corporation (ADC)

AmREIT, Inc. (currently not traded)

Cedar Shopping Centers (CDR)

Cogdell Spencer Inc. (CSA)

First Real Estate Investment Trust NJ (FREVS)

Gladstone Commercial Corporation (GOOD)

Gyrodyne Company of America (GYRO)

Kite Realty Group Trust (KRG)

Mission West Properties, Inc. (MSW)

Monmouth Real Estate Investment Corp. (MNR)

One Liberty Properties, Inc. (OLP)

Urstadt Biddle Properties, Inc. (UBA)

CEL's review and benchmarking analysis reaffirmed that the NEOs' cash compensation, comprised of base salary and annual bonus, is below the Committee's target of the 50th percentile when compared to the new



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Compensation Peer Group. The performance-based equity grants made in January 2009 pursuant to the Plan remain a significant portion of the NEOs' total compensation as compared to cash compensation. In order for the NEOs to earn the performance-based equity grants, they must achieve increasing levels of FFO, ultimately ten times higher than the FFO in 2008, when the goals were established. This long-term, performance-based program motivates the NEOs to profitably grow the company and aligns their interests with those of our shareholders. Based on the foregoing, the Committee concluded that our 2010 NEO compensation levels were appropriate given the economic conditions and our performance. The Committee will consider CEL's 2011 analysis, as well as a variety of other information, to determine the appropriate level and mix of incentive compensation in 2011.

**Executive Compensation****Summary Compensation Table**

The table below summarizes the total compensation paid to or earned by each of our NEOs in 2008, 2009 and 2010. Additionally in October 2009, the NEOs voluntarily agreed to reductions in their base salaries by 12.5% as part of a corporate realignment program to reduce overhead and other operating expenses.

**Whitestone REIT****2010 Summary Compensation Table**

| Name and<br>Principal Position   | Year | Salary <sup>(1)</sup> | Bonus <sup>(2)</sup> | Class A<br>Common<br>Share<br>Awards <sup>(3)</sup> | All Other<br>Compensation | Total     |
|--|------|-----------------------|----------------------|---|---------------------------|-----------|
| <b>James C. Mastandrea</b><br>Chairman & Chief Executive Officer       | 2010 | 262,500               |                      | 79,907  | 83,265 <sup>(4)</sup>     | 425,673   |
|  | 2009 | 291,346               |                      | 2,402,196   | 66,137 <sup>(5)</sup>     | 2,759,679 |
|  | 2008 | 284,616               | 75,000               |   | 89,130 <sup>(6)</sup>     | 448,746   |
| <b>John J. Dee</b><br>Chief Operating Officer                          | 2010 | 175,000               |                      | 62,943  | 23,916 <sup>(7)</sup>     | 261,860   |
|  | 2009 | 194,281               |                      | 1,795,481   | 44,493 <sup>(8)</sup>     | 2,034,255 |
|  | 2008 | 193,846               | 50,000               |   | 40,509 <sup>(9)</sup>     | 284,355   |
| <b>David K. Holeman</b><br>Chief Financial Officer                     | 2010 | 154,875               | 14,271               | 21,862  |                           | 191,008   |
|  | 2009 | 172,674               |                      | 593,010   | 3,472 <sup>(10)</sup>     | 769,156   |
|  | 2008 | 176,703               | 5,000                |   | 4,676 <sup>(10)</sup>     | 186,379   |
| <b>Valarie L. King</b><br>SVP-Regional Director                        | 2010 | 91,000                |                      | 18,494  |                           | 109,494   |
|  | 2009 | 101,000               |                      | 469,560   | 1,440 <sup>(10)</sup>     | 572,000   |
|  | 2008 | 103,385               | 10,000               |   | 3,402 <sup>(10)</sup>     | 116,787   |
| <b>Daniel E. Nixon, Jr.</b><br>Senior Vice President Regional Director | 2010 | 159,425               |                      | 20,301  | 1,394 <sup>(11)</sup>     | 181,120   |
|  | 2009 | 176,944               |                      | 525,230   | 11,073 <sup>(12)</sup>    | 713,247   |
|  | 2008 | 175,000               | 5,396                |   | 26,324 <sup>(13)</sup>    | 206,720   |

<sup>(1)</sup> Base Salary paid in 2010, 2009 and 2008.

<sup>(2)</sup> Discretionary bonuses for 2010, 2009 and 2008.

<sup>(3)</sup> Represents the grant date fair value of restricted common shares and restricted common share units with a 2010 and 2009 grant date and do not necessarily reflect compensation actually received by the named executive officers in 2010 and 2009. The grant date fair values were calculated in accordance with ASC 718, Compensation-Stock Compensation. For further discussion see Note 13 of the accompanying Consolidated Financial Statements.

<sup>(4)</sup> Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$46,657, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel of \$17,688.



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- (5) Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$34,021, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel of \$11,276.
- (6) Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$40,122, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel of \$25,825.
- (7) Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$20,724, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel.
- (8) Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$31,848, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel of \$7,113.
- (9) Represents (a) the incremental cost of a Whitestone automobile not used exclusively for business purposes, (b) housing costs of \$24,177, (c) matching contributions under our 401(k) plan, (d) health insurance, and (e) relocation related travel of \$7,113.
- (10) Represents matching contributions under our 401(k) plan.
- (11) Includes matching contributions under our 401(k) plan of \$1,104.
- (12) Represents (a) auto allowance, (b) matching contributions under our 401(k) plan of \$3,433, and (c) relocation related travel.
- (13) Represents (a) auto allowance, (b) temporary housing costs, (c) matching contributions under our 401(k) plan of \$4,038, (d) health insurance and (e) relocation related travel.

**Grants of Plan Based Awards**

The following table sets forth certain information with respect to shares granted during the year ended December 31, 2010 for each named officer.

| Name                 | Grant Date | Estimated Future Payouts Under<br>Equity Incentive Plan Awards <sup>(1)</sup> |  |
|----------------------|------------|---|--|
|                      |            | All Other<br>Share Awards:<br>Number of<br>Shares <sup>(1)</sup>              | Grant Date<br>Fair Value of<br>Share Awards <sup>(2)</sup> |
| James C. Mastandrea  | 4/19/2010  | 5,172   | \$ 79,907  |
| John J. Dee          | 4/19/2010  | 4,074   | 62,943   |
| David K. Holeman     | 4/19/2010  | 1,415   | 21,862   |
| Valarie L. King      | 4/19/2010  | 1,197   | 18,494   |
| Daniel E. Nixon, Jr. | 4/19/2010  | 1,314   | 20,301   |

<sup>(1)</sup> The restricted Class A common shares vest 1/3<sup>rd</sup> on April 19, 2011, 1/3<sup>rd</sup> on April 19, 2012 and 1/3<sup>rd</sup> on April 19, 2013.

<sup>(2)</sup> Amount represents the grant date fair value of share awards measured in accordance with ASC 718, using the assumptions discussed in Note 13 of the accompanying Consolidated Financial Statements.

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The following table sets forth certain information with respect to the market value as of December 31, 2010 of all unvested share and unit awards held by each NEO as of December 31, 2010.

| Name                 | Number of Shares that Have Not Vested (1) | Market Value of Shares that Have Not Vested (2) | Share Awards  | Equity Incentive Plan Awards Market Value of Shares or Units that Have Not Vested (2) |
|----------------------|---|---|---|---|
|                      |   |   | Equity Incentive Plan Awards Number of Shares or Units that Have Not Vested (3) |   |
| James C. Mastandrea  | 5,172                                     | \$ 76,546                                       | 38,746  | \$ 573,441  |
| John J. Dee          | 4,074                                     | 60,295  | 29,500  | 436,600   |
| David K. Holeman     | 1,415                                     | 20,942  | 9,000   | 133,200   |
| Valarie L. King      | 1,197                                     | 17,716  | 7,334   | 108,543   |
| Daniel E. Nixon, Jr. | 1,314                                     | 19,447  | 8,334   | 123,343   |

(1) The restricted Class A common shares vest 1/3<sup>rd</sup> on April 19, 2011, 1/3<sup>rd</sup> on April 19, 2012 and 1/3<sup>rd</sup> on April 19, 2013.

(2) Market value based on closing price of Class B common shares of \$14.80 on December 31, 2010.

(3) Reflects shares and units that will vest at the target performance goal, or 30% of the total award, less the shares and units that vested upon the company meeting the threshold performance goal, or 10% of the total award. Such shares and units vested on March 25, 2010 based on 2009 performance.

**2010 Option Exercises and Shares Vested**

We have not granted any stock options to employees during the year ended December 31, 2010. The following table sets forth information with respect to shares and units vested during the year ended December 31, 2010.

| Name                 | Class A Common Share Awards (1)          |                               |
|----------------------|--|-------------------------------|
|                      | Number of Shares Acquired on Vesting (2) | Value Realized on Vesting (3) |
| James C. Mastandrea  | 19,373                                   | \$ 299,313                    |
| John J. Dee          | 14,750                                   | 227,888                       |
| David K. Holeman     | 4,500                                    | 69,525                        |
| Valarie L. King      | 3,667                                    | 56,650                        |
| Daniel E. Nixon, Jr. | 4,167                                    | 64,375                        |

(1) All share awards shown were granted on January 2, 2009.

(2) Shares and units vested on March 25, 2010 based on 2009 performance.

(3) Our Class A common shares are not listed on a national exchange. The market value is based on observable transactions.

**Compensation of Trustees****Cash Compensation**

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We pay our non-employee trustees an annual fee of \$10,000 and \$1,000 for each in-person Board meeting and \$500 for each telephonic Board meeting they attend. Trustees do not receive additional compensation for committee meetings. Non-employee trustees also are reimbursed for out-of-pocket expenses incurred to attend Board meetings.

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On March 25, 2009, each of our independent trustees was granted 1,667 restricted common shares which vest in equal installments on or about March 25, 2010, 2011, and 2012. No equity awards were made in 2010.

**2010 Trustee Compensation**

The table below summarizes the compensation we paid to each non-employee trustee in 2010. No employee who serves as a trustee is paid for those services.

| <b>Name <sup>(1)</sup></b> | <b>Fees Earned<br/>or Paid in<br/>Cash</b> | <b>Share<br/>Awards<br/><sup>(2)</sup></b> | <b>Total <sup>(3)</sup></b> |
|----------------------------|--|--|-----------------------------|
| Daryl J. Carter            | \$ 15,500                                  |  | \$ 15,500                   |
| Daniel G. DeVos            | 16,500                                     |  | 16,500                      |
| Donald F. Keating          | 16,500                                     |  | 16,500                      |
| Jack L. Mahaffey           | 16,500                                     |  | 16,500                      |

<sup>(1)</sup> James C. Mastandrea, our Chairman of the Board and Chief Executive Officer, is not included in the table as he is an employee and thus receives no compensation for his services as a trustee. The compensation received by Mr. Mastandrea as an employee is shown in the Summary Compensation Table above.

<sup>(2)</sup> No share awards were made in 2010.

<sup>(3)</sup> We do not have a pension plan or non-qualified deferred compensation plan.



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The following tables set forth beneficial ownership information with respect to our common shares, as of March 23, 2011, including shares such persons had a right to acquire within 60 days after March 23, 2011 through the exercise of vested restricted common share units for (i) each person, or group of affiliated persons, who is known by us to own beneficially five percent or more of any class of our common shares; (ii) each of our trustees, (iii) each of our NEOs and (iv) all of our trustees and executive officers as a group.

| Name of Beneficial Owner <sup>(1)</sup>                                       | Class A<br>Common<br>Shares<br>Beneficially<br>Owned <sup>(2)</sup> | Class A<br>Percentage<br>Ownership Prior<br>to<br>Offering | Class B<br>Common<br>Shares<br>Beneficially<br>Owned <sup>(2)</sup> | Class B<br>Percentage<br>Ownership Prior<br>to<br>Offering | Total Percentage<br>Ownership<br>After<br>Offering<br><sup>(16)</sup> |
|---|---|--|---|--|---|
| <b>5% Beneficial Owners:</b>  |   |  |   |  |   |
| Perritt Capital Management, Inc. <sup>(3)</sup>                               |   |  | 200,000   | 9.1%   | %   |
| FMR, LLC <sup>(4)</sup>   |   |  | 176,667   | 8.0%   | %   |
| <b>Named Executive Officers:</b>  |   |  |   |  |   |
| James C. Mastandrea   | 79,373 <sup>(5)</sup>   | 2.3%   | 10,400  | *  | %   |
| John J. Dee   | 52,250 <sup>(6)</sup>   | 1.5%   | 1,000   | *  | *   |
| David K. Holeman  | 27,000 <sup>(7)</sup>   | *  | 5,000   | *  | *   |
| Valarie L. King   | 18,667 <sup>(8)</sup>   | *  |   | *  | *   |
| Daniel E. Nixon, Jr.  | 19,167 <sup>(9)</sup>   | *  | 1,500   | *  | *   |
| <b>Non-Employee Trustees:</b>   |   |  |   |  |   |
| Daryl J. Carter   | 1,667 <sup>(10)</sup>   | *  |   | *  | *   |
| Daniel G. DeVos   | 1,667 <sup>(11)</sup>   | *  | 16,600  | *  | *   |
| Donald F. Keating   | 14,811 <sup>(12)</sup>  | *  | 2,000   | *  | *   |
| Jack L. Mahaffey  | 25,910 <sup>(13)</sup>  | *  |   | *  | *   |
| All executive officers and trustees as a<br>Group (9 persons) <sup>(14)</sup> | 240,511   | 6.9% <sup>(15)</sup>                                       | 36,500  | 1.7% <sup>(15)</sup>                                       | % <sup>(17)</sup>   |

\* Less than 1%

(1) Unless otherwise indicated, the address for each beneficial owner is 2600 South Gessner, Suite 500, Houston, Texas 77063.

(2) Beneficial ownership is determined in accordance with the rules of the SEC that deem shares to be beneficially owned by any person or group who has or shares voting or investment power with respect to those shares.

(3) Based on information provided by Perritt Capital Management, Inc. ( Perritt ) in a Form 13F filed with the SEC on January 14, 2011, reporting ownership as of December 31, 2010. The address of Perritt is 300 South Wacker Drive, Suite 2880, Chicago, Illinois 60606.

(4) Based on information provided by FMR, LLC ( FMR ) in a Schedule 13G filed with the SEC on February 14, 2011, reporting beneficial ownership as of December 31, 2010. FMR possessed sole voting power over 0 shares and sole dispositive power over 176,667 of our Class B common shares. The address of FMR is 82 Devonshire Street, Boston, MA 02109.

(5) Includes 65,172 restricted Class A common shares and excludes 114,357 restricted Class A common share units issued pursuant to the Plan and 234,637 OP units issued in connection with our acquisition of the Spoerlein property, which are redeemable for cash or, at our option, for Class A common shares on a one-for-one basis. Mr. Mastandrea's total ownership of common shares and OP units represents 4.3% of all common shares outstanding, assuming conversion of all OP units to Class A common shares, excluding OP units held by Whitestone REIT.

(6) Includes 41,574 restricted Class A common shares and excludes 95,249 restricted Class A common share units issued pursuant to the Plan.

(7) Includes 23,915 restricted Class A common shares and excludes 18,000 restricted Class A common share units issued pursuant to the Plan.

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- (8) Includes 16,197 restricted Class A common shares and excludes 18,000 restricted Class A common share units issued pursuant to the Plan.
- (9) Includes 16,314 restricted Class A common shares and excludes 22,500 restricted Class A common share units issued pursuant to the Plan.
- (10) Includes 1,111 restricted Class A common shares.
- (11) Includes 1,111 restricted Class A common shares.
- (12) Includes 1,111 restricted Class A common shares and excludes 7,986 OP units, which are redeemable for cash or, at our option, for Class A common shares on a one-for-one basis.
- (13) Includes 1,111 restricted Class A common shares and excludes 10,648 OP units, which are redeemable for cash or, at our option, for Class A common shares on a one-for-one basis.
- (14) None of the shares beneficially owned by our trustees or NEOs have been pledged as security for an obligation.
- (15) Total ownership of the NEOs and trustees of Class A common shares and OP units represents 7.1% of all common shares assuming conversion of all OP units, excluding OP units held by Whitestone REIT.
- (16) Assumes no purchase of Class B common shares in the offering.
- (17) Total ownership of executive officers and trustees, after giving effect to the offering and assuming the exchange of all Class A common shares and OP units, excluding OP units held by Whitestone REIT, into Class B common shares, represents % of all Class B common shares outstanding after this offering.

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**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

**Executive Relocation**

On July 9, 2010, upon the unanimous recommendation of our Compensation Committee, we entered into an arrangement with Mr. Mastandrea, our president and CEO, 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 the tax amount 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. See Executive Compensation 2010 Executive Compensation Elements Perquisites and Other Personal Benefits.

**Conflicts of Interest**

Under our declaration of trust, we may enter into any contract or transaction with our trustees, officers, employees or agents (or any affiliated person), provided that in the case of any contract or transaction in which any of our trustees, officers, employees or agents (or any affiliated person) have a material financial interest, (1) the fact of the interest is disclosed or known to the following: (a) the Board, and the Board shall approve or ratify the contract or transaction by the affirmative vote of a majority of disinterested trustees, even if the disinterested trustees constitute less than a quorum, or (b) the shareholders entitled to vote, and the contract or transaction is authorized, approved or ratified by a majority of the votes cast by the shareholders entitled to vote other than the votes of shares owned of record or beneficially by the interested party; or (2) the contract or transaction is fair and reasonable to us. In addition, our Nominating and Corporate Governance Committee manages risks associated with the independence of the Board and potential conflicts of interest.

Our bylaws also provide that any of our trustees or officers, in a personal capacity or in a capacity as an affiliate, employee or agent of any other person, or otherwise, may have business interests and engage in business activities similar (and even competitive) to or in addition to those relating to our business. Our independent trustees review these matters annually to determine if there are any potential conflicts of interest.

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**THE OPERATING PARTNERSHIP AGREEMENT**

*The material terms and provisions of the Agreement of Limited Partnership of Whitestone REIT Operating Partnership, L.P. which we refer to as the partnership agreement are summarized below. For more detail, you should refer to the partnership agreement itself, a copy of which is filed as an exhibit to the registration statement of which this prospectus is a part. For purposes of this section, references to we, our, us and our company refer to Whitestone REIT.*

**General**

Our Operating Partnership was formed in December 1998 to acquire, own and operate properties on our behalf. As a result of this structure, we are considered to be an umbrella partnership real estate investment trust, or UPREIT. An UPREIT is a structure REITs often use to acquire real property from owners on a tax deferred basis (the sellers can generally accept partnership units and defer taxable gain otherwise required to be recognized by them upon the disposition of their properties). Such owners may also desire to achieve diversity in their investment and other benefits afforded to shareholders in a REIT. For purposes of satisfying the asset and income tests for qualification as a REIT for tax purposes, the REIT's proportionate share of the assets and income of our Operating Partnership will be deemed to be assets and income of the REIT.

Substantially all of our assets are currently held by our Operating Partnership and we expect that additional investments will also be held in this manner. We are the sole general partner of our Operating Partnership.

**Management of Our Operating Partnership**

As our Operating Partnership's general partner, we generally have complete and exclusive discretion to manage and control our Operating Partnership's business and to make all decisions affecting its assets. This authority generally includes, among other things, the authority to:

operate our business;

prepare applications for rezoning and objections to rezoning of other property;

improve, renovate and perform construction activities with regard to the properties owned by the Operating Partnership;

procure and maintain insurance;

acquire and own real, personal and mixed property of the Operating Partnership in the name of the Operating Partnership or in the name of a nominee;

negotiate, execute and deliver agreements on behalf of and in the name of the Operating Partnership;

borrow money on a secured or unsecured basis;

coordinate all accounting and clerical functions of the Operating Partnership;

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acquire any assets, and encumber, sell, assign, transfer, ground lease or otherwise dispose of any or all of the assets of the Operating Partnership, or any part thereof or interest therein including, without limitation, by way of any OP unit dividend, split, recapitalization, merger, consolidation, combination, exchange of OP units or other similar Operating Partnership organizational change; and

organize one or more partnerships, corporations, limited liability companies or other business entities which are controlled, directly or indirectly, by the Operating Partnership.

Our Operating Partnership will pay all the administrative and operating costs and expenses it incurs in acquiring and operating real properties. Our Operating Partnership also will pay all of our administrative costs and expenses and such expenses will be treated as expenses of our Operating Partnership. Such expenses will include:

all expenses relating to our formation and continuity of existence;

all expenses relating to the public offering and registration of our securities;

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all expenses associated with the preparation and filing of our periodic reports under federal, state or local laws or regulations;

all expenses associated with our compliance with applicable laws, rules and regulations; and

all of our other operating or administrative costs incurred in the ordinary course of business.

The only costs and expenses we may incur for which we will not be reimbursed by our Operating Partnership will be costs and expenses relating to properties we may own outside of our Operating Partnership. We will pay the expenses relating to such properties directly.

### **Transferability of Interests**

We are generally not allowed to withdraw as the general partner of our Operating Partnership or transfer our general partnership interest in our Operating Partnership (except to an affiliate of us) without the consent of limited partners holding not less than a majority of the issued and outstanding OP units held by all limited partners. The principal exception to this is if we transfer our general partnership interest in connection with a recapitalization of our Operating Partnership and either (1) such recapitalization has been approved by the consent of limited partners holding not less than a majority of the issued and outstanding OP units held by all limited partners or (2) an appropriate adjustment to the number of units held by each limited partner is made in accordance with the terms of the partnership agreement. The limited partners have no right to remove us as general partner.

### **Capital Contributions**

We will transfer substantially all of the net proceeds of this offering to our Operating Partnership as a capital contribution; however, we will be deemed to have made capital contributions in the amount of the gross offering proceeds received from investors. If our Operating Partnership requires additional funds at any time in excess of capital contributions made by us or from borrowing, we may borrow funds from a financial institution or other lender and lend or contribute such funds to our Operating Partnership.

### **Amendment to the Partnership Agreement**

By its execution of the partnership agreement, each limited partner grants to us the power to amend the partnership agreement other than any amendment:

to enlarge the obligation of any partner to make contributions to the capital of our Operating Partnership, which requires our consent and the consent of any partner affected by such amendment;

to modify the allocation of profits or losses or distributions among partners except as may be otherwise permitted under the partnership agreement, which requires our consent and the consent of the holders of not less than 67% of the issued and outstanding OP units held by all limited partners;

to amend the transferability provisions contained in the partnership agreement, the provision regarding the limitations on the power and authority of the general partner and certain provisions regarding the organization and name of our Operating Partnership, which requires our consent and the consent of the holders of not less than 67% of the issued and outstanding OP units held by all limited partners; or

the amendment provisions contained in the partnership agreement, which requires our consent and the consent of all of the limited partners.

### **Redemption Rights**

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The limited partners of our Operating Partnership have the right to cause our Operating Partnership to redeem all or a portion of their OP units for cash equal to the value of an equivalent number of our Class A

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common shares, or, at our option, we may issue one of our Class A common shares for each OP unit redeemed. These exchange rights may not be exercised, however, if and to the extent that the delivery of shares upon such exercise would:

result in our shares being beneficially owned by fewer than 100 persons;

result in any person owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding Class A common shares (unless exempted by our Board);

result in us being closely held within the meaning of Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT under the Code; (including by causing us to own 10% or more of the ownership interests in a tenant within the meaning of Section 856(d)(2)(B) of the Code);

cause the acquisition of our shares to be integrated with any other distribution of interests in us for purposes of complying with the registration provisions of the Securities Act of 1933, as amended, or the Securities Act; or

cause the Operating Partnership to be terminated as a partnership under Section 708 of the Code.

**Issuance of Additional Units, Common Shares or Convertible Securities**

We as the general partner may cause our Operating Partnership to issue additional units as follows:

to us upon our issuance of additional common shares and the contribution of the net proceeds thereof as a capital contribution to the partnership;

upon exercise of conversion rights to holders of preference units that are convertible into OP units;

to us or limited partners holding OP units if and to the extent of such partner's participation in any reinvestment program as defined in the partnership agreement;

preference units to us upon our issuance of debt or equity securities other than common shares and the contribution of the net proceeds thereof as a capital contribution to the partnership; and

at our discretion, OP units or preference units to existing or newly admitted partners in exchange for the contribution by a partner of capital contributions to the partnership.

**Allocations of Net Income and Net Losses to Partners**

The partnership agreement provides that taxable income is allocated to the partners of our Operating Partnership in accordance with their relative percentage interests. Subject to compliance with the provisions of Sections 704(b) and 704(c) of the Code and corresponding Treasury Regulations, the effect of these allocations will be that a holder of one OP unit will be allocated taxable income for each taxable year in an amount equal to the amount of taxable income to be recognized by a holder of one of our common shares. Losses, if any, will generally be



allocated among the partners in accordance with their respective percentage interests in our Operating Partnership. Losses cannot be passed through to our shareholders.

**Operations and Distributions**

The partnership agreement provides that, so long as we remain qualified as a REIT, our Operating Partnership is to be operated in a manner that will enable us to satisfy the requirements for being classified as a REIT for federal income tax purposes. As a general partner of our Operating Partnership, we are also empowered to take steps to ensure that our Operating Partnership will not be classified as a publicly traded partnership for purposes of Section 7704 of the Code. Classification as a publicly traded partnership could result in our Operating Partnership being taxed as a corporation, rather than as a partnership.

The partnership agreement provides that our Operating Partnership will distribute cash flow from operations to its partners in accordance with their relative percentage interests on at least an annual basis in amounts we, as

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general partner, determine. The effect of these distributions will be that a holder of one OP unit will receive the same amount of annual cash flow distributions as the amount of annual distributions paid to the holder of one of our common shares. See Description of Securities Distributions.

If our Operating Partnership liquidates, debts and other obligations must be satisfied before the partners may receive any distributions. Any distributions to partners then will be made to partners in accordance with their respective positive capital account balances.

**Term**

The partnership will continue until December 31, 2046, or until sooner dissolved upon:

the sale of all or substantially all the assets of the partnership;

the agreement of those partners holding at least 67% of the OP units; or

the bankruptcy of us or the partnership.

**Indemnification and Limitation of Liability**

Our Operating Partnership shall indemnify us and our trustees and officers from any liability, loss, cost or damage incurred by us and our trustees and officers by reason of anything done or refrained from in connection with our Operating Partnership, except for any liability, loss, cost or damage incurred as a result of fraud, willful misconduct or gross negligence. In addition, the partnership agreement expressly limits our liability by providing that we shall not be liable or accountable to our Operating Partnership for anything in the absence of fraud, willful misconduct, or gross negligence and breaches of the partnership agreement, and we shall not be liable to our Operating Partnership for money damages except (1) for active and deliberate dishonesty established by a final judgment, order or decree of a court of competent jurisdiction, or (2) if the indemnified party received an improper personal benefit in money, property or services.

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**DESCRIPTION OF SECURITIES**

The following description of the terms of our shares is not complete, but is a summary. For a complete description, we refer you to the Maryland REIT Law, our declaration of trust and our bylaws. Our declaration of trust and bylaws are included as exhibits to this registration statement.

**General**

Our declaration of trust provides that we may issue up to 50,000,000 Class A common shares, \$0.001 par value per share, up to 350,000,000 Class B common shares \$0.001 par value per share, and up to 50,000,000 preferred shares, \$0.001 par value per share. In addition, our Board, without any action by our shareholders, may amend our declaration of trust to increase or decrease the aggregate number of shares or the number of shares of any class or series that we have authority to issue. As of December 31, 2010, we had 3,471,187 Class A common shares outstanding held by approximately 1,400 shareholders, 2,200,000 Class B common shares outstanding held by approximately 3,300 shareholders and no preferred shares outstanding. Pursuant to Maryland law and our declaration of trust, no shareholder will be liable for any debt, claim, demand, judgment or obligation of any kind of, against or with respect to us by reason of his being a shareholder, nor shall any shareholder be subject to any personal liability whatsoever, in tort, contract or otherwise, to any person in connection with our property or affairs by reason of his being a shareholder.

**Common Shares**

All the Class B common shares offered by this prospectus will be duly authorized, fully paid and non-assessable. Holders of our common shares are entitled to receive distributions when authorized by our Board and declared by us out of assets legally available for the payment of distributions. Class B common shares will be entitled to dividends equal to the dividends paid with respect to Class A common shares. Holders of our common shares are also entitled to share ratably in our assets legally available for distribution to our shareholders in the event of our liquidation, dissolution or winding up, after payment of or adequate provision for all of our known debts and liabilities. All of these rights are subject to the preferential rights of any other class or series of our shares and to the provisions of our declaration of trust regarding restrictions on transfer of our shares.

Subject to the provisions of our declaration of trust regarding restrictions on transfer and ownership of our shares, each outstanding Class A common share entitles the holder to one vote on all matters submitted to a vote of shareholders, including the election of trustees, and each outstanding Class B common share entitles the holder to one vote on all matters submitted to shareholders, including the election of trustees. The Class A and Class B common shareholders vote together as a single class. There is no cumulative voting in the election of trustees, which means that the holders of Class A and Class B common shares entitled to cast a majority of all the votes entitled to be cast can elect all of the trustees then standing for election, and the holders of the remaining shares will not be able to elect any trustees.

Holders of our common shares have no preference, conversion, exchange, sinking fund or redemption rights, have no preemptive rights to subscribe for any of our securities and generally have no appraisal rights unless our Board determines that appraisal rights apply, with respect to all or any classes or series of shares, to one or more transactions occurring after the date of such determination in connection with which shareholders would otherwise be entitled to exercise appraisal rights.

**Power to Reclassify Our Shares**

Our declaration of trust authorizes our Board to classify and reclassify any of our unissued common shares and preferred shares into other classes or series of shares. Prior to issuance of classified or reclassified shares of each class or series, our Board is required by Maryland law and by our declaration of trust to set, subject to the restrictions on transfer and ownership of shares contained in our declaration of trust, the terms, preferences,

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conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, our Board could authorize the issuance of common or preferred shares with terms and conditions that could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common shares or otherwise be in their best interest. No preferred shares are presently outstanding, and we have no present plans to issue any preferred shares.

**Power to Issue Additional Common Shares and Preferred Shares**

We believe that our Board's power to amend our declaration of trust to increase the aggregate number of shares or the number of shares of any class or series that we have authority to issue, to issue additional common shares or preferred shares, and to classify or reclassify unissued common or preferred shares and thereafter to issue the classified or reclassified shares provides us with increased flexibility in structuring possible future financings and acquisitions and in meeting other needs that might arise. These actions can be taken without shareholder approval, unless shareholder approval is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Although we have no present intention of doing so, we could issue a class or series of shares that could delay, defer or prevent a transaction or a change in control that might involve a premium price for holders of our common shares or otherwise be in their best interest.

**Restrictions on Ownership and Transfer**

For us to qualify as a REIT under the Code, our shares must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of twelve months or during a proportionate part of a shorter taxable year. Also, not more than 50% of the value of our outstanding shares may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities such as qualified pension plans) during the last half of a taxable year. These requirements do not apply to the first year for which an election to be a REIT is made.

Our declaration of trust contains restrictions on the number of our shares that a person may own. No person may acquire or hold, directly or indirectly, more than 9.8% (by value or by number of shares, whichever is more restrictive) of our outstanding Class A or Class B common shares or more than 9.8% (by value or by number of shares, whichever is more restrictive) of the outstanding shares of any class or series of our preferred shares.

Our declaration of trust further prohibits (a) any person from owning our shares if that ownership would result in our being "closely held" under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT and (b) any person from transferring our shares if the transfer would result in our shares being beneficially owned by fewer than 100 persons. Any person who acquires or intends to acquire any of our shares that may violate any of these restrictions, or who is the intended transferee of our shares that are transferred to the trust for the charitable beneficiary, as described below, is required to give us immediate written notice or, in the case of a proposed or attempted transaction, 15 days prior written notice and provide us with such information as we may request in order to determine the effect of the transfer on our status as a REIT. The above restrictions will not apply if our Board determines that it is no longer in our best interests to continue to qualify as a REIT.

Our Board, in its sole discretion, may exempt, prospectively or retroactively, a person from the 9.8% ownership limits. However, the Board may not exempt a person unless, among other information, such person submits to the Board information satisfactory to the Board, in its reasonable discretion, demonstrating that (i) such person is not an individual, (ii) no individual would be considered to beneficially own shares in excess of the 9.8% ownership limits by reason of the exemption of such person from the 9.8% ownership limits and (iii) the exemption of such person from the 9.8% ownership limits will not cause us to fail to qualify as a REIT. The person also must agree that any violation or attempted violation of these restrictions will result in the automatic transfer of the shares causing the violation to the trust for the charitable beneficiary, as described below. Our Board may require a ruling from the IRS or an opinion of counsel in order to determine or ensure our status as a REIT.

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Any attempted transfer of our shares that, if effective, would result in our shares being beneficially owned by fewer than 100 persons will be null and void and the proposed transferee will not acquire any rights in the shares. Any attempted transfer of our shares that, if effective, would result in violation of the 9.8% ownership limits discussed above or in our being closely held under Section 856(h) of the Code or otherwise failing to qualify as a REIT will cause the number of shares causing the violation (rounded to the nearest whole share) to be automatically transferred to a trust for the exclusive benefit of one or more charitable beneficiaries, and the proposed transferee will not acquire any rights in the shares. The automatic transfer will be deemed to be effective as of the close of business on the Business Day (as defined in the declaration of trust) prior to the date of the transfer. Shares held in the trust for the charitable beneficiary will be issued and outstanding shares. The proposed transferee will not benefit economically from ownership of any shares held in that trust, will have no rights to dividends or other distributions and no rights to vote or other rights attributable to the shares held in that trust. The trustee of the trust for the charitable beneficiary will have all voting rights and rights to dividends or other distributions with respect to shares held in that trust. These rights will be exercised for the exclusive benefit of the charitable beneficiary. Any dividend or other distribution paid prior to our discovery that the shares have been transferred to the trust for the charitable beneficiary will be paid by the recipient to the trustee upon demand. Any dividend or other distribution authorized but unpaid will be paid when due to the trustee. Any dividend or other distribution paid to the trustee will be held in trust for the charitable beneficiary. Subject to Maryland law, the trustee will have the authority (i) to rescind as void any vote cast by the proposed transferee prior to our discovery that the shares have been transferred to the trust and (ii) to recast the vote in accordance with the desires of the trustee acting for the benefit of the charitable beneficiary. However, if we have already taken irreversible corporate action, then the trustee will not have the authority to rescind and recast the vote.

Within 20 days of receiving notice from us that any of our shares have been transferred to the trust for the charitable beneficiary, the trustee will sell those shares to a person designated by the trustee, whose ownership of the shares will not violate the above ownership limitations. Upon the sale, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee and to the charitable beneficiary as follows. The proposed transferee will receive the lesser of (i) the price paid by the proposed transferee for the shares or, if the proposed transferee did not give value for the shares in connection with the event causing the shares to be held in the trust (e.g., a gift, devise or other similar transaction), the Market Price (as defined in our declaration of trust) of the shares on the day of the event causing the shares to be held in the trust and (ii) the price received by the trustee from the sale or other disposition of the shares. Any net sale proceeds in excess of the amount payable to the proposed transferee will be paid immediately to the charitable beneficiary. If, prior to our discovery that shares have been transferred to the trust, the shares are sold by the proposed transferee, then (i) the shares shall be deemed to have been sold on behalf of the trust and (ii) to the extent that the proposed transferee received an amount for the shares that exceeds the amount he was entitled to receive, the excess shall be paid to the trustee upon demand.

In addition, shares held in the trust for the charitable beneficiary will be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price per share in the transaction that resulted in the transfer to the trust (or, in the case of a devise or gift, the Market Price at the time of the devise or gift) and (ii) the Market Price on the date we, or our designee, accept the offer. We will have the right to accept the offer until the trustee has sold the shares. Upon a sale to us, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee.

All certificates evidencing our shares will bear a legend referring to the restrictions described above.

Every owner of more than five percent (or such lower percentage as required by the Code or the regulations promulgated thereunder) of our outstanding shares, within 30 days after the end of each taxable year, is required to give us written notice, stating his or her name and address, the number of shares of each class and series of our shares which he or she beneficially owns and a description of the manner in which the shares are held. Each such owner shall provide us with such additional information as we may request in order to determine the effect, if any, of his or her beneficial ownership on our status as a REIT and to ensure compliance with the ownership

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limits. In addition, each shareholder shall upon demand be required to provide us with such information as we may request in good faith in order to determine our status as a REIT and to comply with the requirements of any taxing authority or governmental authority or to determine such compliance.

These ownership limits could delay, defer or prevent a transaction or a change in control that might involve a premium price for our common shares or otherwise be in the best interest of the shareholders.

### **Transfer Agent and Registrar**

The transfer agent and registrar for our common shares is American Stock Transfer and Trust Company.

### **Distributions**

Our declaration of trust provides that our Board may authorize and we may declare such dividends or other distributions as our Board, in its discretion, determines. When making a determination of whether to authorize a dividend, the trustees will make the determination consistent with their duties as trustees. We will not make or pay a dividend, however, when the payment of such dividend would result in us being unable to pay our debts as they become due in the usual course of business or our assets being less than the sum of our total liabilities.

We have paid regular distributions to our shareholders. Because all of our operations are performed through our Operating Partnership, our ability to pay distributions depends on our Operating Partnership's ability to make distributions to us and its other partners.

Provided we have sufficient cash flow to pay distributions, we intend to continue to declare distributions to our shareholders on a quarterly basis and to pay the distributions in three equal monthly installments during the following quarter.

We are required to make distributions sufficient to satisfy the requirements for qualification as a REIT for tax purposes. Generally, income distributed to our shareholders will not be taxable to us under the Code so long as we distribute at least 90% of our taxable income each year. See Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT.

Distributions will be authorized at the discretion of our Board, in accordance with our earnings, cash flow and general financial condition. The Board's discretion will be directed, in substantial part, by its obligation to cause us to comply with the REIT requirements. Because we may receive income from interest or rents at various times during our fiscal year, distributions may not reflect our income earned in that particular dividend period but may be made in anticipation of cash flow that we expect to receive during a later period and may be made in advance of actual receipt of funds in an attempt to make distributions relatively uniform. We may borrow money, issue new securities or sell assets in order to make dividend distributions. Our Board, in its discretion, may retain any portion of our cash on hand for working capital. We cannot assure you that sufficient cash will be available to pay distributions to you.

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The following table summarizes the cash dividends/distributions paid to holders of common shares and holders of OP units for the four quarters of 2009 and 2010 and the first quarter of 2011.

**Total Dividends and Distributions Paid**

| <b>Amount Per Common Share/OP Unit</b> | <b>Quarter Paid</b> | <b>Total Amount (in thousands)</b> |
|--|---------------------|------------------------------------|
| \$0.3375                               | 03/31/2009          | \$1,687                            |
| 0.3375                                 | 06/30/2009          | 1,693                              |
| 0.3375                                 | 09/30/2009          | 1,773                              |
| 0.3375                                 | 12/31/2009          | 1,773                              |
| 0.3375                                 | 03/31/2010          | 1,773                              |
| 0.2850                                 | 06/30/2010          | 1,786                              |
| 0.2850                                 | 09/30/2010          | 1,718                              |
| 0.2850                                 | 12/31/2010          | 2,130                              |
| 0.2850                                 | 03/31/2011          | 2,131                              |

Beginning in the quarter ended June 30, 2010, we declared a distribution per share and OP unit of \$0.2850, which represents a decrease from the quarterly distribution rate of \$0.3375 per share and OP unit declared previously.

Our distribution rate for the year ended December 31, 2010 was approximately 88% of our funds from operations per share. We typically declare our distributions quarterly and pay our distributions in three equal monthly installments. For the fourth quarter of 2010, we declared a distribution per common share and OP unit of \$0.2850, which was paid as follows: \$0.0950 on January 3, 2011, \$0.0950 on February 8, 2011 and \$0.0950 on March 8, 2011. For the first quarter of 2011, we declared a distribution per common share and OP unit of \$0.2850, which will be paid as follows: \$0.0950 on April 7, 2011, \$0.0950 on May 6, 2011 and \$0.0950 on June 7, 2011.

We cannot assure you that our historical or expected level of distributions will be maintained or achieved in the future. Our ability to pay distributions will be impacted by our investing and financing strategies. In particular, we expect to continue to finance certain acquisitions and redevelopments partially through borrowings. As a result, our need to repay and/or refinance such indebtedness may adversely affect our ability to pay future distributions.

However, on occasion, we may have to make distributions in excess of our funds from operations generated in order to maintain our qualification as a REIT. On such occasions, we may have to borrow the excess funds required from third parties or make taxable distributions of our shares or debt securities. We refer you to the Risk Factors Risks Associated with Income Tax Laws We may need to incur additional borrowings to meet the REIT minimum distribution requirement and to avoid excise tax and Material U.S. Federal Income Tax Considerations Requirements for Qualification as a REIT sections in this prospectus.

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**CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR DECLARATION  
OF TRUST AND BYLAWS**

*The following summary of certain provisions of Maryland law and of our declaration of trust and bylaws does not purport to be complete and is subject to and qualified in its entirety by reference to Maryland law and our declaration of trust and bylaws, copies of which are exhibits to the registration statement of which this prospectus is a part. See Where You Can Find More Information.*

**General**

We are organized as a real estate investment trust under the laws of the state of Maryland. We have a perpetual duration. Our declaration of trust permits us to be terminated upon the affirmative vote of the holders of a majority of the outstanding shares entitled to vote and the approval of a majority of the entire Board. Our bylaws require us to conduct annual meetings of our shareholders for the purpose of electing trustees, each of whom will serve for a three-year term, and to transact any other business as may properly come before the shareholders.

**Our Board of Trustees**

Our declaration of trust provides that the number of our trustees may be determined pursuant to our bylaws and our bylaws provide that such number may be established, increased or decreased by the Board but may not be fewer than one or more than fifteen. Our Board is divided into three classes, with each trustee holding office for three years and until his successor is duly elected and qualifies. Any vacancy may be filled only by the affirmative vote of a majority of the remaining trustees in office, even if the remaining trustees do not constitute a quorum, and any trustee elected to fill a vacancy will serve for the remainder of the full term of the trusteeship in which the vacancy occurred.

The Board is responsible for the management of our business and affairs. We currently have a total of five members on our Board. Of our five current trustees, four are considered independent trustees. Each trustee will serve until the annual meeting of shareholders at which his three-year term ends and until his successor has been duly elected and qualifies. Although the number of trustees may be increased or decreased, a decrease will not have the effect of shortening the term of any incumbent trustee. Any trustee may resign at any time and may be removed for cause by the shareholders upon the affirmative vote of not less than two-thirds of the shares then outstanding and entitled to vote generally in the election of trustees.

Our trustees must perform their duties in good faith and in a manner reasonably believed to be in our best interests. Further, trustees must act with such care as an ordinarily prudent person in a like position would use under similar circumstances, including exercising reasonable inquiry, when taking actions.

**Removal of Trustees**

Our declaration of trust provides that a trustee may be removed only for cause upon the affirmative vote of not less than two-thirds of the shares then outstanding and entitled to vote generally in the election of trustees. This provision, when coupled with the exclusive power of our Board to fill vacancies on the Board, precludes shareholders from (1) removing incumbent trustees except for cause upon a substantial affirmative vote and (2) filling the vacancies created by such removal with their own nominees.

**Business Combinations**

Under Maryland law, business combinations between a Maryland real estate investment trust and an interested shareholder or an affiliate of an interested shareholder are prohibited for five years after the most recent date on which the interested shareholder becomes an interested shareholder. These business combinations



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include a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested shareholder is defined as:

any person who beneficially owns ten percent or more of the voting power of the trust's voting shares; or

an affiliate or associate of the trust who, at any time within the two-year period prior to the date in question, was the beneficial owner of ten percent or more of the voting power of the then outstanding shares of the trust.

A person is not an interested shareholder under the statute if the board of trustees of the trust approved in advance the transaction by which he otherwise would have become an interested shareholder. However, in approving a transaction, the board may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the Board.

After the five-year prohibition, any business combination between a Maryland real estate investment trust and an interested shareholder generally must be recommended by the board of trustees of the trust and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of outstanding voting shares of the trust; and

two-thirds of the votes entitled to be cast by holders of voting shares of the trust other than shares held by the interested shareholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested shareholder.

These super-majority vote requirements do not apply if the trust's common shareholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested shareholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of trustees of the trust before the time that the interested shareholder becomes an interested shareholder. Pursuant to the statute, our Board has exempted any business combination involving any person. Consequently, the five-year prohibition and the super-majority vote requirements will not apply to business combinations between us and any person. As a result, any person may be able to enter into business combinations with us that may not be in the best interest of our shareholders, without compliance with the super-majority vote requirements and the other provisions of the statute.

Should our Board later resolve to opt back into these provisions, the business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

**Control Share Acquisitions**

Maryland law provides that control shares of a Maryland real estate investment trust acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast on the matter. Shares owned by the acquiror, by officers or by employees who are trustees of the trust are excluded from shares entitled to vote on the matter. Control shares are voting shares which, if aggregated with all other shares owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing trustees within one of the following ranges of voting power:

one-tenth or more but less than one-third,

one-third or more but less than a majority, or

a majority or more of all voting power.

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Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained shareholder approval. A control share acquisition means the acquisition of issued and outstanding control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the Board of the trust to call a special meeting of shareholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the trust may itself present the question at any shareholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the trust may redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the trust to redeem control shares is subject to certain conditions and limitations. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of shareholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a shareholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other shareholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply (a) to shares acquired in a merger, consolidation or share exchange if the trust is a party to the transaction, or (b) to acquisitions approved or exempted by the declaration of trust or bylaws of the trust.

The control share acquisition statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

### **Subtitle 8**

Subtitle 8 of Title 3 of the Maryland General Corporation Law permits a Maryland real estate investment trust with a class of equity securities registered under the Exchange Act and at least three independent trustees to elect to be subject, by provision in its declaration of trust or bylaws or a resolution of its Board and notwithstanding any contrary provision in the declaration of trust or bylaws, to any or all of five provisions:

a classified board,

two-thirds vote requirement for removing a trustee,

a requirement that the number of trustees be fixed only by vote of the trustees,

a requirement that a vacancy on the board be filled only by the remaining trustees and for the remainder of the full term of the class in which the vacancy occurred until a successor is elected and qualifies, and

a majority requirement for the calling of a special meeting of shareholders.

Our bylaws already provide that, except as may be provided by our Board in setting the terms of any class or series of preferred shares, any vacancy on the Board may be filled only by a majority of the remaining trustees, even if the remaining trustees do not constitute a quorum, and any trustee elected to fill a vacancy will serve for the remainder of the full term of the trusteeship in which the vacancy occurred and until a successor is elected and qualifies. Pursuant to Subtitle 8, we have elected to be subject to the remaining provisions described above.

### **Amendments to Our Declaration of Trust and Bylaws**

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Our declaration of trust may be amended by a majority of the trustees, without any action by the shareholders (i) to qualify as a REIT under the Code or under the Maryland REIT Law, (ii) in any respect in

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which the charter of a corporation may be amended under Maryland General Corporation Law, and (iii) as otherwise provided in our declaration of trust. All other amendments must be declared advisable by our Board and approved by the affirmative vote of holders of a majority of all shares entitled to vote on the matter, except that any amendment to the provisions of our declaration of trust addressing the removal of trustees and certain amendments to our declaration of trust must be approved by the affirmative vote of holders of two-thirds of all shares entitled to vote on the matter. Our Board has the exclusive power to adopt, amend and repeal any provision of our bylaws or to make new bylaws.

**Meetings and Special Voting Requirements**

An annual meeting of our shareholders will be held each year. Special meetings of shareholders may be called by the chairman of the Board, a majority of our trustees, our chief executive officer or our president and must be called by or at the direction of the chairman of the Board upon the written request of shareholders entitled to cast at least a majority of the votes entitled to be cast on any matter that may properly be considered at a meeting of shareholders. Upon receipt of such written request and other required information, the chairman of the Board will inform the requesting shareholders of the estimated cost of preparing and mailing a notice, payment for which must be received prior to the mailing of any notice. Our Board must designate a date for the special meeting within ten days of receiving the request, or if it does not, the date will be the 90th day after the record date, and the record date, unless otherwise set by our Board within 30 days of receiving the request, will be the 30th day after the date of delivery of the request. The presence, either in person or by proxy, of shareholders entitled to cast a majority of all votes entitled to be cast will constitute a quorum at any meeting of shareholders. Generally, the affirmative vote of a majority of the votes cast at a meeting at which a quorum is present is sufficient to take shareholder action, except that the approval of shareholders entitled to cast at least two-thirds of the votes entitled to be cast is required remove a trustee or to amend the declaration of trust provisions addressing the removal of trustees and certain amendments to our declaration of trust and the affirmative vote of shareholders entitled to cast at least a majority of the votes entitled to be cast is required for:

any other amendment of our declaration of trust, except that our Board may amend our declaration of trust without shareholder approval to increase or decrease the aggregate number of our shares or the number of our shares of any class or series that we have the authority to issue, to qualify as a REIT under the Code or the Maryland REIT Law or in any respect in which the charter of a Maryland corporation may be amended without stockholder approval;

any merger, consolidation or sale or other disposition of all or substantially all of our assets (which also requires the approval of our Board); and

our termination (which also must be approved by action of our Board).

**Advance Notice of Trustee Nominations and New Business**

Our bylaws provide that with respect to an annual meeting of shareholders, nominations of individuals for election to our Board and the proposal of business to be considered by shareholders may be made only (i) pursuant to our notice of the meeting, (ii) by or at the direction of the Board or (iii) by a shareholder who is a shareholder of record both at the time of giving the advance notice required by our bylaws and at the time of the meeting, who is entitled to vote at the meeting in the election of each individual so nominated or on any such other business and who has complied with the advance notice procedures of the bylaws. With respect to special meetings of shareholders, only the business specified in our notice of the meeting may be brought before the meeting. Nominations of individuals for election to the Board at a special meeting may be made only (i) by or at the direction of the Board, or (ii) provided that the meeting has been called in accordance with our bylaws for the purpose of electing trustees, by a shareholder who is a shareholder of record both at the time of giving the advance notice required by our bylaws and at the time of the meeting, who is entitled to vote at the meeting in the election of each individual so nominated and who has complied with the advance notice provisions of the bylaws.

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**Anti-Takeover Effect of Certain Provisions of Maryland Law and our Declaration of Trust and Bylaws**

The business combination provisions of Maryland law (if our Board opts back into them), the control share acquisition provisions of Maryland law, the classification of our Board, the two-thirds vote and cause requirements for removing a trustee, the restrictions on transfer and ownership of shares in our declaration of trust, and the advance notice provisions of our bylaws could delay, defer or prevent a transaction or a change in control that might involve a premium price for our common shares or otherwise be in the best interest of our shareholders.

**Ownership Limit**

Our declaration of trust provides that no person or entity may beneficially own, or be deemed to own by virtue of the applicable constructive ownership provisions of the Code, more than 9.8% (by value or by number of shares, whichever is more restrictive) of our outstanding common shares or more than 9.8% (by value or by number of shares, whichever is more restrictive) of the outstanding shares of any class or series of our preferred shares. We refer to these restrictions as the ownership limits. For a fuller description of this restriction and the constructive ownership rules, see Description of Securities Restrictions on Ownership and Transfer.

**Limited Liability and Indemnification of Trustees, Officers, Employees and Other Agents**

Maryland law permits us to include in our declaration of trust a provision limiting the liability of our trustees and officers to us and our shareholders for money damages, except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment and that is material to the cause of action. Our declaration of trust contains a provision that eliminates trustees and officers liability to the maximum extent permitted by Maryland law.

Maryland law permits a Maryland real estate investment trust to indemnify and advance expenses to its trustees, officers, employees and agents to the same extent as permitted for directors and officers of Maryland corporations. Maryland law permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made or threatened to be made a party by reason of their service in those or other capacities unless it is established that:

the act or omission of the director or officer was material to the matter giving rise to the proceeding and (i) was committed in bad faith or (ii) was the result of active and deliberate dishonesty;

the director or officer actually received an improper personal benefit in money, property or services; or

in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful. However, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that personal benefit was improperly received, unless in either case a court orders indemnification and then only for expenses. In addition, Maryland law permits a corporation to advance reasonable expenses to a director or officer upon the corporation's receipt of:

a written affirmation by the director or officer of his good faith belief that he has met the standard of conduct necessary for indemnification by the corporation; and

a written undertaking by him on his behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

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Our declaration of trust authorizes our company, to the maximum extent permitted by Maryland law, to obligate itself to indemnify any present or former trustee or officer or any individual who, while a trustee or

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officer and at our request, serves or has served another real estate investment trust, corporation, partnership, joint venture, trust, employee benefit plan or other enterprise as a trustee, director, officer, partner, employee or agent, against any claim or liability arising from that status and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us to provide such indemnification and advance of expenses. Our declaration of trust and bylaws also permit us to indemnify and advance expenses to any person who served our predecessor in any of the capacities described above and any employee or agent of us or our predecessor.



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**SHARES ELIGIBLE FOR FUTURE SALE**

**General**

Upon completion of this offering, we will have outstanding 7,200,000 Class B common shares (7,950,000 Class B common shares if the underwriters exercise their over-allotment option in full) and 3,471,187 Class A common shares. In addition, 1,814,569 Class A common shares are reserved for issuance upon exchange of OP units and 632,589 Class A common shares are reserved for issuance upon vesting of Class A restricted common share units.

The 5,000,000 Class B common shares sold in this offering (5,750,000 Class B common shares if underwriters exercise their over-allotment option in full) will be freely transferable without restriction or further registration under the Securities Act, subject to the limitations on ownership set forth in our declaration of trust, except for any Class B common shares held by our affiliates, as that term is defined by Rule 144 under the Securities Act. As defined in Rule 144, an affiliate of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the issuer. All of our Class B common shares held by our affiliates, including our officers and trustees, will be restricted securities as that term is defined in Rule 144 under the Securities Act. Restricted securities may be sold in the public market only if registered under the securities laws or if they qualify for an exemption from registration under Rule 144, as described below. In addition, subject to the same limitations described above with respect to our Class B common shares, our Class A common shares are freely transferable. However, our Class A common shares are not, and will not be listed on a national securities exchange, and we do not expect a market to develop for our Class A common shares.

**Exchange Offers for Class A Shares**

Following this offering, we intend to conduct a series of exchange offers to exchange our Class A common shares and OP units for Class B common shares. In exchange for one Class A common share or one OP unit, we will issue one Class B common share. We intend to commence the exchange offers in 25% increments on the following schedule:

on or about 90 days following the date of this prospectus ( , 2011);

on or about 180 days following the date of this prospectus ( , 2011);

on or about 270 days following the date of this prospectus ( , 2012); and

on or about 360 days following the date of this prospectus ( , 2012).

As of March 23, 2011, we had 3,471,187 Class A common shares outstanding and 1,814,569 OP units, not held by us, outstanding. Following the completion of the series of exchange offers, we intend to submit to our shareholders for approval at our 2012 Annual Meeting of Shareholders an amendment to our declaration of trust to reclassify the Class A common shares remaining outstanding after the completion of the exchange offers to Class B common shares.

**Rule 144**

In general, under Rule 144 under the Securities Act, a person (or persons whose shares are aggregated) who is not deemed to have been an affiliate of ours at any time during the three months preceding a sale, and who has beneficially owned restricted securities within the meaning of Rule 144 for at least six months (including any period of consecutive ownership of preceding non-affiliated holders), would be entitled to sell those shares, subject only to the availability of current public information about us. A non-affiliated person who has beneficially owned restricted securities within the meaning of Rule 144 for at least one year would be entitled to sell those shares without regard to the provisions of Rule 144.



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A person (or persons whose shares are aggregated) who is deemed to be an affiliate of ours and who has beneficially owned restricted securities within the meaning of Rule 144 for at least six months would be entitled to sell within any three-month period a number of shares that does not exceed the greater of one percent of the then outstanding common shares or the average weekly trading volume of our common shares reported through the NYSE Amex during the four calendar weeks preceding such sale. Such sales are also subject to certain manner of sale provisions, notice requirements and the availability of current public information about us.

### **Share Repurchases/Redemptions**

The limited partners of our Operating Partnership have the right to cause our Operating Partnership to redeem their OP units for cash equal to the value of an equivalent number of our Class A common shares, or, at our option, we may convert their OP units to Class A common shares on a one-for-one basis.

### **Incentive Award Plan**

On July 29, 2008, our shareholders approved the Plan. On December 22, 2010, our Board amended the Plan to authorize the issuance of Class B common shares pursuant to the Plan. The 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 Class A common shares of Whitestone. The Plan authorizes awards in respect of an aggregate of 1,035,767 common shares (12.5% of our outstanding Class A and Class B common shares and OP units). The maximum aggregate number of common shares that may be issued under the Plan will be increased upon each issuance of our common shares so that at any time the maximum number of shares that may be issued under the Plan shall equal 12.5% of the aggregate number of our Class A and Class B common shares and OP units issued and outstanding (other than units issued to or held by Whitestone REIT).

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

We recognized \$0.3 million and \$1.0 million in share-based compensation expense for the years ended December 31, 2010 and December 31, 2009, respectively. No share-based compensation expense was recognized prior to 2009 as no awards had been granted.

### **Lock-up Agreements and Other Contractual Restrictions on Resale**

In addition to the limits placed on the sale of common shares by operation of Rule 144 and other provisions of the Securities Act, (i) our officers and trustees have agreed, subject to certain limited exceptions, not to sell or otherwise transfer or encumber any common shares or securities convertible into common shares (including OP units) owned by them at the completion of this offering or thereafter acquired by them for a period of 90 days after the date of this prospectus without the prior consent of the underwriters, and (ii) we have agreed that we will not offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, or file with the SEC a registration statement, with the exception of a shelf registration statement, under the Securities Act relating to, any common shares or securities convertible into or exchangeable or exercisable for any common shares (except for a registration statement on Form S-8 relating to our Plan or a registration statement on Form S-4 relating to an acquisition of a real estate company), or publicly disclose the intention to make any offer, sale, pledge, disposition or filing, without the prior written consent of the underwriters for a period of 90 days after the date of this prospectus, subject to certain limited exceptions.

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**MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS**

This section summarizes the current material federal income tax consequences generally resulting from our election to be taxed as a REIT and the current material federal income tax considerations relating to the ownership and disposition of our Class B common shares. As used in this section, the terms *we* and *our* refer solely to Whitestone REIT and not to our subsidiaries and affiliates which have not elected to be taxed as REITs under the Code, and the term *common shares* refers solely to our Class B common shares. This discussion is not exhaustive of all possible tax considerations and does not provide a detailed discussion of any state, local or foreign tax considerations. This discussion does not address all aspects of taxation that may be relevant to particular investors in light of their personal investment or tax circumstances, or to certain types of investors that are subject to special treatment under the federal income tax laws, such as insurance companies, tax-exempt organizations (except to the limited extent discussed below under *Taxation of Tax-Exempt Shareholders*), financial institutions or broker-dealers, non-U.S. individuals and foreign corporations (except to the limited extent discussed below under *Taxation of Non-U.S. Shareholders*) and other persons subject to special tax rules.

The statements in this section and the opinion of Bass, Berry & Sims PLC, described below, are based on the current federal income tax laws governing qualification as a REIT. We cannot assure you that new laws, interpretations of law or court decisions, any of which may take effect retroactively, will not cause any statement in this section to be inaccurate.

**We urge you to consult your own tax advisor regarding the specific tax consequences to you of acquisition, ownership and disposition of our common shares and of our election to be taxed as a REIT. Specifically, you should consult your own tax advisor regarding the federal, state, local, foreign, and other tax consequences of such acquisition, ownership and disposition and election, and regarding potential changes in applicable tax laws.**

**Taxation of Our Company**

We elected to be taxed as a REIT under the federal income tax laws beginning with our taxable year ended December 31, 1999. We believe that, beginning with such taxable year, we have been organized and have operated in such a manner as to qualify for taxation as a REIT under the Code and intend to continue to operate in such a manner. However, no assurances can be given that our beliefs or expectations will be fulfilled, since qualification as a REIT depends on our continuing to satisfy numerous asset, income, share ownership and distribution tests described below, the satisfaction of which depends, in part, on our operating results.

The sections of the Code relating to qualification and operation as a REIT, and the federal income taxation of a REIT, are highly technical and complex. The following discussion sets forth only the material aspects of those sections. This summary is qualified in its entirety by the applicable Code provisions and the related rules and regulations.

In the opinion of Bass, Berry & Sims PLC, we qualified to be taxed as a REIT under the federal income tax laws for our taxable years ended December 31, 2007 through December 31, 2010 and our organization and current and proposed method of operation will enable us to continue to qualify as a REIT for our taxable year ending December 31, 2011 and in the future. Investors should be aware that Bass, Berry & Sims PLC's opinion is based upon customary assumptions, is conditioned upon certain representations made by us as to factual matters, including representations regarding the nature of our properties and the future conduct of our business, and is not binding upon the IRS or any court and speaks only as of the date issued. In addition, Bass, Berry & Sims PLC's opinion is based on existing federal income tax law governing qualification as a REIT, which is subject to change, possibly on a retroactive basis. Moreover, our continued qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual results, certain qualification tests set forth in the federal income tax laws. Those qualification tests involve the percentage of income that we earn from

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specified sources, the percentage of our assets that falls within specified categories, the diversity of our share ownership, and the percentage of our earnings that we distribute. While Bass, Berry & Sims PLC has reviewed those matters in connection with the foregoing opinion, Bass, Berry & Sims PLC will not review our compliance with those tests on a continuing basis. Accordingly, no assurance can be given that the actual results of our operations for any particular taxable year will satisfy such requirements. For a discussion of the tax consequences of our failure to qualify as a REIT, see Requirements for Qualification as a REIT Failure to Qualify as a REIT below.

Pursuant to our declaration of trust, our Board has the authority to make any tax elections on our behalf that, in its sole judgment, are in our best interest. This authority includes the ability to revoke or otherwise terminate our status as a REIT. Our Board has the authority under our declaration of trust to make these elections without the necessity of obtaining the approval of our shareholders. In addition, our Board has the authority to waive any restrictions and limitations contained in our declaration of trust that are intended to preserve our status as a REIT during any period in which our Board has determined that it is no longer in our best interests to pursue or preserve our status as a REIT.

If we qualify as a REIT, we generally will not be subject to federal income tax on the taxable income that we distribute to our shareholders. The benefit of that tax treatment is that it avoids the double taxation, or taxation at both the corporate and shareholder levels, that generally results from owning shares in a corporation. However, we will be subject to federal tax in the following circumstances:

We are subject to the corporate federal income tax on any taxable income, including net capital gain, that we do not distribute to shareholders during, or within a specified time period after, the calendar year in which the income is earned.

We may be subject to the corporate alternative minimum tax on any items of tax preference, including any deductions of net operating losses.

We are subject to tax, at the highest corporate rate, on:

net income from the sale or other disposition of property acquired through foreclosure ( foreclosure property ), as described below under Requirements for Qualification as a REIT Gross Income Tests Foreclosure Property, that we hold primarily for sale to customers in the ordinary course of business, and

other non-qualifying income from foreclosure property.

We are subject to a 100% tax on net income from sales or other dispositions of property, other than foreclosure property, that we hold primarily for sale to customers in the ordinary course of business.

If we fail to satisfy one or both of the 75% gross income test or the 95% gross income test, as described below under Requirements for Qualification as a REIT Gross Income Tests, but nonetheless continue to qualify as a REIT because we meet other requirements, we will be subject to a 100% tax on:

the greater of the amount by which we fail the 75% gross income test or the 95% gross income test, multiplied, in either case, by

a fraction intended to reflect our profitability.

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If we fail to distribute during a calendar year at least the sum of: (1) 85% of our REIT ordinary income for the year, (2) 95% of our REIT capital gain net income for the year, and (3) any undistributed taxable income required to be distributed from earlier periods, then we will be subject to a 4% nondeductible excise tax on the excess of the required distribution over the amount we actually distributed.

If we fail any of the asset tests (other than a de minimis failure of the 5% asset test or the 10% vote or value test), as described below under Requirements for Qualification as a REIT Asset Tests, as

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long as (1) the failure was due to reasonable cause and not to willful neglect, (2) we file a description of each asset that caused such failure with the IRS, and (3) we dispose of the assets or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure, we will pay a tax equal to the greater of \$50,000 or the highest federal corporate income tax rate (currently 35%) multiplied by the net income from the nonqualifying assets during the period in which we failed to satisfy the asset tests.

If we fail to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, and such failure is due to reasonable cause and not to willful neglect, we will be required to pay a penalty of \$50,000 for each such failure.

We may elect to retain and pay income tax on our net long-term capital gain, as described below under Taxation of Taxable U.S. Shareholders.

We will be subject to a 100% excise tax on transactions with a taxable REIT subsidiary that are not conducted on an arm's-length basis.

If we acquire any asset from a C corporation, or a corporation that generally is subject to full corporate-level tax, in a merger or other transaction in which we acquire a basis in the asset that is determined by reference either to the C corporation's basis in the asset or to another asset, we will pay tax at the highest regular corporate rate applicable if we recognize gain on the sale or disposition of the asset during the 10-year period after we acquire the asset. The amount of gain on which we will pay tax generally is the lesser of:

the amount of gain that we recognize at the time of the sale or disposition, and

the amount of gain that we would have recognized if we had sold the asset at the time we acquired it.

We may be required to pay monetary penalties to the IRS in certain circumstances, including if we fail to meet record-keeping requirements intended to monitor our compliance with rules relating to the composition of a REIT's shareholders, as described below in Requirements for Qualification as a REIT Recordkeeping Requirements.

The earnings of our lower-tier entities that are C corporations, including taxable REIT subsidiaries, are subject to federal corporate income tax.

In addition, we may be subject to a variety of taxes, including payroll taxes and state, local and foreign income, property and other taxes on our assets and operations. We could also be subject to tax in situations and on transactions not presently contemplated.

**Requirements for Qualification as a REIT**

To qualify as a REIT, we must elect to be treated as a REIT, and we must meet various (a) organizational requirements, (b) gross income tests, (c) asset tests, and (d) annual distribution requirements.

**Organizational Requirements.** A REIT is a corporation, trust or association that meets each of the following requirements:

- (1) It is managed by one or more trustees or directors;
- (2) Its beneficial ownership is evidenced by transferable shares, or by transferable certificates of beneficial interest;

(3) It would be taxable as a domestic corporation, but for Sections 856 through 860 of the Code;



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- (4) It is neither a financial institution nor an insurance company subject to special provisions of the federal income tax laws;
- (5) At least 100 persons are beneficial owners of its shares or ownership certificates (determined without reference to any rules of attribution);
- (6) Not more than 50% in value of its outstanding shares or ownership certificates is owned, directly or indirectly, by five or fewer individuals, which the federal income tax laws define to include certain entities, during the last half of any taxable year;
- (7) It elects to be a REIT, or has made such election for a previous taxable year, and satisfies all relevant filing and other administrative requirements established by the IRS that must be met to elect and maintain REIT status;
- (8) It uses a calendar year for federal income tax purposes and complies with the recordkeeping requirements of the federal income tax laws; and
- (9) It meets certain other qualifications, tests described below, regarding the nature of its income and assets and the distribution of its income.

We must meet requirements 1 through 4, 8 and 9 during our entire taxable year and must meet requirement 5 during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months. If we comply with all the requirements for ascertaining information concerning the ownership of our outstanding shares in a taxable year and have no reason to know that we violated requirement 6, we will be deemed to have satisfied requirement 6 for that taxable year. Our declaration of trust provides for restrictions regarding the ownership and transfer of our shares of beneficial interest that should allow us to continue to satisfy these requirements. The provisions of the declaration of trust restricting the ownership and transfer of our shares of beneficial interest are described in Description of Securities Restrictions on Ownership and Transfer.

For purposes of determining share ownership under requirement 6, an individual generally includes a supplemental unemployment compensation benefits plan, a private foundation, or a portion of a trust permanently set aside or used exclusively for charitable purposes. An individual, however, generally does not include a trust that is a qualified employee pension or profit sharing trust under the federal income tax laws, and beneficiaries of such a trust will be treated as holding our shares in proportion to their actuarial interests in the trust for purposes of requirement 6. We believe we have issued sufficient shares of beneficial interest with enough diversity of ownership to satisfy requirements 5 and 6 set forth above.

A corporation that is a qualified REIT subsidiary is not treated as a corporation separate from its parent REIT. A qualified REIT subsidiary is a corporation, all of the capital stock of which is owned by its parent REIT and that has not elected to be a taxable REIT subsidiary. All assets, liabilities, and items of income, deduction, and credit of a qualified REIT subsidiary are treated as assets, liabilities, and items of income, deduction, and credit of the REIT. Thus, in applying the requirements described herein, any qualified REIT subsidiary that we own will be ignored, and all assets, liabilities, and items of income, deduction, and credit of such subsidiary will be treated as our assets, liabilities, and items of income, deduction, and credit.

An unincorporated domestic entity, such as a partnership or limited liability company that has a single owner, generally is not treated as an entity separate from its parent for federal income tax purposes. An unincorporated domestic entity with two or more owners is generally treated as a partnership for federal income tax purposes. In the case of a REIT that is a partner in a partnership, the REIT is treated as owning its proportionate share of the assets of the partnership and as earning its allocable share of the gross income of the partnership for purposes of the applicable REIT qualification tests. Thus, our proportionate share of the assets, liabilities and items of income of our Operating Partnership and any other partnership, joint venture, or limited

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liability company that is treated as a partnership for federal income tax purposes in which we acquire an interest, directly or indirectly, is treated as our assets and gross income for purposes of applying the various REIT qualification tests. For purposes of the 10% value test (described in Requirements for Qualification as a REIT – Asset Tests ), our proportionate share is based on our proportionate interest in the equity interests and certain debt securities issued by a partnership. For all of the other asset and income tests, our proportionate share is based on our proportionate interest in the capital of the partnership.

A REIT is permitted to own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary is a fully taxable corporation that may earn income that would not be qualifying income if earned directly by the parent REIT. The subsidiary and the REIT must jointly elect to treat the subsidiary as a taxable REIT subsidiary. A taxable REIT subsidiary will pay income tax at regular corporate rates on any income that it earns. In addition, the taxable REIT subsidiary rules limit the deductibility of interest paid or accrued by a taxable REIT subsidiary to its parent REIT to assure that the taxable REIT subsidiary is subject to an appropriate level of corporate taxation. Further, the rules impose a 100% excise tax on transactions between a taxable REIT subsidiary and its parent REIT or the REIT's tenants that are not conducted on an arm's-length basis. We may engage in activities indirectly through a taxable REIT subsidiary as necessary or convenient to avoid obtaining the benefit of income or services that would jeopardize our REIT status if we engaged in the activities directly. In particular, we would likely engage in activities through a taxable REIT subsidiary if we wished to provide services to unrelated parties which might produce income that does not qualify under the gross income tests described below. We might also dispose of an unwanted asset through a taxable REIT subsidiary as necessary or convenient to avoid the 100% tax on income from prohibited transactions. See description below under Prohibited Transactions. We do not currently own an interest in a taxable REIT subsidiary but may form one in the future.

**Gross Income Tests.** We must satisfy two gross income tests annually to maintain our qualification as a REIT. First, at least 75% of our gross income for each taxable year must consist of defined types of income that we derive, directly or indirectly, from investments relating to real property or mortgages on real property or qualified temporary investment income. Qualifying income for purposes of that 75% gross income test generally includes:

rents from real property;

interest on debt secured by mortgages on real property or on interests in real property;

dividends or other distributions on, and gain from the sale of, shares in other REITs (excluding dividends from our taxable REIT subsidiaries);

gain from the sale of real estate assets;

income and gain derived from foreclosure property; and

income derived from the temporary investment of new capital that is attributable to the issuance of our shares of beneficial interest or a public offering of our debt with a maturity date of at least five years and that we receive during the one-year period beginning on the date on which we receive such new capital.

Second, in general, at least 95% of our gross income for each taxable year must consist of income that is qualifying income for purposes of the 75% gross income test, other types of interest and dividends (including dividends from any taxable REIT subsidiaries), gain from the sale or disposition of stock or securities, or any combination of these. Gross income from our sale of property that we hold primarily for sale to customers in the ordinary course of business is excluded from both the numerator and the denominator in both gross income tests. In addition, any gains from hedging transactions, as defined in Hedging Transactions, that are clearly and timely identified as such will be excluded from both the numerator and the denominator for purposes of the 95% gross income test. Income and gain from hedging transactions entered into after July 30, 2008 that are clearly and timely identified as such will also be excluded from both the numerator and the denominator for purposes of



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the 75% gross income test; however, income and gain from hedging transactions entered into on or before July 30, 2008 will be treated as non-qualifying income for purposes of the 75% gross income test. In addition, certain foreign currency gains recognized after July 30, 2008 will be excluded from gross income for purposes of one or both of the gross income tests. See Foreign Currency Gain. The following paragraphs discuss the specific application of the gross income tests to us.

**Rents from Real Property.** Rent that we receive from our real property will qualify as rents from real property, which is qualifying income for purposes of the 75% and 95% gross income tests, only if the following conditions are met:

First, the rent must not be based in whole or in part on the income or profits of any person. Participating rent, however, will qualify as rents from real property if it is based on percentages of receipts or sales and the percentages:

are fixed at the time the leases are entered into;

are not renegotiated during the term of the leases in a manner that has the effect of basing percentage rent on income or profits; and

conform with normal business practice.

More generally, the rent will not qualify as rents from real property if, considering the relevant lease and all the surrounding circumstances, the arrangement does not conform with normal business practice, but is in reality used as a means of basing the rent on income or profits. We have represented to Bass, Berry & Sims PLC that we intend to set and accept rents which are fixed dollar amounts or a fixed percentage of gross revenue, and not to any extent determined by reference to any person's income or profits, in compliance with the rules above.

Second, we must not own, actually or constructively, 10% or more of the stock of any corporate tenant or the assets or net profits of any tenant, referred to as a related-party tenant, other than a taxable REIT subsidiary. The constructive ownership rules generally provide that, if 10% or more in value of our shares is owned, directly or indirectly, by or for any person, we are considered as owning the stock owned, directly or indirectly, by or for such person. We do not own any stock or any assets or net profits of any tenant directly. Additionally, we have represented to Bass, Berry & Sims PLC that we will not rent any property to a related-party tenant. However, because the constructive ownership rules are broad and it is not possible to monitor continually direct and indirect transfers of our shares, no absolute assurance can be given that such transfers or other events of which we have no knowledge will not cause us to own constructively 10% or more of a tenant (or a subtenant, in which case only rent attributable to the subtenant is disqualified) other than a taxable REIT subsidiary at some future date.

Under an exception to the related-party tenant rule described in the preceding paragraph, rent that we receive from a taxable REIT subsidiary will qualify as rents from real property as long as (1) at least 90% of the leased space in the property is leased to persons other than taxable REIT subsidiaries and related-party tenants, and (2) the amount paid by the taxable REIT subsidiary to rent space at the property is substantially comparable to rents paid by other tenants of the property for comparable space. The substantially comparable requirement must be satisfied when the lease is entered into, when it is extended, and when the lease is modified, if the modification increases the rent paid by the taxable REIT subsidiary. If the requirement that at least 90% of the leased space in the related property is rented to unrelated tenants is met when a lease is entered into, extended, or modified, such requirement will continue to be met as long as there is no increase in the space leased to any taxable REIT subsidiary or related-party tenant. Any increased rent attributable to a modification of a lease with a taxable REIT subsidiary in which we own directly or indirectly more than 50% of the voting power or value of the stock (a controlled taxable REIT subsidiary) will not be treated as rents from real property.

Third, the rent attributable to any personal property leased in connection with a lease of real property must not be greater than 15% of the total rent received under the lease. The rent attributable to personal property under

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a lease is the amount that bears the same ratio to total rent under the lease for the taxable year as the average of the fair market values of the leased personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real and personal property covered by the lease at the beginning and at the end of such taxable year, or the personal property ratio. With respect to each of our leases, we believe that the personal property ratio generally is less than 15%. Where that is not, or may in the future not be, the case, we believe that any income attributable to personal property will not jeopardize our ability to qualify as a REIT. There can be no assurance, however, that the IRS would not challenge our calculation of a personal property ratio, or that a court would not uphold such assertion. If such a challenge were successfully asserted, we could fail to satisfy the 75% or 95% gross income test and thus potentially lose our REIT status.

Fourth, we cannot furnish or render noncustomary services to the tenants of our properties, or manage or operate our properties, other than through an independent contractor who is adequately compensated and from whom we do not derive or receive any income. However, we need not provide services through an independent contractor, but instead may provide services directly to our tenants, if the services are usually or customarily rendered in connection with the rental of space for occupancy only and are not considered to be provided for the tenants' convenience. In addition, we may provide a minimal amount of noncustomary services to the tenants of a property, other than through an independent contractor, as long as our income from the services (valued at not less than 150% of our direct cost for performing such services) does not exceed 1% of our income from the related property. Finally, we may own up to 100% of the stock of one or more taxable REIT subsidiaries, which may provide noncustomary services to our tenants without tainting our rents from the related properties. We have not performed, and do not intend to perform, any services other than customary ones for our tenants, other than services provided through independent contractors or taxable REIT subsidiaries.

If a portion of the rent we receive from a property does not qualify as rents from real property because the rent attributable to personal property exceeds 15% of the total rent for a taxable year, the portion of the rent attributable to personal property will not be qualifying income for purposes of either the 75% or 95% gross income test. Thus, if rent attributable to personal property, plus any other income that is nonqualifying income for purposes of the 95% gross income test, during a taxable year exceeds 5% of our gross income during the year, we would lose our REIT status, unless we qualified for certain statutory relief provisions. By contrast, in the following circumstances, none of the rent from a lease of property would qualify as rents from real property: (1) the rent is considered based on the income or profits of the tenant; (2) the lessee is a related-party tenant or fails to qualify for the exception to the related-party tenant rule for qualifying taxable REIT subsidiaries; or (3) we furnish noncustomary services to the tenants of the property, or manage or operate the property, other than through a qualifying independent contractor or a taxable REIT subsidiary, in excess of 1% of our income from the related property. In any of these circumstances, we could lose our REIT status, unless we qualified for certain statutory relief provisions, because we would be unable to satisfy either the 75% or 95% gross income test.

Tenants may be required to pay, in addition to base rent, reimbursements for certain amounts we are obligated to pay to third parties (such as a lessee's proportionate share of a property's operational or capital expenses), penalties for nonpayment or late payment of rent or additions to rent. These and other similar payments should qualify as rents from real property. To the extent they do not, they should be treated as interest that qualifies for the 95% gross income test.

**Interest.** The term *interest* generally does not include any amount received or accrued, directly or indirectly, if the determination of the amount depends in whole or in part on the income or profits of any person. However, an amount received or accrued generally will not be excluded from the term *interest* solely because it is based on a fixed percentage or percentages of receipts or sales. Furthermore, to the extent that interest from a loan that is based on the profit or net cash proceeds from the sale of the property securing the loan constitutes a shared appreciation provision, income attributable to such participation feature will be treated as gain from the sale of the secured property.

We may invest opportunistically from time to time in mortgage debt and mezzanine loans when we believe our investment will allow us to acquire control of the related real estate. Interest on debt secured by a mortgage

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on real property or on interests in real property, including, for this purpose, discount points, prepayment penalties, loan assumption fees, and late payment charges that are not compensation for services, generally is qualifying income for purposes of the 75% gross income test. However, if a loan is secured by real property and other property and the highest principal amount of such loan that was outstanding during a taxable year exceeds the fair market value of the real property securing the loan as of the date the REIT agreed to originate or acquire the loan, or on the date that the loan is modified (if the modification is treated as significant for tax purposes), a portion of the interest income from such loan will not be qualifying income for purposes of the 75% gross income test, but will be qualifying income for purposes of the 95% gross income test. The portion of the interest income that will not be qualifying income for purposes of the 75% gross income test will be equal to the portion of the principal amount of the loan that is not secured by real property—that is, the amount by which the loan exceeds the value of the real estate that is security for the loan. For purposes of this paragraph, however, under recently issued IRS guidance, we do not need to redetermine the fair market value of the real property in connection with a loan modification that is occasioned by a borrower default or made at a time when we reasonably believe the modification to the loan will substantially reduce a significant risk of default on the original loan.

Mezzanine loans are loans secured by equity interests in an entity that directly or indirectly owns real property, rather than by a direct mortgage of the real property. IRS Revenue Procedure 2003-65 provides a safe harbor pursuant to which a mezzanine loan, if it meets each of the requirements contained in the Revenue Procedure, will be treated by the IRS as a real estate asset for purposes of the REIT asset tests described below, and interest derived from it will be treated as qualifying mortgage interest for purposes of the 75% gross income test. Although the Revenue Procedure provides a safe harbor on which taxpayers may rely, it does not prescribe rules of substantive tax law. Moreover, we anticipate that the mezzanine loans we will acquire typically will not meet all of the requirements for reliance on this safe harbor. We intend to invest in mezzanine loans in manner that will enable us to continue to satisfy the gross income and asset tests.

**Dividends.** Our share of any dividends received from any corporation (including any taxable REIT subsidiary, but excluding any REIT) in which we own an equity interest will qualify for purposes of the 95% gross income test but not for purposes of the 75% gross income test. Our share of any dividends received from any other REIT in which we own an equity interest, if any, will be qualifying income for purposes of both gross income tests.

**Prohibited Transactions.** A REIT will incur a 100% tax on the net income derived from any sale or other disposition of property, other than foreclosure property, that the REIT holds primarily for sale to customers in the ordinary course of a trade or business. We believe that none of our assets are held primarily for sale to customers and that a sale of any of our assets will not be in the ordinary course of our business. Whether a REIT holds an asset primarily for sale to customers in the ordinary course of a trade or business depends, however, on the facts and circumstances in effect from time to time, including those related to a particular asset. A safe harbor to the characterization of the sale of property by a REIT as a prohibited transaction and the 100% prohibited transaction tax is available if the following requirements are met:

the REIT has held the property for not less than two years (or, for sales made on or before July 30, 2008, four years);

the aggregate expenditures made by the REIT, or any partner of the REIT, during the two-year period (or, for sales made on or before July 30, 2008, four-year period) preceding the date of the sale that are includable in the basis of the property do not exceed 30% of the selling price of the property;

either (1) during the year in question, the REIT did not make more than seven sales of property other than foreclosure property or sales to which Section 1033 of the Code applies, (2) the aggregate adjusted bases of all such properties sold by the REIT during the year did not exceed 10% of the aggregate bases of all of the assets of the REIT at the beginning of the year or (3) for sales made after July 30, 2008, the aggregate fair market value of all such properties sold by the REIT during the year did not exceed 10% of the aggregate fair market value of all of the assets of the REIT at the beginning of the year;

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in the case of property not acquired through foreclosure or lease termination, the REIT has held the property for at least two years (or, for sales made on or before July 30, 2008, four years) for the production of rental income; and

if the REIT has made more than seven sales of non-foreclosure property during the taxable year, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor from whom the REIT derives no income.

We will attempt to comply with the terms of the safe-harbor provision in the federal income tax laws prescribing when an asset sale will not be characterized as a prohibited transaction. We cannot assure you, however, that we can comply with the safe-harbor provisions or that we will avoid owning property that may be characterized as property held primarily for sale to customers in the ordinary course of a trade or business. We may, however, form or acquire a taxable REIT subsidiary to hold and dispose of those properties we conclude may not fall within the safe-harbor provisions.

**Foreclosure Property.** We will be subject to tax at the maximum corporate rate on any income from foreclosure property, which includes certain foreign currency gains and related deductions recognized subsequent to July 30, 2008, other than income that otherwise would be qualifying income for purposes of the 75% gross income test, less expenses directly connected with the production of that income. However, gross income from foreclosure property will qualify under the 75% and 95% gross income tests. Foreclosure property is any real property, including interests in real property, and any personal property incident to such real property:

that is acquired by a REIT as the result of the REIT having bid on such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on a lease of such property or on indebtedness that such property secured;

for which the related loan or leased property was acquired by the REIT at a time when the default was not imminent or anticipated; and

for which the REIT makes a proper election to treat the property as foreclosure property.

A REIT will not be considered to have foreclosed on a property where the REIT takes control of the property as a mortgagee-in-possession and cannot receive any profit or sustain any loss except as a creditor of the mortgagor. Property generally ceases to be foreclosure property at the end of the third taxable year following the taxable year in which the REIT acquired the property (or longer if an extension is granted by the Secretary of the Treasury). This period (as extended, if applicable) terminates, and foreclosure property ceases to be foreclosure property on the first day:

on which a lease is entered into for the property that, by its terms, will give rise to income that does not qualify for purposes of the 75% gross income test, or any amount is received or accrued, directly or indirectly, pursuant to a lease entered into on or after such day that will give rise to income that does not qualify for purposes of the 75% gross income test;

on which any construction takes place on the property, other than completion of a building or, any other improvement, where more than 10% of the construction was completed before default became imminent; or

which is more than 90 days after the day on which the REIT acquired the property and the property is used in a trade or business which is conducted by the REIT, other than through an independent contractor from whom the REIT itself does not derive or receive any income.

**Hedging Transactions.** From time to time, we enter into hedging transactions with respect to our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps, and floors, options to purchase such items, and futures and forward contracts. For hedging

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transactions entered into on or before July 30, 2008, income and gain from hedging transactions will be excluded from gross income for purposes of



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the 95% gross income test, but not the 75% gross income test. For hedging transactions entered into after July 30, 2008, income and gain from hedging transactions will be excluded from gross income for purposes of both the 75% and 95% gross income tests. A hedging transaction means either (1) any transaction entered into in the normal course of our trade or business primarily to manage the risk of interest rate, price changes, or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets or (2) for transactions entered into after July 30, 2008, any transaction entered into primarily to manage the risk of currency fluctuations with respect to any item of income or gain that would be qualifying income under the 75% or 95% gross income test (or any property which generates such income or gain). We are required to clearly identify any such hedging transaction before the close of the day on which it was acquired, originated, or entered into and to satisfy other identification requirements. We intend to structure any hedging transactions in a manner that does not jeopardize our qualification as a REIT; however, no assurance can be given that our hedging activities will not give rise to income that does not qualify for purposes of either or both of the gross income tests.

**Foreign Currency Gain.** Certain foreign currency gains recognized after June 30, 2008 will be excluded from gross income for purposes of one or both of the gross income tests. Real estate foreign exchange gain will be excluded from gross income for purposes of the 75% gross income test. Real estate foreign exchange gain generally includes foreign currency gain attributable to any item of income or gain that is qualifying income for purposes of the 75% gross income test, foreign currency gain attributable to the acquisition or ownership of (or becoming or being the obligor under) obligations secured by mortgages on real property or an interest in real property and certain foreign currency gain attributable to certain qualified business units of a REIT. Passive foreign exchange gain will be excluded from gross income for purposes of the 95% gross income test. Passive foreign exchange gain generally includes real estate foreign exchange gain as described above, and also includes foreign currency gain attributable to any item of income or gain that is qualifying income for purposes of the 95% gross income test and foreign currency gain attributable to the acquisition or ownership of (or becoming or being the obligor under) debt obligations. Because passive foreign exchange gain includes real estate foreign exchange gain, real estate foreign exchange gain is excluded from gross income for purposes of both the 75% and 95% gross income test. These exclusions for real estate foreign exchange gain and passive foreign exchange gain do not apply to any certain foreign currency gain derived from dealing, or engaging in substantial and regular trading, in securities. Such gain is treated as nonqualifying income for purposes of both the 75% and 95% gross income tests.

**Failure to Satisfy Gross Income Tests.** If we fail to satisfy one or both of the gross income tests for any taxable year, we nevertheless may qualify as a REIT for that year if we qualify for relief under certain provisions of the federal income tax laws. Those relief provisions will be available if:

our failure to meet those tests is due to reasonable cause and not to willful neglect; and

following such failure for any taxable year, a schedule of the sources of our income is filed with the IRS in accordance with regulations prescribed by the Secretary of the Treasury.

We cannot predict, however, whether any failure to meet these tests will qualify for the relief provisions. As discussed above in Taxation of Our Company, even if the relief provisions apply, we would incur a 100% tax on the gross income attributable to the greater of (1) the amount by which we fail the 75% gross income test, or (2) the amount by which we fail the 95% gross income test, multiplied, in either case, by a fraction intended to reflect our profitability.

**Asset Tests.** To maintain our qualification as a REIT, we also must satisfy the following asset tests at the end of each quarter of each taxable year.

First, at least 75% of the value of our total assets must consist of:

cash or cash items, including certain receivables;

government securities;



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interests in real property, including leaseholds and options to acquire real property and leaseholds;

interests in mortgages on real property;

stock in other REITs; and

investments in stock or debt instruments during the one-year period following our receipt of new capital that we raise through equity offerings or public offerings of debt with at least a five-year term.

Second, of our investments not included in the 75% asset class, the value of our interest in any one issuer's securities may not exceed 5% of the value of our total assets, or the 5% asset test.

Third, of our investments not included in the 75% asset class, we may not own more than 10% of the voting power or value of any one issuer's outstanding securities, or the 10% vote test and 10% value test, respectively.

Fourth, no more than 25% of the value of our total assets (or, prior to our 2009 taxable year, 20% of the value of our total assets) may consist of the securities of one or more taxable REIT subsidiaries.

Fifth, no more than 25% of the value of our total assets may consist of the securities of taxable REIT subsidiaries and other taxable subsidiaries and other assets that are not qualifying assets for purposes of the 75% asset test.

For purposes of the 5% asset test, the 10% vote test and 10% value test, the term securities does not include stock in another REIT, equity or debt securities of a qualified REIT subsidiary or taxable REIT subsidiary, mortgage loans that constitute real estate assets, or equity interests in a partnership. The term securities, however, generally includes debt securities issued by a partnership or another REIT, except that for purposes of the 10% value test, the term securities does not include:

Straight debt securities, which is defined as a written unconditional promise to pay on demand or on a specified date a sum certain in money if (i) the debt is not convertible, directly or indirectly, into stock, and (ii) the interest rate and interest payment dates are not contingent on profits, the borrower's discretion, or similar factors. Straight debt securities do not include any securities issued by a partnership or a corporation in which we or any controlled taxable REIT subsidiary hold non- straight debt securities that have an aggregate value of more than 1% of the issuer's outstanding securities. However, straight debt securities include debt subject to the following contingencies:

a contingency relating to the time of payment of interest or principal, as long as either (i) there is no change to the effective yield of the debt obligation, other than a change to the annual yield that does not exceed the greater of 0.25% or 5% of the annual yield, or (ii) neither the aggregate issue price nor the aggregate face amount of the issuer's debt obligations held by us exceeds \$1 million and no more than 12 months of unaccrued interest on the debt obligations can be required to be prepaid; and

a contingency relating to the time or amount of payment upon a default or prepayment of a debt obligation, as long as the contingency is consistent with customary commercial practice.

Any loan to an individual or an estate.

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Any section 467 rental agreement, other than an agreement with a related-party tenant.

Any obligation to pay rents from real property.

Certain securities issued by governmental entities.

Any security issued by a REIT.

Any debt instrument issued by an entity treated as a partnership for federal income tax purposes in which we are a partner to the extent of our proportionate interest in the debt and equity securities of the partnership.

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Any debt instrument issued by an entity treated as a partnership for federal income tax purposes not described in the preceding bullet points if at least 75% of the partnership's gross income, excluding income from prohibited transactions, is qualifying income for purposes of the 75% gross income test described above in Requirements for Qualification as a REIT Gross Income Tests. For purposes of the 10% value test, our proportionate share of the assets of a partnership is our proportionate interest in any securities issued by the partnership, without regard to the securities described in the preceding two bullet points above.

We believe that the assets that we hold satisfy the foregoing asset test requirements. However, we will not obtain independent appraisals to support our conclusions as to the value of our assets and securities. Moreover, the values of some assets may not be susceptible to a precise determination. As a result, there can be no assurance that the IRS will not contend that our ownership of securities and other assets violates one or more of the asset tests applicable to REITs.

As noted above, we may invest opportunistically in loans secured by interests in real property when we believe our investment will allow us to acquire control of the related real property. If the outstanding principal balance of a loan during a taxable year exceeds the fair market value of the real property securing such loan as of the date the REIT agreed to originate or acquire the loan, a portion of such loan likely will not constitute a qualifying real estate asset under the federal income tax laws. Although the law on the matter is not entirely clear, it appears that the nonqualifying portion of such loan will be equal to the portion of the loan amount that exceeds the value of the associated real property that serves as security for that loan. Under recently issued guidance, the IRS has stated that it will not challenge a REIT's treatment of a loan as being, in part, a real estate asset for purposes of the 75% asset test if the REIT treats the loan as being a qualifying real estate asset in an amount equal to the lesser of (i) the fair market value of the real property securing the loan on the date that the REIT acquires the loan or (ii) the fair market value of the loan.

We will monitor the status of our assets for purposes of the various asset tests and will manage our portfolio in order to comply at all times with such tests. If we fail to satisfy the asset tests at the end of a calendar quarter, we would not lose our REIT status if:

we satisfied the asset tests at the end of the preceding calendar quarter; and

the discrepancy between the value of our assets and the asset test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets.

If we did not satisfy the condition described in the second bullet point above, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which the discrepancy arose.

In the event that, at the end of any calendar quarter, we violate the 5% asset test, the 10% vote test or the 10% value test described above, we will not lose our REIT status if (i) the failure is de minimis (up to the lesser of 1% of our assets or \$10 million) and (ii) we dispose of assets causing the failure or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify such failure.

In the event of any other failure of the asset tests, we will not lose our REIT status if (i) the failure was due to reasonable cause and not to willful neglect, (ii) we file a description of each asset causing the failure with the IRS, (iii) we dispose of assets causing the failure or otherwise comply with the asset tests within six months after the last day of the quarter in which we identify the failure, and (iv) we pay a tax equal to the greater of \$50,000 or 35% of the net income from the nonqualifying assets during the period in which we failed to satisfy the asset tests.

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In 2010, we discovered that we may have inadvertently violated the 5% asset test for the quarter ended March 31, 2009 as a result of utilizing a certain cash management arrangement with a commercial bank. If that investment in a commercial paper investment account is not treated as cash, and is instead treated as a security for purposes of the quarterly 5% asset test described above, then we will have failed the 5% asset test for the first quarter of our 2009 taxable year by an amount that is greater than the threshold for de minimis failures of the 5% asset test described above. We believe, however, that if we in fact failed the test, our failure would be considered due to reasonable cause and not willful neglect. Consequently, we would not be disqualified as a REIT for failure of the 5% asset test, provided that we comply with certain reporting requirements and pay 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. We complied with the applicable reporting requirements, and we paid such tax on April 27, 2010.

Bass Berry & Sims PLC, our tax counsel, in providing the tax opinion set out under Taxation of Our Company, has concluded that if we are considered to have failed the 5% asset test for the first quarter of our 2009 taxable year, such failure will be considered to be due to reasonable cause and not willful neglect such that the failure will not result in our disqualification as a REIT for our 2009 taxable year. Opinions of counsel are not, however, binding on the IRS or the courts. If, notwithstanding the opinion of Bass Berry & Sims PLC, 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 for our 2009 taxable year. We would not be eligible to again elect REIT status until our 2014 taxable year. See Failure to Qualify as a REIT below.

**Annual Distribution Requirements.** Each taxable year, we must distribute dividends, other than capital gain dividends and deemed distributions of retained capital gain, to our shareholders in an aggregate amount not less than:

the sum of

90% of our REIT taxable income, computed without regard to the dividends paid deduction and our net capital gain or loss, and

90% of our after-tax net income, if any, from foreclosure property, minus

the sum of certain items of non-cash income.

Generally, we must pay such distributions in the taxable year to which they relate, or in the following taxable year if either (a) we declare the distribution before we timely file our federal income tax return for the year and pay the distribution on or before the first regular dividend payment date after such declaration or (b) we declare the distribution in October, November, or December of the taxable year, payable to shareholders of record on a specified day in any such month, and we actually pay the dividend before the end of January of the following year. In both instances, these distributions relate to our prior taxable year for purposes of the 90% distribution requirement.

We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to shareholders. Furthermore, if we fail to distribute during a calendar year, or by the end of January of the following calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of:

85% of our REIT ordinary income for the year,

95% of our REIT capital gain income for the year, and

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any undistributed taxable income from prior periods, we will incur a 4% nondeductible excise tax on the excess of such required distribution over the amounts we actually distributed. If we so elect, we will be treated as having distributed any such retained amount for purposes of the 4% nondeductible excise tax described above.

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It is possible that, from time to time, we may experience timing differences between the actual receipt of income and actual payment of deductible expenses and the inclusion of that income and deduction of such expenses in arriving at our REIT taxable income. For example, we may not deduct recognized capital losses from our REIT taxable income. Further, it is possible that, from time to time, we may be allocated a share of net capital gain from a partnership in which we own an interest attributable to the sale of depreciated property that exceeds our allocable share of cash attributable to that sale. Although several types of non-cash income are excluded in determining the annual distribution requirement, we will incur corporate income tax and the 4% nondeductible excise tax with respect to those non-cash income items if we do not distribute those items on a current basis. As a result of the foregoing, we may have less cash than is necessary to distribute all of our taxable income and thereby avoid corporate income tax and the 4% nondeductible excise tax imposed on certain undistributed income. In such a situation, we may need to borrow funds or issue additional common or preferred shares or, if possible, pay taxable dividends of our shares or debt securities.

Under certain circumstances, we may be able to correct a failure to meet the distribution requirement for a year by paying deficiency dividends to our shareholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest to the IRS based upon the amount of any deduction we take for deficiency dividends.

IRS guidance permits certain distributions made by a publicly traded REIT that (i) are declared before December 31, 2012 with respect to a taxable year ending on or before December 31, 2011 and (ii) consist of both cash and its shares to be treated as dividend distributions for purposes of satisfying the annual distribution requirements applicable to REITs. Based on that guidance, if our common shares continue to be publicly traded on an established securities market in the United States and if we satisfy certain requirements, including the requirement that at least 10% of the total value of any such distribution consists of cash, the cash and our shares that we distribute will be treated as a dividend, to the extent of our earnings and profits. If we make such a distribution to our shareholders, each of our shareholders will be required to treat the total value of the distribution that each shareholder receives as a dividend, to the extent of each shareholder's pro-rata share of our earnings and profits, regardless of whether such shareholder receives cash, our shares or a combination of cash and our shares. For a general discussion of the federal income tax consequences to our shareholders on the receipt of dividends, see below, [Taxation of Taxable U.S. Shareholders](#), [Taxation of Tax-Exempt Shareholders](#) and [Taxation of Non-U.S. Shareholders](#).

We advise each of our shareholders that the taxes resulting from your receipt of a distribution consisting of cash and our shares may exceed the cash that you receive in the distribution. We urge each of our shareholders to consult your tax advisor regarding the specific federal, state, local and foreign income and other tax consequences of distributions consisting of both cash and our shares.

**Recordkeeping Requirements.** We must maintain certain records in order to qualify as a REIT. In addition, to avoid paying a penalty, we must request on an annual basis information from our shareholders designed to disclose the actual ownership of our outstanding common shares.

**Failure to Qualify as a REIT.** If we were to fail to qualify as a REIT in any taxable year and no relief provision applied, we would have the following consequences: We would be subject to federal income tax and any applicable alternative minimum tax at regular corporate rates applicable to regular C corporations on our taxable income, determined without reduction for amounts distributed to shareholders. We would not be required to make any distributions to shareholders. Unless we qualified for relief under specific statutory provisions, we would not be permitted to elect taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT.

If we fail to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, we could avoid disqualification if our failure is due to reasonable cause and not to willful neglect



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and we pay a penalty of \$50,000 for each such failure. In addition, there are relief provisions for a failure of the gross income tests and asset tests, as described in Requirements for Qualification as a REIT Gross Income Tests and Requirements for Qualification as a REIT Asset Tests. We cannot predict whether, in all circumstances, we would qualify for such relief provisions.

**Taxable REIT Subsidiaries.** As described above, we may own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary is a fully taxable corporation that is permitted to have income that would not be qualifying income if earned directly by us. A taxable REIT subsidiary may provide services to our tenants and engage in activities unrelated to our tenants, such as third-party management, development, and other independent business activities.

We and a subsidiary must elect for the subsidiary to be treated as a taxable REIT subsidiary. If a taxable REIT subsidiary directly or indirectly owns more than 35% of the value or voting power of all outstanding stock of a corporation, the corporation will automatically also be treated as a taxable REIT subsidiary.

Rent we receive from a taxable REIT subsidiary will qualify as rents from real property as long as at least 90% of the leased space in the property is leased to persons other than taxable REIT subsidiaries and related-party tenants, and the amount paid by the taxable REIT subsidiary to rent space at the property is substantially comparable to rents paid by other tenants of the property for comparable space. The substantially comparable requirement must be satisfied when the lease is entered into, when it is extended, and when the lease is modified, if the modification increases the rent paid by the taxable REIT subsidiary. If the requirement that at least 90% of the leased space in the related property is rented to unrelated tenants is met when a lease is entered into, extended, or modified, such requirement will continue to be met as long as there is no increase in the space leased to any taxable REIT subsidiary or related-party tenant. Any increased rent attributable to a modification of a lease with a controlled taxable REIT subsidiary will not be treated as rents from real property. The taxable REIT subsidiary rules limit the deductibility of interest paid or accrued by a taxable REIT subsidiary to us to assure that the taxable REIT subsidiary is subject to an appropriate level of corporate taxation. Further, the rules impose a 100% excise tax on transactions between a taxable REIT subsidiary and us or our tenants that are not conducted on an arm's-length basis.

**State and Local Taxes.** We may be subject to taxation by various states and localities, including those in which we transact business or own property. The state and local tax treatment in such jurisdictions may differ from the federal income tax treatment described above.

**Taxation of Taxable U.S. Shareholders**

For purposes of our discussion, the term U.S. shareholder means a holder of our common shares that, for U.S. federal income tax purposes, is:

a citizen or resident of the United States;

a corporation (including an entity treated as a corporation for federal income tax purposes) created or organized under the laws of the United States, any of its states or the District of Columbia;

an estate whose income is subject to U.S. federal income taxation regardless of its source; or

any trust if (1) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person.

If a partnership, entity or arrangement treated as a partnership for federal income tax purposes holds our common shares, the federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. If you are a partner in a partnership holding our common shares, you should consult your tax advisor regarding the consequences of the ownership and disposition of our common shares by the partnership.



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As long as we qualify as a REIT, distributions made out of our current or accumulated earnings and profits that we do not designate as capital gain dividends or retained long-term capital gains will be ordinary dividend income to taxable U.S. shareholders. A U.S. shareholder will not qualify for the dividends-received deduction generally available to corporations. Dividends paid to a U.S. shareholder generally will not qualify for the 15% tax rate for qualified dividend income. Legislation enacted in 2003, 2006 and 2010 reduced the maximum tax rate for qualified dividend income from 38.6% to 15% for tax years 2003 through 2012. Without future congressional action, the maximum tax rate on qualified dividend income will increase to 39.6% in 2013. Qualified dividend income generally includes dividends paid by domestic C corporations and certain qualified foreign corporations to most noncorporate U.S. shareholders. Because a REIT is not generally subject to federal income tax on the portion of its REIT taxable income distributed to its shareholders, our dividends generally will not be eligible for the 15% rate on qualified dividend income. As a result, our ordinary REIT dividends will be taxed at the higher rate applicable to ordinary income. The highest marginal individual income tax rate on ordinary income is 35% (currently through 2012). The 15% tax rate for qualified dividend income will apply, however, to our ordinary REIT dividends, if any, that are (i) attributable to dividends received by us prior to 2013 from non-REIT corporations, such as any taxable REIT subsidiaries, and (ii) attributable to income recognized by us prior to 2013 and on which we have paid corporate income tax (e.g., to the extent that we distribute less than 100% of our taxable income). In general, to qualify for the reduced tax rate on qualified dividend income under such circumstances, a U.S. shareholder must hold our common shares for more than 60 days during the 121-day period beginning on the date that is 60 days before the date on which our common shares become ex-dividend. In addition, dividends paid to certain individuals, estates or trusts after December 31, 2012 will be subject to a 3.8% Medicare tax.

Any distribution we declare in October, November, or December of any year that is payable to a U.S. shareholder of record on a specified date in any of those months will be treated as paid by us and received by the U.S. shareholder on December 31 of the year, provided we actually pay the distribution during January of the following calendar year.

Distributions to a U.S. shareholder which we designate as capital gain dividends will generally be treated as long-term capital gain, without regard to the period for which the U.S. shareholder has held our shares. We generally will designate our capital gain dividends as either 15% or 25% rate distributions. A corporate U.S. shareholder, however, may be required to treat up to 20% of certain capital gain dividends as ordinary income.

We may elect to retain and pay income tax on the net long-term capital gain that we receive in a taxable year. In that case, a U.S. shareholder would be taxed on its proportionate share of our undistributed long-term capital gain. The U.S. shareholder would receive a credit or refund for its proportionate share of the tax we paid. The U.S. shareholder would increase the basis in its common shares by the amount of its proportionate share of our undistributed long-term capital gain, minus its share of the tax we paid.

A U.S. shareholder will not incur tax on a distribution in excess of our current and accumulated earnings and profits if the distribution does not exceed the adjusted basis of the U.S. shareholder's common shares. Instead, the distribution will reduce the adjusted basis of the shares, and any amount in excess of both our current and accumulated earnings and profits and the adjusted basis will be treated as capital gain, long-term if the shares have been held for more than one year, provided the shares are a capital asset in the hands of the U.S. shareholder.

U.S. shareholders may not include in their individual income tax returns any of our net operating losses or capital losses. Instead, these losses are generally carried over by us for potential offset against our future income. Taxable distributions from us and gain from the disposition of common shares will not be treated as passive activity income; and, therefore, U.S. shareholders generally will not be able to apply any passive activity losses, such as, for example, losses from certain types of limited partnerships in which a U.S. shareholder is a limited partner, against such income. In addition, taxable distributions from us and gain from the disposition of common shares generally will be treated as investment income for purposes of the investment interest limitations.

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We will notify U.S. shareholders after the close of our taxable year as to the portions of the distributions attributable to that year that constitute ordinary income, return of capital and capital gain.

***Taxation of Taxable U.S. Shareholders on the Disposition of Common Shares.*** In general, a U.S. shareholder who is not a dealer in securities must treat any gain or loss realized upon a taxable disposition of our common shares as long-term capital gain or loss if the U.S. shareholder has held the shares for more than one year, and otherwise as short-term capital gain or loss. In general, a U.S. shareholder will realize gain or loss in an amount equal to the difference between the sum of the fair market value of any property and the amount of cash received in such disposition and the U.S. shareholder's adjusted tax basis. A U.S. shareholder's adjusted tax basis generally will equal the U.S. shareholder's acquisition cost, increased by the excess of undistributed net capital gains deemed distributed to the U.S. shareholder over the tax deemed paid by it and decreased by any returns of capital. However, a U.S. shareholder must treat any loss upon a sale or exchange of common shares held by such shareholder for six months or less as a long-term capital loss to the extent of capital gain dividends and any actual or deemed distributions from us that such U.S. shareholder treats as long-term capital gain. All or a portion of any loss that a U.S. shareholder realizes upon a taxable disposition of common shares may be disallowed if the U.S. shareholder purchases other common shares within 30 days before or after the disposition. In addition, capital gain recognized by certain individuals, estates or trusts on dispositions of our common shares after December 31, 2012 will be subject to a 3.8% Medicare tax.

***Capital Gains and Losses.*** The tax-rate differential between capital gain and ordinary income for non-corporate taxpayers may be significant. A taxpayer generally must hold a capital asset for more than one year for gain or loss derived from its sale or exchange to be treated as long-term capital gain or loss. The highest marginal individual income tax rate is currently 35% (which rate currently is scheduled to apply through December 31, 2012). The maximum tax rate on long-term capital gain applicable to U.S. shareholders taxed at individual rates currently is 15% (which rate currently is scheduled to apply through December 31, 2012). The maximum tax rate on long-term capital gain from the sale or exchange of section 1250 property (i.e., generally, depreciable real property) is 25% to the extent the gain would have been treated as ordinary income if the property were section 1245 property (i.e., generally, depreciable personal property). We generally may designate whether a distribution we designate as capital gain dividends (and any retained capital gain that we are deemed to distribute) is taxable to non-corporate shareholders at a 15% or 25% rate. The characterization of income as capital gain or ordinary income may affect the deductibility of capital losses. A non-corporate taxpayer may deduct capital losses not offset by capital gains against its ordinary income only up to a maximum of \$3,000 annually. A non-corporate taxpayer may carry unused capital losses forward indefinitely. A corporate taxpayer must pay tax on its net capital gain at corporate ordinary-income rates. A corporate taxpayer may deduct capital losses only to the extent of capital gains, with unused losses carried back three years and forward five years.

***Information Reporting Requirements, Backup Withholding and Certain Other Required Withholding.*** We will report to our shareholders and to the IRS the amount of distributions we pay during each calendar year and the amount of tax we withhold, if any. A shareholder may be subject to backup withholding at a rate of up to 28% (which rate is currently scheduled to apply through December 31, 2012) with respect to distributions unless the shareholder:

is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact; or

provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with the applicable requirements of the backup withholding rules.

A shareholder who does not provide us with its correct taxpayer identification number also may be subject to penalties imposed by the IRS. Any amount paid as backup withholding will be creditable against the shareholder's income tax liability. In addition, we may be required to withhold a portion of capital gain distributions to any shareholders who fail to certify their non-foreign status to us.

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For taxable years beginning after December 31, 2012, if certain disclosure requirements related to U.S. accounts or ownership are not satisfied, a U.S. withholding tax at a 30% rate will be imposed on dividends and proceeds of sale in respect of our common shares received by (i) U.S. shareholders that own their shares through foreign accounts or foreign intermediaries and (ii) certain non-U.S. shareholders. If payment of withholding taxes is required, non-U.S. shareholders that are otherwise eligible for an exemption from, or reduction of, U.S. withholding taxes with respect to such dividends and proceeds will be required to seek a refund from the IRS to obtain the benefit of such exemption or reduction. We will not pay any additional amounts in respect of any amounts withheld.

### **Taxation of Tax-Exempt Shareholders**

Tax-exempt entities, including qualified employee pension and profit sharing trusts and individual retirement accounts and annuities, generally are exempt from federal income taxation. However, they are subject to taxation on their unrelated business taxable income. While many investments in real estate generate unrelated business taxable income, the IRS has issued a ruling that dividend distributions from a REIT to an exempt employee pension trust do not constitute unrelated business taxable income so long as the exempt employee pension trust does not otherwise use the shares of the REIT in an unrelated trade or business of the pension trust. Based on that ruling, amounts we distribute to tax-exempt shareholders generally should not constitute unrelated business taxable income. However, if a tax-exempt shareholder were to finance its acquisition of common shares with debt, a portion of the income it received from us would constitute unrelated business taxable income pursuant to the debt-financed property rules. Furthermore, social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, and qualified group legal services plans that are exempt from taxation under special provisions of the federal income tax laws are subject to different unrelated business taxable income rules, which generally will require them to characterize distributions they receive from us as unrelated business taxable income.

Finally, in certain circumstances, a qualified employee pension or profit-sharing trust that owns more than 10% of our shares of beneficial interest (by value) must treat a percentage of the dividends it receives from us as unrelated business taxable income. This rule applies to a pension trust holding more than 10% of our shares only if:

the percentage of our dividends that the tax-exempt trust must treat as unrelated business taxable income is at least 5%;

we qualify as a REIT by reason of the modification of the rule requiring that no more than 50% of our shares of beneficial interest be owned by five or fewer individuals that allows the beneficiaries of the pension trust to be treated as holding our shares in proportion to their actuarial interests in the pension trust; and

either:

one pension trust owns more than 25% of the value of our shares of beneficial interest; or

one or more pension trusts each individually holding more than 10% of the value of our shares of beneficial interest collectively owns more than 50% of the value of our shares of beneficial interest.

As a result of limitations included in our declaration of trust on the transfer and ownership of our shares, we do not expect to be classified as a pension-held REIT, and as a result, the tax treatment described in this paragraph should be inapplicable to our shareholders. However, because our common shares are publicly traded, we cannot guarantee that this will always be the case.

### **Taxation of Non-U.S. Shareholders**

For purposes of our discussion, the term non-U.S. shareholder means a holder of our common shares that is not a U.S. shareholder, a partnership (or an entity treated as a partnership for federal income tax purposes) or a tax-exempt shareholder. The rules governing U.S. federal income taxation of non-U.S. shareholders are complex. This section is only a summary of such rules.



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**We urge non-U.S. shareholders to consult their own tax advisors to determine the impact of federal, state, local and foreign income tax laws on the acquisition, ownership and disposition of our common shares, including any reporting requirements.**

***Distributions.*** A non-U.S. shareholder that receives a distribution that is not attributable to gain from our sale or exchange of a United States real property interest, or a USRPI, (discussed below) and that we do not designate a capital gain dividend or retained capital gain will recognize ordinary income to the extent that we pay such distribution out of our current or accumulated earnings and profits. A withholding tax equal to 30% of the gross amount of the distribution ordinarily will apply unless an applicable tax treaty reduces or eliminates the tax. However, a non-U.S. shareholder generally will be subject to federal income tax at graduated rates on any distribution treated as effectively connected with the non-U.S. shareholder's conduct of a U.S. trade or business, in the same manner as U.S. shareholders are taxed on distributions. A corporate non-U.S. shareholder may, in addition, be subject to the 30% branch profits tax with respect to that distribution. We plan to withhold U.S. income tax at the rate of 30% on the gross amount of any distribution paid to a non-U.S. shareholder unless either:

a lower treaty rate applies and the non-U.S. shareholder submits an IRS Form W-8BEN to us evidencing eligibility for that reduced rate;

the non-U.S. shareholder submits an IRS Form W-8ECI to us claiming that the distribution is effectively connected income; or

the distribution is treated as attributable to a sale of a USRPI under FIRPTA (discussed below).

A non-U.S. shareholder will not incur tax on a distribution in excess of our current and accumulated earnings and profits if the excess portion of such distribution does not exceed the adjusted basis of its common shares. Instead, the excess portion of the distribution will reduce the adjusted basis of such shares. A non-U.S. shareholder will be subject to tax on a distribution that exceeds both our current and accumulated earnings and profits and the adjusted basis of its shares, if the non-U.S. shareholder otherwise would be subject to tax on gain from the sale or disposition of common shares, as described below. We may be required to withhold 10% of any distribution that exceeds our current and accumulated earnings and profits. Although we intend to withhold at a rate of 30% on the entire amount of any distribution (other than a distribution attributable to a sale of a USRPI), to the extent we do not do so, we may withhold at a rate of 10% on any portion of a distribution not subject to withholding at a rate of 30%. Because we generally cannot determine at the time we make a distribution whether the distribution will exceed our current and accumulated earnings and profits, we normally will withhold tax on the entire amount of any distribution. A non-U.S. shareholder may obtain a refund of amounts we withhold if we later determine that a distribution in fact exceeded our current and accumulated earnings and profits.

For any year in which we qualify as a REIT, the Foreign Investment in Real Property Tax Act of 1980, or FIRPTA, may apply to our sale or exchange of a USRPI. A USRPI includes certain interests in real property and shares in corporations at least 50% of whose assets consist of interests in real property. Under FIRPTA, a non-U.S. shareholder is taxed on distributions attributable to gain from sales of USRPIs as if the gain were effectively connected with the conduct of a U.S. business of the non-U.S. shareholder. A non-U.S. shareholder thus would be taxed on such a distribution at the normal capital gain rates applicable to U.S. shareholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of a nonresident alien individual. A non-U.S. corporate shareholder not entitled to treaty relief or exemption also may be subject to the 30% branch profits tax on such a distribution.

As long as our common shares continue to be regularly traded on an established securities market in the United States, capital gain distributions to a non-U.S. shareholder of our common shares that are attributable to our sale of real property will be treated as ordinary dividends rather than as gain from the sale of a USRPI, as long as the non-U.S. shareholder did not own more than 5% of our common shares any time during the one-year period prior to the distribution. As a result, non-U.S. shareholders owning 5% or less of our common shares

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generally would be subject to withholding tax on such capital gain distributions in the same manner as they are subject to withholding tax on other distributions. We expect that our common shares will continue to be regularly traded on an established securities market in the United States following this offering. If our common shares are not regularly traded on an established securities market in the United States or the non-U.S. shareholder owned more than 5% of our common shares any time during the one-year period prior to the distribution, capital gain distributions that are attributable to our sale of real property would be subject to tax under FIRPTA, as described in the preceding paragraph. In such case, we must withhold 35% of any distribution that we could designate as a capital gain dividend. A non-U.S. shareholder may receive a credit against its tax liability for the amount we withhold. Moreover, if a non-U.S. shareholder disposes of our common shares during the 30-day period preceding a dividend payment, and such non-U.S. shareholder (or a person related to such non-U.S. shareholder) acquires or enters into a contract or option to acquire our common shares within 61 days of the 1st day of the 30-day period described above, and any portion of such dividend payment would, but for the disposition, be treated as a USRPI capital gain to such non-U.S. shareholder, then such non-U.S. shareholder shall be treated as having USRPI capital gain in an amount that, but for the disposition, would have been treated as USRPI capital gain.

**Dispositions.** Non-U.S. shareholders could incur tax under FIRPTA with respect to gain realized upon a disposition of our common shares. However, non-U.S. shareholders generally will not incur tax under FIRPTA with respect to gain on a sale of common shares as long as, at all times, non-U.S. persons hold, directly or indirectly, less than 50% in value of the outstanding common shares. We cannot assure you that this test will be met. In addition, a non-U.S. shareholder that owned, actually or constructively, 5% or less of the outstanding common shares of a REIT at all times during a specified testing period will not incur tax under FIRPTA on gain from a sale of common shares if the shares are regularly traded on an established securities market. We expect that our common shares will continue to be regularly traded on an established securities market following this offering.

Even if we fail to be domestically controlled (as described above), we expect that a non-U.S. shareholder generally will not incur tax under FIRPTA on gain from a sale of our common shares unless it owns or has owned more than 5% of our common shares at any time during the five year period prior to such sale. Any gain subject to tax under FIRPTA will be treated in the same manner as it would be in the hands of U.S. shareholders subject to alternative minimum tax, but under a special alternative minimum tax in the case of nonresident alien individuals.

A non-U.S. shareholder generally will incur tax on gain from a disposition of our common shares not subject to FIRPTA if:

the gain is effectively connected with the conduct of the non-U.S. shareholder's U.S. trade or business, in which case the non-U.S. shareholder will be subject to the same treatment as U.S. shareholders with respect to the gain; or

the non-U.S. shareholder is a nonresident alien individual who was present in the U.S. for 183 days or more during the taxable year and has a tax home in the United States, in which case the non-U.S. shareholder will incur a 30% tax on capital gains.

**Other Tax Consequences**

**Tax Aspects of Our Investments in Our Operating Partnership.** The following discussion summarizes certain federal income tax considerations applicable to our direct or indirect investment in our Operating Partnership and any subsidiary partnerships or limited liability companies we form or acquire that are treated as partnerships for federal income tax purposes, each individually referred to as a Partnership and, collectively, as Partnerships. The following discussion does not address state or local tax laws or any federal tax laws other than income tax laws.



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***Classification as Partnerships.*** We are required to include in our income our distributive share of each Partnership's income and to deduct our distributive share of each Partnership's losses but only if such Partnership is classified for federal income tax purposes as a partnership (or an entity that is disregarded for federal income tax purposes if the entity is treated as having only one owner or member for federal income tax purposes), rather than as a corporation or an association taxable as a corporation.

An organization with at least two owners or members will be classified as a partnership, rather than as a corporation, for federal income tax purposes if it:

is treated as a partnership under the Treasury regulations relating to entity classification, or the check-the-box regulations; and

is not a publicly traded partnership.

Under the check-the-box regulations, an unincorporated entity with at least two owners or members may elect to be classified either as an association taxable as a corporation or as a partnership. If such an entity does not make an election, it generally will be treated as a partnership for federal income tax purposes. We intend that each Partnership will be classified as a partnership for federal income tax purposes (or else a disregarded entity where there are not at least two separate owners for federal income tax purposes).

A publicly traded partnership is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or a substantial equivalent). A publicly traded partnership is generally treated as a corporation for federal income tax purposes, but will not be so treated if, for each taxable year beginning after December 31, 1987 in which it was classified as a publicly traded partnership, at least 90% of the partnership's gross income consisted of specified passive income, including real property rents (which includes rents that would be qualifying income for purposes of the 75% gross income test, with certain modifications that make it easier for the rents to qualify for the 90% passive income exception), gains from the sale or other disposition of real property, interest, and dividends, or the 90% passive income exception.

Treasury regulations, referred to as PTP regulations, provide limited safe harbors from treatment as a publicly traded partnership. If any partnership in which we own an interest does not qualify for any safe harbor and is treated as a publicly traded partnership, we believe that such partnership would have sufficient qualifying income to satisfy the 90% passive income exception and, therefore, would not be treated as a corporation for federal income tax purposes.

We have not requested, and do not intend to request, a ruling from the IRS that the Partnerships will be classified as partnerships for federal income tax purposes (or disregarded entities, if the entity has only one owner or member for federal income tax purposes). If for any reason a Partnership were taxable as a corporation, rather than as a partnership, for federal income tax purposes, we may not be able to qualify as a REIT, unless we qualify for certain relief provisions. See Requirements for Qualification as a REIT Gross Income Tests and Requirements for Qualification as a REIT Asset Tests. In addition, any change in a Partnership's status for tax purposes might be treated as a taxable event, in which case we might incur tax liability without any related cash distribution. See Requirements for Qualification as a REIT Annual Distribution Requirements. Further, items of income and deduction of such Partnership would not pass through to its partners, and its partners would be treated as shareholders for tax purposes. Consequently, such Partnership would be required to pay income tax at corporate rates on its net income, and distributions to its partners would constitute dividends that would not be deductible in computing such Partnership's taxable income.

**Income Taxation of the Partnerships and Their Partners**

***Partners, Not the Partnerships, Subject to Tax.*** A partnership is not a taxable entity for federal income tax purposes. We will therefore take into account our allocable share of each Partnership's income, gains, losses, deductions, and credits for each taxable year of the Partnership ending with or within our taxable year, even if we

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receive no distribution from the Partnership for that year or a distribution less than our share of taxable income. Similarly, even if we receive a distribution, it may not be taxable if the distribution does not exceed our adjusted tax basis in our interest in the Partnership.

**Partnership Allocations.** Although a partnership agreement generally will determine the allocation of income and losses among partners, allocations will be disregarded for tax purposes if they do not comply with the provisions of the federal income tax laws governing partnership allocations. If an allocation is not recognized for federal income tax purposes, the item subject to the allocation will be reallocated in accordance with the partners' interests in the partnership, which will be determined by taking into account all of the facts and circumstances relating to the economic arrangement of the partners with respect to such item.

**Tax Allocations With Respect to Contributed Properties.** Income, gain, loss, and deduction attributable to appreciated or depreciated property that is contributed to a partnership in exchange for an interest in the partnership must be allocated for federal income tax purposes in a manner such that the contributing partner is charged with, or benefits from, respectively, the unrealized gain or unrealized loss associated with the property at the time of the contribution (the 704(c) Allocations). The amount of such unrealized gain or unrealized loss, referred to as built-in gain or built-in loss, at the time of contribution is generally equal to the difference between the fair market value of the contributed property at the time of contribution and the adjusted tax basis of such property at that time, referred to as a book-tax difference. A book-tax difference attributable to depreciable property generally is decreased on an annual basis as a result of the allocation of depreciation deductions to the contributing partner for book purposes, but not for tax purposes. The 704(c) Allocations are solely for federal income tax purposes and do not affect the book capital accounts or other economic or legal arrangements among the partners. The U.S. Treasury Department has issued regulations requiring partnerships to use a reasonable method for allocating items with respect to which there is a book-tax difference and outlining several reasonable allocation methods.

Under certain available methods, including the traditional method, the carryover basis of contributed properties in the hands of our Operating Partnership (i) would cause us to be allocated lower amounts of depreciation deductions for tax purposes than would be allocated to us if all contributed properties were to have a tax basis equal to their fair market value at the time of the contribution and (ii) in the event of a sale of such properties, could cause us to be allocated taxable gain in excess of the economic or book gain allocated to us as a result of such sale, with a corresponding tax benefit to the contributing partners. An allocation described in (ii) above might cause us to recognize taxable income in excess of cash proceeds in the event of a sale or other disposition of property, which might adversely affect our ability to comply with the REIT distribution requirements and may result in a greater portion of our distributions being taxed as dividends.

**Basis in Partnership Interest.** Our adjusted tax basis in any partnership interest we own generally will be:

the amount of cash and the basis of any other property we contribute to the partnership;

increased by our allocable share of the partnership's income (including tax-exempt income) and any increase in our allocable share of indebtedness of the partnership; and

reduced, but not below zero, by our allocable share of the partnership's loss (excluding any non-deductible items), the amount of cash and the basis of property distributed to us, and any reduction in our allocable share of indebtedness of the partnership.

Loss allocated to us in excess of our basis in a partnership interest will not be taken into account until we again have basis sufficient to absorb the loss. A reduction of our share of partnership indebtedness will be treated as a constructive cash distribution to us, and will reduce our adjusted tax basis. Distributions, including constructive distributions, in excess of the basis of our partnership interest will constitute taxable income to us. Such distributions and constructive distributions normally will be characterized as long-term capital gain.

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*Sale of a Partnership's Property.* Generally, any gain realized by a Partnership on the sale of property held for more than one year will be long-term capital gain, except for any portion of the gain treated as depreciation or cost recovery recapture.

Our share of any Partnership gain from the sale of inventory or other property held primarily for sale to customers in the ordinary course of the Partnership's trade or business will be treated as income from a prohibited transaction subject to a 100% tax. Income from a prohibited transaction may have an adverse effect on our ability to satisfy the gross income tests for REIT status. See Requirements for Qualification as a REIT - Gross Income Tests. We do not presently intend to acquire or hold, or to allow any Partnership to acquire or hold, any property that is likely to be treated as inventory or property held primarily for sale to customers in the ordinary course of our, or any Partnership's, trade or business.

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**ERISA CONSIDERATIONS**

**General**

The following is a summary of certain material considerations arising under the Employee Retirement Income Security Act of 1974, as amended, or ERISA, and the prohibited transaction provisions of Section 4975 of the Code that may be relevant to a prospective purchaser. The following summary may also be relevant to a prospective purchaser that is not an employee benefit plan which is subject to ERISA, but is a tax-qualified retirement plan or an individual retirement account, individual retirement annuity, an Archer MSA, a health savings account, or an education individual retirement account or certain other plans designated by the Secretary of the Treasury, which we refer to collectively as an IRA; provided, however, that the term IRA excludes governmental plans and church plans (if no election has been made under Section 410(d) of the Code). Also, Section 4975 of the Code shall not apply, in the case of a plan to which a guaranteed benefit policy is issued, to any assets of an insurance company, insurance service or insurance organization, merely because of its issuance of such policy.

This discussion does not address all aspects of ERISA or Section 4975 of the Code or, to the extent not preempted, state law that may be relevant to particular employee benefit plan shareholders in light of their particular circumstances, including plans subject to Title I of ERISA, or ERISA plans, other employee benefit plans and IRAs subject to the prohibited transaction provisions of Section 4975 of the Code, and governmental, church, foreign and other plans that may be exempt from all or certain provisions of ERISA and Section 4975 of the Code but that may be subject to other federal, state, local or foreign law requirements.

A fiduciary making the decision to invest in our Class B common shares on behalf of a prospective purchaser which is an ERISA plan or an IRA or other employee benefit plan is advised to consult its legal advisor regarding the specific considerations arising under ERISA, Section 4975 of the Code, and, to the extent not preempted, state law with respect to the purchase, ownership or sale of our Class B common shares by the plan or IRA.

Plans should also consider the entire discussion under the heading Material U.S. Federal Income Tax Considerations, as material contained in that section is relevant to any decision by an employee benefit plan, tax-qualified retirement plan or IRA to purchase our common shares.

**Employee Benefit Plans, Tax-Qualified Retirement Plans and IRAs**

Each fiduciary of an ERISA plan, which is an employee benefit plan subject to Title I of ERISA, should carefully consider whether an investment in our Class B common shares is consistent with its fiduciary responsibilities under ERISA. In particular, the fiduciary requirements of Part 4 of Subtitle B of Title I of ERISA require that:

an ERISA plan make investments that are prudent and in the best interests of the ERISA plan, its participants and beneficiaries;

an ERISA plan make investments that are diversified in order to reduce the risk of large losses, unless it is clearly prudent for the ERISA plan not to do so;

an ERISA plan's investments are authorized under ERISA and the terms of the governing documents of the ERISA plan; and

the fiduciary not cause the ERISA plan to enter into transactions prohibited under Section 406 of ERISA, and certain corresponding provisions of the Code (which are not exempt from such rules under Section 408 of ERISA).

In determining whether an investment in our Class B common shares is prudent for ERISA purposes, the appropriate fiduciary of an ERISA plan should consider all of the facts and circumstances, including whether the



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investment is reasonably designed, as a part of the ERISA plan's portfolio for which the fiduciary has investment responsibility, to meet the objectives of the ERISA plan, taking into consideration the risk of loss and opportunity for gain or other return from the investment, the diversification, cash flow and funding requirements of the ERISA plan, and the liquidity and current return of the ERISA plan's portfolio. A fiduciary should also take into account the nature of our business, the length of our operating history and other matters described in the section entitled "Risk Factors."

The fiduciary of an employee benefit plan not subject to Title I of ERISA because, among other reasons, it is an IRA, a governmental or church plan (if no election has been made under Section 410(d) of the Code) or because it does not cover common law employees should consider that it may only make investments that are either authorized or not prohibited by the appropriate governing documents and permitted under applicable state law, and such fiduciary should also confirm the extent to which, if at all, Section 4975 of the Code and ERISA applies to such plan.

**Our Status Under ERISA**

In some circumstances where an ERISA plan or an IRA (collectively referred to as a Benefit Plan) holds an interest in an entity, the assets of the entity are deemed to be ERISA plan assets. This is known as the "look-through rule." Under those circumstances, the obligations and other responsibilities of plan sponsors, plan fiduciaries and plan administrators, and of parties in interest and disqualified persons, under Parts 1 and 4 of Subtitle B of Title I of ERISA and Section 4975 of the Code, as applicable, may be expanded, and there may be an increase in their liability under these and other provisions of ERISA and the Code (except to the extent (if any) that a favorable statutory or administrative exemption or exception applies). For example, a prohibited transaction may occur if our assets are deemed to be assets of investing Benefit Plans and persons who have certain specified relationships to a Benefit Plan ( "parties in interest" within the meaning of ERISA, and "disqualified persons" within the meaning of the Code) deal with these assets. Further, if our assets are deemed to be assets of investing Benefit Plans, any person that exercises authority or control with respect to the management or disposition of the assets is a Benefit Plan fiduciary.

Benefit Plan assets are defined in ERISA Section 3(42), and the U.S. Department of Labor has issued regulations, 29 C.F.R. Section 2510.3-101, or the Department of Labor regulations, that outline the circumstances under which a Benefit Plan's interest in an entity will be subject to the look-through rule. The Department of Labor regulations apply to the purchase by a Benefit Plan of an equity interest in an entity, such as shares of a REIT. The look-through rule generally is not triggered unless 25% or more of the value of any class of equity interests in the entity is held by Benefit Plan investors. In calculating this 25% threshold, the interests held by certain persons are disregarded, including persons (other than benefit plan investors) who have discretionary authority or control with respect to the entity's assets, persons who provide investment advice for a fee with respect to the assets, and the affiliates of such persons. For purposes of this paragraph, a benefit plan investor includes:

- (i) an employee benefit plan(as defined in Section 3(3) of ERISA);
- (ii) any plan to which Section 4975 of the Code applies, namely IRAs and ERISA plans; and
- (iii) any entity whose underlying assets include plan assets by reason of a plan's investment in the entity.

Department of Labor regulations also provide an exception to the look-through rule for equity interests that are publicly offered securities. Therefore, if the Class B common shares are publicly offered securities, our assets should not be deemed to be Benefit Plan assets under ERISA or the Code. Under the Department of Labor regulations, a publicly offered security is a security that is:

freely transferable;

part of a class of securities that is widely held; and

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either part of a class of securities that is registered under Section 12(b) or 12(g) of the Exchange Act or sold to a Benefit Plan as part of an offering of securities to the public pursuant to an effective registration statement under the Securities Act, and the class of securities of which this security is a part is registered under the Exchange Act within 120 days, or longer if allowed by the SEC, after the end of the fiscal year of the issuer during which this offering of these securities to the public occurred.

Whether a security is considered freely transferable depends on the facts and circumstances of each case. Under the Department of Labor regulations, if the security is part of an offering in which the minimum investment is \$10,000 or less, then any restriction on or prohibition against any transfer or assignment of the security for the purposes of preventing a termination or reclassification of the entity for federal or state tax purposes will not ordinarily prevent the security from being considered freely transferable. Additionally, limitations or restrictions on the transfer or assignment of a security which are created or imposed by persons other than the issuer of the security or persons acting for or on behalf of the issuer will ordinarily not prevent the security from being considered freely transferable. Certain other restrictions and limitations may also be permissible and will not affect whether such security is freely transferable under the applicable Department of Labor regulations when the minimum investment is \$10,000 or less, including the following restrictions, limitations or prohibitions, as follows:

(i) a requirement that not less than a minimum number of share or units of such security be transferred or assigned by any investor, provided, however, that such requirement does not prevent transfer of all of the then remaining shares or units held by an investor;

(ii) any prohibition against transfer or assignment of such security or any corresponding rights to an ineligible or unsuitable investor;

(iii) any requirement that reasonable transfer or administrative fee(s) be paid in connection with a transfer or assignment;

(iv) a requirement for advance notice to the entity of a transfer or assignment and a requirement regarding execution of documentation of the transfer or assignment, including documentation of representations from the transferor or the transferee evidencing compliance with regulations regarding free transferability of the security or with any restriction or requirement in such entity's governing instrument;

(v) a restriction on substitution of an assignee as a limited partner of a partnership, including a general partner consent requirement, provided that the economic benefits of ownership of the assignee may be transferred or assigned without regard to the restriction or consent; and

(vii) an administrative procedure that establishes an effective date or an event, such as the completion of the offering, prior to which a transfer or assignment will not be effective.

A class of securities is considered widely held if it is a class of securities that is owned by 100 or more investors independent of the issuer and of one another. A security will not fail to be widely held because the number of independent investors falls below 100 subsequent to the initial public offering as a result of events beyond the issuer's control.

Our Class B common shares offered in this prospectus may meet the criteria of the publicly offered securities exception to the look-through rule. First, the Class B common shares could be considered to be freely transferable, as the minimum investment will be less than \$10,000 and the only restrictions upon its transfer are those generally permitted under the Department of Labor regulations, those required under federal tax laws to maintain our status as a REIT, resale restrictions under applicable federal securities laws with respect to securities not purchased pursuant to this prospectus and those owned by our officers, trustees and other affiliates, and voluntary restrictions agreed to by the selling shareholder regarding volume limitations.

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Second, we expect that our Class B common shares will continue to be held by 100 or more investors, and we expect that at least 100 or more of these investors will continue to be independent of us and of one another.

Third, our Class B common shares will be part of an offering of securities to the public pursuant to an effective registration statement under the Securities Act and the Class B common shares will be registered under the Exchange Act.

In addition, the Department of Labor regulations provide other exceptions that may be applicable to us, but we have not endeavored to determine their applicability to us. You should consult your tax advisor to determine, if applicable, whether one or more exceptions may be applicable to such Benefit Plan in the event that the Class B common shares are found not to be publicly offered securities under ERISA.

If for any reason our assets are deemed to be ERISA plan assets because we do not qualify for any exception under the Department of Labor regulations, certain transactions that we might enter into, or may have entered into, in the ordinary course of our business might constitute non-exempt prohibited transactions under Section 406 of ERISA or Section 4975 of the Code and might have to be rescinded and may give rise to prohibited transaction excise taxes and fiduciary liability, as described above. In addition, if our assets are deemed to be ERISA plan assets, our management may be considered to be fiduciaries under ERISA and Section 4975 of the Code. Moreover, if our underlying assets were deemed to be assets constituting plan assets, there are several other provisions of ERISA or the Code that could be implicated for a Benefit Plan if it were to acquire and hold our Class B common shares either directly or by investing in an entity whose underlying assets are deemed to be assets of the Benefit Plan.

Prior to making an investment in the shares offered in this prospectus, prospective employee benefit plan investors (whether or not subject to ERISA or section 4975 of the Code) should consult with their legal and other advisors concerning the impact of ERISA and the Code (and, particularly in the case of non-ERISA plans and arrangements, any additional state, local and foreign law considerations), as applicable, and the potential consequences in their specific circumstances of an investment in such shares.



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We intend to offer the Class B common shares through the underwriters. BMO Capital Markets Corp., JMP Securities LLC, and Wunderlich Securities, Inc. are acting as the representatives of the underwriters named below. Subject to the terms and conditions described in an underwriting agreement among us and the underwriters, we have agreed to sell to the underwriters, and the underwriters severally have agreed to purchase from us, the number of Class B common shares listed opposite their names below.

| <b>Underwriter</b>               | <b>Number of Shares</b> |
|----------------------------------|-------------------------|
| BMO Capital Markets Corp.        |                         |
| JMP Securities LLC               |                         |
| Wunderlich Securities, Inc.      |                         |
| Ladenburg Thalmann & Co. Inc.    |                         |
| J.J.B. Hilliard, W.L. Lyons, LLC |                         |
| Southwest Securities, Inc.       |                         |
| Maxim Group LLC                  |                         |

Total

The underwriters have agreed to purchase all of the Class B common shares sold under the underwriting agreement if any of these Class B common shares are purchased. If an underwriter defaults, the underwriting agreement provides that the purchase commitments of the nondefaulting underwriters may be increased or the underwriting agreement may be terminated.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act, and to contribute to payments the underwriters may be required to make in respect of those liabilities.

The underwriters are offering the Class B common shares, subject to prior sale, when, as and if issued to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the Class B common shares, and other conditions contained in the underwriting agreement, such as the receipt by the underwriters of officer's certificates and legal opinions. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part.

**Commissions and Discounts**

The representatives have advised us that the underwriters propose initially to offer the Class B common shares to the public at the public offering price on the cover page of this prospectus and to dealers at that price less a concession not in excess of \$ \_\_\_\_\_ per share. After the public offering, the public offering price and concession may be changed.

The following table shows the public offering price, underwriting discount and proceeds before expenses to us. The information assumes either no exercise or full exercise by the underwriters of their overallotment option.

|                                      | <b>Per Class B<br/>Common<br/>Share</b> | <b>Without Option</b> | <b>With Option</b> |
|--------------------------------------|---|-----------------------|--------------------|
| Public offering price                |   |                       |                    |
| Underwriting discount <sup>(1)</sup> |   |                       |                    |
| Proceeds, before expenses, to us     |   |                       |                    |

<sup>(1)</sup> The expenses of the offering, not including the underwriting discount, estimated at \$400,000 are payable by us.



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**Overallotment Option**

We have granted to the underwriters an option to purchase up to 750,000 additional Class B common shares at the public offering price, less the underwriting discount. The underwriters may exercise this option for 30 days after the date of this prospectus solely to cover overallotments. To the extent that the underwriters exercise this option, each underwriter will purchase a number of additional Class B common shares from us proportionate to that underwriter's initial amount reflected in the table above.

**No Sales of Similar Securities**

We, and each of our trustees and executive officers, have agreed not to sell or otherwise transfer any common shares for 90 days after the date of this prospectus without first obtaining the written consent of the representatives. Specifically, we and these other persons have agreed not to directly or indirectly:

offer, pledge, sell or contract to sell any common shares,

sell any option or contract to purchase any common shares,

purchase any option or contract to sell any common shares,

grant any option, right or warrant for the sale of any common shares,

otherwise dispose of or transfer any common shares,

request or demand that we file a registration statement related to the common shares, or

enter into any swap or other agreement that transfers, in whole or in part, the economic consequence of ownership of any common shares whether any such swap or transaction is to be settled by delivery of common shares or other securities, in cash or otherwise, other than the shares to be sold hereunder, our issuance of shares upon the conversion of OP units outstanding on the date of the underwriting agreement, grants of restricted common shares or restricted common share units pursuant to the Plan, provided that such securities will not vest or become exercisable, as applicable, during the 90-day restricted period without the representatives' prior written consent, the filing of a registration statement or the issuance of common shares pursuant to a dividend reinvestment plan, the issuance of common shares or OP units as consideration for the acquisition of real estate assets or any post-effective amendment to a registration statement on Form S-8 effective on the date of the underwriting agreement.

This lockup provision applies to common shares and to securities convertible into or exchangeable or exercisable for or repayable with the common shares. It also applies during the lockup period to common shares acquired later by the person executing the agreement or for which the person executing the agreement later acquires the power of disposition.

Each restricted period will be automatically extended if (1) during the last 17 days of the restricted period, we issue an earnings release or material news or a material event relating to us occurs or (2) before the expiration of such restricted period, we announce that we will release earnings results or become aware that material news or a material event will occur during the 16-day period beginning on the last day of such restricted period, in which case the restrictions described above will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event, unless the representatives of the underwriters waive, in writing, such an extension.

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There are no agreements between the representatives and any of our shareholders or affiliates releasing them from these lockup agreements prior to the expiration of the lockup periods described above.

### **NYSE Amex Exchange Listing**

Our Class B common shares are listed on the NYSE Amex under the symbol WSR. We cannot assure you that the prices at which the Class B common shares will sell in the public market after this offering will not be

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lower than the price at which they were sold by the underwriters or that an active trading market in Class B the common shares will continue after the offering.

**Price Stabilization and Short Positions**

Until the distribution of the Class B common shares is completed, SEC rules may limit underwriters and selling group members from bidding for and purchasing our Class B common shares. However, the underwriters may engage in transactions that stabilize the price of the common shares, such as bids or purchases to peg, fix or maintain that price.

If the underwriters create a short position in the Class B common shares in connection with the offering, i.e., if they sell more Class B common shares than are listed on the cover of this prospectus, the representatives may reduce that short position by purchasing common shares in the open market. The representatives may also elect to reduce any short position by exercising all or part of the underwriters' option to purchase additional Class B common shares described above. Purchases of our Class B common shares to stabilize the price or to reduce a short position may cause the price of our Class B common shares to be higher than it might be in the absence of such purchases.

The underwriters may also impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the representatives have repurchased Class B common shares sold by or for the account of such underwriter in stabilizing or short covering transactions.

Similar to other purchase transactions, the underwriters' purchases to cover the syndicate short sales may have the effect of raising or maintaining the market price of our Class B common shares or preventing or retarding a decline in the market price of our Class B common shares. As a result, the price of our Class B common shares may be higher than the price that might otherwise exist in the open market.

Neither we nor any of the underwriters makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the Class B common shares. In addition, neither we nor any of the underwriters makes any representation that the representatives will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

**Electronic Distribution**

In connection with the offering, certain of the underwriters or securities dealers may distribute prospectuses by electronic means, such as e-mail. In addition, the representatives may facilitate Internet distribution for this offering to certain of its Internet subscription customers. An electronic prospectus is available on the Internet website maintained by the representatives. Other than the prospectus in electronic format, the information on the representatives' websites is not part of this prospectus.

**Affiliations**

Some of the underwriters and their affiliates may from time to time engage in investment banking and other commercial transactions with us and perform services for us in the ordinary course of business. They are expected to receive customary fees and commissions for these transactions.

Certain affiliates of BMO Capital Markets Corp. may participate as lenders under the \$20 million unsecured revolving credit facility, which may be expandable to \$75 million under certain circumstances, that we anticipate entering into upon the completion of this offering. In their capacity as lenders, these affiliates will receive certain customary cash fees in connection with the credit facility.

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**LEGAL MATTERS**

Certain legal matters, including our qualification as a REIT for federal income tax purposes, will be passed upon for us by Bass, Berry & Sims PLC, Memphis, Tennessee, and for the underwriters by Hunton & Williams LLP, Dallas, Texas. Venable LLP, Baltimore, Maryland, will issue an opinion to us regarding certain matters of Maryland law, including the validity of the common shares offered hereby.

**EXPERTS**

The financial statements as of December 31, 2010 and 2009 and for the years ended December 31, 2010, 2009 and 2008 included in this prospectus have been so included in reliance on the report of Pannell Kerr Forster of Texas, P.C., an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

**WHERE YOU CAN FIND MORE INFORMATION**

We are presently subject to the reporting requirements of the Exchange Act and periodically file reports with the SEC pursuant to such requirements. We have filed with the SEC, a registration statement on Form S-11, including exhibits, schedules and amendments filed with this registration statement, under the Securities Act with respect to our common shares to be sold in this offering. This prospectus does not contain all the information set forth in the registration statement and the exhibits related thereto filed with the SEC. For further information with respect to us and our common shares to be sold in this offering, reference is made to the registration statement, including the exhibits to the registration statement. Statements contained in this prospectus as to the contents of any contract or other document referred to in this prospectus are not necessarily complete and, where that contract is an exhibit to the registration statement, each statement is qualified in all respects by the exhibit to which the reference relates. Copies of the registration statement, including the exhibits and schedules thereto, as well as periodic reports and information filed by us, may be examined without charge at the public reference room of the Securities and Exchange Commission, 450 Fifth Street, N.W. Room 1024, Washington, DC 20549. Information about the operation of the public reference room may be obtained by calling the Securities and Exchange Commission at 1-800-SEC-0300. Copies of all or a portion of the registration statement can be obtained from the public reference room of the Securities and Exchange Commission upon payment of prescribed fees. Our SEC filings, including our registration statement, are also available to you on the SEC's website, [www.sec.gov](http://www.sec.gov).

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**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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| All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted. |             |

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**Index to Financial Statements**

**Report of Independent Registered Public Accounting Firm**

To the Board of Trustees and Shareholders of Whitestone REIT

We have audited the accompanying consolidated balance sheets of Whitestone REIT and subsidiaries (the Company ) as of December 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income, shareholders' equity and cash flows, for each of the three years in the period ended December 31, 2010. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Whitestone REIT and subsidiaries as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ PANNELL KERR FORSTER OF TEXAS, P.C.

Houston, Texas

March 1, 2011



**Table of Contents****Index to Financial Statements****Whitestone REIT and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

|  | December 31, |            |
|--|--------------|------------|
|  | 2010         | 2009       |
| <b>ASSETS</b>  |              |            |
| Real estate assets, at cost:   |              |            |
| Property   | \$ 204,954   | \$ 192,832 |
| Accumulated depreciation   | (39,556)     | (34,434)   |
| Total real estate assets   | 165,398      | 158,398    |
| Cash and cash equivalents  | 17,591       | 6,275      |
| Escrows and acquisition deposits   | 4,385        | 8,155      |
| Accrued rent and accounts receivable, net of allowance for doubtful accounts   | 4,726        | 4,514      |
| Unamortized lease commissions and loan costs   | 3,598        | 3,973      |
| Prepaid expenses and other assets  | 747          | 685        |
| Total assets   | \$ 196,445   | \$ 182,000 |
| <b>LIABILITIES AND EQUITY</b>  |              |            |
| Liabilities:   |              |            |
| Notes payable  | \$ 100,941   | \$ 101,782 |
| Accounts payable and accrued expenses  | 7,292        | 9,954      |
| Tenants' security deposits   | 1,796        | 1,630      |
| Dividends and distributions payable  | 2,133        | 1,775      |
| Total liabilities  | 112,162      | 115,141    |
| Commitments and Contingencies:   |              |            |
| Equity:  |              |            |
| Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at December 31, 2010 and December 31, 2009, respectively                            |              |            |
| Class A common shares, \$0.001 par value per share; 50,000,000 shares authorized; 3,471,187 and 3,445,769 issued and outstanding as of December 31, 2010 and December 31, 2009, respectively | 3            | 10         |
| Class B common shares, \$0.001 par value per share; 350,000,000 shares authorized; 2,200,000 and 0 issued and outstanding as of December 31, 2010 and December 31, 2009, respectively        | 2            |            |
| Additional paid-in capital   | 93,357       | 69,952     |
| Accumulated deficit  | (30,654)     | (26,372)   |
| Total Whitestone REIT shareholders' equity   | 62,708       | 43,590     |
| Noncontrolling interest in subsidiary  | 21,575       | 23,269     |
| Total equity   | 84,283       | 66,859     |
| Total liabilities and equity   | \$ 196,445   | \$ 182,000 |

See notes to consolidated financial statements.

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**Table of Contents****Index to Financial Statements****Whitestone REIT and Subsidiaries****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME****(in thousands, except per share data)**

|  | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2010                    | 2009      | 2008      |
| <b>Property revenues</b>   |                         |           |           |
| Rental revenues  | \$ 25,901               | \$ 26,449 | \$ 24,999 |
| Other revenues   | 5,632                   | 6,236     | 6,202     |
| Total property revenues  | 31,533                  | 32,685    | 31,201    |
| <b>Property expenses</b>   |                         |           |           |
| Property operation and maintenance   | 8,358                   | 8,519     | 8,862     |
| Real estate taxes  | 3,925                   | 4,472     | 3,973     |
| Total property expenses  | 12,283                  | 12,991    | 12,835    |
| <b>Other expenses (income)</b>   |                         |           |           |
| General and administrative   | 4,992                   | 6,072     | 6,708     |
| Depreciation & amortization  | 7,225                   | 6,958     | 6,859     |
| Involuntary conversion   | (558)                   | (1,542)   | 358       |
| Interest expense   | 5,620                   | 5,749     | 5,857     |
| Interest income  | (28)                    | (36)      | (182)     |
| Total other expenses   | 17,251                  | 17,201    | 19,600    |
| <b>Income (loss) from continuing operations before loss on disposal of assets and income taxes</b> | 1,999                   | 2,493     | (1,234)   |
| Provision for income taxes   | (264)                   | (222)     | (219)     |
| Loss on sale or disposal of assets   | (160)                   | (196)     | (223)     |
| <b>Income (loss) from continuing operations</b>  | 1,575                   | 2,075     | (1,676)   |
| Loss from discontinued operations  |                         |           | (188)     |
| Gain on sale of properties from discontinued operations  |                         |           | 3,619     |
| <b>Net income</b>  | 1,575                   | 2,075     | 1,755     |
| Less: Net income attributable to noncontrolling interests  | 470                     | 733       | 621       |
| <b>Net income attributable to Whitestone REIT</b>  | \$ 1,105                | \$ 1,342  | \$ 1,134  |

See notes to consolidated financial statements.



**Table of Contents****Index to Financial Statements****Whitestone REIT and Subsidiaries****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****(in thousands, except per share data)**

|   | <b>Year Ended December 31,</b> |                 |                 |
|---|--------------------------------|-----------------|-----------------|
|   | <b>2010</b>                    | <b>2009</b>     | <b>2008</b>     |
| <b>Earnings per share basic</b>   |                                |                 |                 |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27                        | \$ 0.41         | \$ (0.32)       |
| Income from discontinued operations attributable to Whitestone REIT   |                                |                 | 0.67            |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares                           | \$ 0.27                        | \$ 0.41         | \$ 0.35         |
| <b>Earnings per share diluted</b>   |                                |                 |                 |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27                        | \$ 0.40         | \$ (0.32)       |
| Income from discontinued operations attributable to Whitestone REIT   |                                |                 | 0.67            |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares                           | \$ 0.27                        | \$ 0.40         | \$ 0.35         |
| <b>Weighted average number of common shares outstanding:</b>  |                                |                 |                 |
| Basic   | 4,012                          | 3,236           | 3,277           |
| Diluted   | 4,041                          | 3,302           | 3,277           |
| <b>Dividends declared per Class A common share</b>  | <b>\$ 1.19</b>                 | <b>\$ 1.35</b>  | <b>\$ 1.59</b>  |
| <b>Dividends declared per Class B common share</b> <sup>(1)</sup>   | <b>0.57</b>                    |                 |                 |
| <b>Condensed Consolidated Statements of Comprehensive Income</b>  |                                |                 |                 |
| <b>Net income</b>   | <b>\$ 1,575</b>                | <b>\$ 2,075</b> | <b>\$ 1,755</b> |
| <b>Other comprehensive gain</b>   |                                |                 |                 |
| Unrealized gain on cash flow hedging activities   |                                |                 | 368             |
| <b>Comprehensive income</b>   | <b>1,575</b>                   | <b>2,075</b>    | <b>2,123</b>    |
| Less: Comprehensive income attributable to noncontrolling interests   | 470                            | 733             | 759             |
| <b>Comprehensive income attributable to Whitestone REIT</b>   | <b>\$ 1,105</b>                | <b>\$ 1,342</b> | <b>\$ 1,364</b> |

<sup>(1)</sup> Dividend rate is the same as Class A, but represents a partial year for Class B common shares issued August 31, 2010, which began receiving dividends in September 2010.

See notes to consolidated financial statements.



**Table of Contents****Index to Financial Statements****Whitestone REIT and Subsidiaries****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(in thousands, except per share and unit data)

|   | Class A<br>Common<br>Shares |        | Class B<br>Common<br>Shares |        | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders<br>Equity | Noncontrolling<br>Interests |           | Total<br>Equity |
|---|-----------------------------|--------|-----------------------------|--------|----------------------------------|------------------------|---|---------------------------------|-----------------------------|-----------|-----------------|
|   | Shares                      | Amount | Shares                      | Amount |                                  |                        |   |                                 | Units                       | Dollars   |                 |
| Balance, December 31,<br>2007   | 3,334                       | \$ 10  |                             | \$     | \$ 72,273                        | \$ (19,210)            | \$ (230)                                      | \$ 52,843                       | 1,936                       | \$ 28,039 | \$ 80,882       |
| Repurchase of common<br>stock and units   | (98)                        |        |                             |        | (2,479)                          |                        |   | (2,479)                         | (356)                       | (4,762)   | (7,241)         |
| Reclassification of<br>dividend reinvestment<br>plan shares with<br>rescission rights to<br>liabilities at \$28.50<br>per share |                             |        |                             |        | (606)                            |                        |   | (606)                           |                             |           | (606)           |
| Dividends and<br>distributions  |                             |        |                             |        |                                  | (5,231)                |   | (5,231)                         |                             | (2,755)   | (7,986)         |
| Unrealized loss on change<br>in fair value of cash<br>flow hedges   |                             |        |                             |        |                                  |                        | 230   | 230                             |                             | 138       | 368             |
| Net income  |                             |        |                             |        |                                  | 1,134                  |   | 1,134                           |                             | 621       | 1,755           |
| Balance, December 31,<br>2008   | 3,236                       | 10     |                             |        | 69,188                           | (23,307)               |   | 45,891                          | 1,580                       | 21,281    | 67,172          |
| OP units issued at \$15.45<br>per unit in connection<br>with property acquisition   |                             |        |                             |        |                                  |                        |   |                                 | 235                         | 3,625     | 3,625           |
| Share-based<br>compensation   | 210                         |        |                             |        | 764                              |                        |   | 764                             |                             |           | 764             |
| Dividends and<br>distributions  |                             |        |                             |        |                                  | (4,407)                |   | (4,407)                         |                             | (2,370)   | (6,777)         |
| Net income  |                             |        |                             |        |                                  | 1,342                  |   | 1,342                           |                             | 733       | 2,075           |
| Balance, December 31,<br>2009   | 3,446                       | 10     |                             |        | 69,952                           | (26,372)               |   | 43,590                          | 1,815                       | 23,269    | 66,859          |
| Change in par value of<br>common shares   |                             | (7)    |                             |        | 7                                |                        |   |                                 |                             |           |                 |
| Issuance of common<br>shares  |                             |        | 2,200                       | 2      | 22,968                           |                        |   | 22,970                          |                             |           | 22,970          |
| Share-based<br>compensation   | 41                          |        |                             |        | 73                               |                        |   | 73                              |                             |           | 73              |
| Dividends and<br>distributions  |                             |        |                             |        |                                  | (5,387)                |   | (5,387)                         |                             | (2,164)   | (7,551)         |
| Repurchase of<br>common shares <sup>(1)</sup>   | (16)                        |        |                             |        | (249)                            |                        |   | (249)                           |                             |           | (249)           |
| Reclassification of<br>dividend reinvestment<br>plan shares with expired  |                             |        |                             |        | 606                              |                        |   | 606                             |                             |           | 606             |

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rescission rights to equity  
from liabilities at \$28.50  
per share

|                   |       |       |     |       |
|-------------------|-------|-------|-----|-------|
| <b>Net income</b> | 1,105 | 1,105 | 470 | 1,575 |
|-------------------|-------|-------|-----|-------|

Balance, December 31,

|      |       |    |   |       |    |   |    |        |    |          |    |        |       |    |        |    |        |
|------|-------|----|---|-------|----|---|----|--------|----|----------|----|--------|-------|----|--------|----|--------|
| 2010 | 3,471 | \$ | 3 | 2,200 | \$ | 2 | \$ | 93,357 | \$ | (30,654) | \$ | 62,708 | 1,815 | \$ | 21,575 | \$ | 84,283 |
|------|-------|----|---|-------|----|---|----|--------|----|----------|----|--------|-------|----|--------|----|--------|

(1) During the three months ended June 30, 2010, the Company acquired Class A common shares held by employees who tendered owned Common Shares to satisfy the tax withholding on the lapse of certain restrictions on restricted shares.

See notes to consolidated financial statements.

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**Table of Contents****Index to Financial Statements****Whitestone REIT and Subsidiary****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

|   | Year Ended December 31, |          |            |
|---|-------------------------|----------|------------|
|   | 2010                    | 2009     | 2008       |
| <b>Cash flows from operating activities:</b>  |                         |          |            |
| Net income (loss)   | \$ 1,575                | \$ 2,075 | \$ (1,676) |
| Net income from discontinued operations   |                         |          | 3,431      |
|   | 1,575                   | 2,075    | 1,755      |
| <b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b> |                         |          |            |
| Depreciation and amortization   | 7,225                   | 6,958    | 6,859      |
| Loss on sale or disposal of assets  | 160                     | 196      | 223        |
| Bad debt expense  | 536                     | 877      | 731        |
| Share-based compensation  | 297                     | 1,013    |            |
| Changes in operating assets and liabilities:  |                         |          |            |
| Escrows and acquisition deposits  | 3,840                   | (3,700)  | (3,590)    |
| Accrued rent and accounts receivable  | (748)                   | (511)    | (225)      |
| Unamortized lease commissions and loan costs  | (783)                   | (634)    | (813)      |
| Prepaid expenses and other assets   | 446                     | 527      | 417        |
| Accounts payable and accrued expenses   | (2,319)                 | 2,096    | 655        |
| Tenants' security deposits  | 166                     | 1        | 31         |
| Net cash provided by operating activities   | 10,395                  | 8,898    | 2,612      |
| Net cash provided by operating activities of discontinued operations                            |                         |          | 8          |
| <b>Cash flows from investing activities:</b>  |                         |          |            |
| Acquisitions of real estate   | (8,625)                 | (5,619)  |            |
| Additions to real estate  | (4,143)                 | (3,611)  | (5,153)    |
| Net cash used in investing activities   | (12,768)                | (9,230)  | (5,153)    |
| Net cash used in investing activities of discontinued operations                                |                         |          | (8)        |
| <b>Cash flows from financing activities:</b>  |                         |          |            |
| Dividends paid  | (5,158)                 | (4,645)  | (5,578)    |
| Distributions paid to OP unit holders   | (2,249)                 | (2,281)  | (3,094)    |
| Proceeds from issuance of common shares   | 22,970                  |          |            |
| Proceeds from notes payable   | 1,430                   | 9,557    | 95,053     |
| Repayments of notes payable   | (2,957)                 | (8,725)  | (78,990)   |
| Payments of loan origination costs  | (98)                    | (288)    | (2,672)    |
| Repurchase of common stock  | (249)                   |          |            |
| Net cash provided by (used in) financing activities   | 13,689                  | (6,382)  | 4,719      |
| Net increase (decrease) in cash and cash equivalents  | 11,316                  | (6,714)  | 2,178      |

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|   |           |          |           |
|---|-----------|----------|-----------|
| Cash and cash equivalents at beginning of period                        | 6,275     | 12,989   | 10,811    |
| Cash and cash equivalents at end of period                              | \$ 17,591 | \$ 6,275 | \$ 12,989 |
| <b>Supplemental disclosure of cash flow information:</b>                |           |          |           |
| Cash paid for interest  | \$ 5,621  | \$ 5,535 | \$ 5,189  |
| Cash paid for taxes   | 262       | 223      | 224       |
| <b>Non cash Investing and financing activities:</b>                     |           |          |           |
| Disposal of fully depreciated real estate                               | \$ 598    | \$ 564   | \$ 698    |
| Financed insurance premiums   | 616       | 568      | 476       |
| Acquisition of real estate in exchange for OP units                     |           | 3,625    |           |
| Change in par value of Class A common shares                            | 7         |          |           |
| Disposal of real estate in settlement of lawsuit                        |           |          | 7,844     |
| Reclassification of dividend reinvestment shares with rescission rights | 606       |          | (606)     |

See notes to consolidated financial statements.

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**WHITESTONE REIT AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**December 31, 2010**

**1. DESCRIPTION OF BUSINESS AND NATURE OF OPERATIONS**

Whitestone REIT ( Whitestone ) was formed as a real estate investment trust, pursuant to the Texas Real Estate Investment Trust Act on August 20, 1998. In July 2004, Whitestone changed its state of organization from Texas to Maryland pursuant to a merger of Whitestone directly with and into a Maryland real estate investment trust formed for the sole purpose of the reorganization and the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity. Whitestone serves as the general partner of Whitestone REIT Operating Partnership, L.P. (the Operating Partnership or WROP or OP ), which was formed on December 31, 1998 as a Delaware limited partnership. Whitestone currently conducts substantially all of its operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, Whitestone has the exclusive power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of December 31, 2010, 2009 and 2008, we owned and operated 38, 36, and 35 retail, warehouse and office properties 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 December 31, 2010, 2009 and 2008, 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 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 ( OP Units ) changes the ownership interests of both the noncontrolling interests and Whitestone.

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

*Use of Estimates.* The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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 allocated purchase price of acquired properties, the estimated useful lives for depreciable and amortizable assets and costs, the estimated allowance for doubtful accounts, the estimated fair value of interest rate swaps and the 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. All of these adjustments are of a normal recurring nature with the exception of a retroactive restatement of share and unit counts and per share and unit amounts to reflect our 1-for-3 reverse share split in August 2010. For further details see Note 12, Equity.

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*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 trustees, executive officers and employees under our 2008 Long-Term Equity Incentive Ownership Plan (the 2008 Plan ). The vast majority of the awarded shares and units vest when certain performance conditions are met. We recognize compensation expense when achievement of the performance conditions is probable based on management's most recent estimates using the fair value of the shares as of the grant date. We recognized \$0.3 million and \$1.0 million in share-based compensation expense for the years ended December 31, 2010 and December 31, 2009, respectively. No share-based compensation expense was recognized prior to 2009 as no awards had been granted.

*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 condensed consolidated balance sheets but separate from Whitestone's equity. On the consolidated statements of operations and comprehensive income, the subsidiaries are reported at the consolidated amount, including both the amount attributable to Whitestone and noncontrolling interests. Consolidated statements of changes in equity are included for both quarterly and annual financial statements, including beginning balances, activity for the period and ending balances for shareholders' equity, noncontrolling interests and total equity.

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

*Cash and Cash Equivalents.* We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents as of December 31, 2010 and 2009 consist of demand deposits at commercial banks and brokerage accounts.

***Real Estate***

*Development Properties.* Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges and development costs. Carrying charges, primarily interest, real estate taxes and loan acquisition costs, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases when the property, or any completed portion, becomes available for occupancy. Prior to that time, we expense these costs as acquisition expense. No interest was capitalized for the years ended December 31, 2010 and 2009. Approximately \$0.4 million in interest was capitalized for the year ended December 31, 2008.

*Acquired Properties and Acquired Lease Intangibles.* We allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management

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also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.

*Depreciation.* Depreciation is computed using the straight-line method over the estimated useful lives of 5 to 39 years for the buildings and improvements. Tenant improvements are depreciated using the straight-line method over the life of the improvement or remaining term of the lease, whichever is shorter.

*Impairment.* We review our properties for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the property exceeds its fair value. Management has determined that there has been no impairment in the carrying value of our real estate assets as of December 31, 2010.

*Accrued Rent and Accounts Receivable.* Included in accrued rent and accounts receivable are base rents, tenant reimbursements and receivables attributable to recording rents on a straight-line basis. An allowance for the uncollectible portion of accrued rents and accounts receivable is determined based upon customer credit-worthiness (including expected recovery of our claim with respect to any tenants in bankruptcy), historical bad debt levels, and current economic trends. As of December 31, 2010 and 2009, we had an allowance for uncollectible accounts of \$1.3 million and \$0.9 million, respectively. During 2010, 2009 and 2008, we recorded bad debt expense in the amount of \$0.5 million, \$0.9 million and \$0.7 million, respectively, related to tenant receivables that we specifically identified as potentially uncollectible based on our assessment of each tenant's credit-worthiness. Bad debt expenses and any related recoveries are included in property operation and maintenance expense.

*Unamortized Lease Commissions and Loan Costs.* Leasing commissions are amortized using the straight-line method over the terms of the related lease agreements. Loan costs are amortized on the straight-line method over the terms of the loans, which approximates the interest method.

*Prepays and Other Assets.* Prepays and other assets include escrows established pursuant to certain mortgage financing arrangements for real estate taxes and insurance and acquisition deposits which include earnest money deposits on future acquisitions.

*Federal Income Taxes.* We elected to be taxed as a real estate investment trust ( REIT ) under 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 such a manner as to qualify to be taxed as a REIT, and we intend to operate so as to remain qualified as a REIT for federal income tax purposes.

*State Taxes.* In May 2006, the State of Texas adopted House Bill 3, which modified the state's franchise tax structure, replacing the previous tax based on capital or earned surplus with one based on margin (often referred to as 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, FASB Accounting Standards Codification ( ASC ) 740, *Income Taxes* applies to the Texas Margin Tax. We have recorded a margin tax provision of \$0.3 million, \$0.2 million and \$0.2 million for the Texas Margin Tax for each of the years ended December 31, 2010, 2009 and 2008.

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*Derivative Instruments.* We have initiated a program designed to manage exposure to interest rate fluctuations by entering into financial derivative instruments. The primary objective of this program is to comply with debt covenants on a credit facility. We sometimes enter into interest rate swap agreements with respect to amounts borrowed under certain of our credit facilities, which effectively exchanges existing obligations to pay interest based on floating rates for obligations to pay interest based on fixed LIBOR rates.

We have adopted provisions of ASC 820, *Fair Value Measurements and Disclosures* ( ASC 820 ) which requires for items appropriately classified as cash flow hedges, that changes in the market value of the instrument and in the market value of the hedged item be recorded as other comprehensive income or loss with the exception of the portion of the hedged items that are considered ineffective. The derivative instruments are reported at fair value as other assets or other liabilities as applicable. As of December 31, 2010 and 2009, we did not have any interest rate swaps.

*Fair Value of Financial Instruments.* Our financial instruments consist primarily of cash, cash equivalents, accounts receivable, derivative instruments, accounts and notes payable. The carrying value of cash, cash equivalents, accounts receivable and accounts payable are representative of their respective fair values due to the short-term nature of these instruments. The fair value of our debt obligations is representative of its carrying value based upon current rates offered for similar types of borrowing arrangements. The fair value of interest rate swaps (used for hedging purposes) is the estimated amount that the financial institution would receive or pay to terminate the swap agreements at the reporting date, taking into account current interest rates and the current credit worthiness of the swap counterparties.

*Concentration of Risk.* Substantially all of our revenues are obtained from office, warehouse and retail locations in the Houston, Dallas and San Antonio, Texas metropolitan areas. We maintain cash accounts in major U.S. financial institutions. The terms of these deposits are on demand to minimize risk. The balances of these accounts sometimes exceed the federally insured limits, although no losses have been incurred in connection with these deposits.

*Comprehensive Loss.* In October 2007, we entered into an interest rate swap which was designated as a cash flow hedge. Amounts recorded to other comprehensive income are \$0.0 million, \$0.0 million and \$0.4 million for the years ended December 31, 2010, 2009 and 2008, respectively. This swap matured in October 2008.

**3. DERIVATIVES AND HEDGING**

On September 28, 2007, we entered into an interest rate swap transaction which was designated as a cash flow hedge. The effective date of the swap transaction was October 1, 2007, which had a total notional amount of \$70 million, and fixed the swap rate at 4.77% plus the LIBOR margin through October 1, 2008. The purpose of this swap was to mitigate the risk of future fluctuations in interest rates on our variable rate debt. We determined that this swap was highly effective in offsetting future variable interest cash flows on variable rate debt. During 2008, the balance in other comprehensive loss as of December 31, 2007 was amortized to interest expense.

On September 28, 2007, in conjunction with the execution of the \$70 million interest rate swap transaction, we terminated an interest rate swap transaction that was initiated on March 16, 2006. This swap transaction had a total notional amount of \$30 million, was at a fixed rate of 5.09% plus the LIBOR margin and was set to mature on March 11, 2008. As a result of this termination (\$0.03) million is included in other income in our consolidated statements of operations for the year ended December 31, 2007.

**4. REAL ESTATE**

As of December 31, 2010, we owned 38 commercial properties in the Houston, Dallas, San Antonio, Phoenix and Chicago areas comprising approximately 3.2 million square feet of total area.

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In November 2010, we acquired a property that meets our Community Centered Property strategy, containing 111,227 leasable square feet located in central Phoenix, Arizona for approximately \$6.4 million in cash and net prorations. The property, Sunnyslope, a Class B community center, 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.

In September 2010, we acquired 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, The Citadel, a Class A community center, is strategically located at a prime intersection at Pinnacle Peak and Pima Roads.

In January 2009, we acquired a property that meets our Community Centered Property strategy, containing 41,396 leasable square feet located in Buffalo Grove, Illinois for approximately \$9.4 million, including cash of \$5.5 million, issuance of 703,912 OP units valued at approximately \$3.6 million and credit for net prorations of \$0.3 million. The property, Spoerlein Commons, is a two-story complex of retail, medical and professional office tenants. We acquired the property from Midwest Development Venture IV, an Illinois limited partnership controlled by James C. Mastandrea, our Chairman, President and Chief Executive Officer. Because of Mr. Mastandrea's relationship with the seller, a special committee consisting solely of the independent trustees, negotiated the terms of the transaction, which included the use of an independent appraiser to value the property.

**5. 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):

|                                 | <b>December 31,</b> |                 |
|---------------------------------|---------------------|-----------------|
|                                 | <b>2010</b>         | <b>2009</b>     |
| Tenant receivables              | \$ 1,742            | \$ 1,770        |
| Accrued rent                    | 4,288               | 3,636           |
| Allowance for doubtful accounts | (1,304)             | (894)           |
| Other receivables               |                     | 2               |
| <b>Totals</b>                   | <b>\$ 4,726</b>     | <b>\$ 4,514</b> |

**6. UNAMORTIZED LEASING COMMISSIONS AND LOAN COSTS**

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

|  | <b>December 31,</b> |                 |
|--|---------------------|-----------------|
|  | <b>2010</b>         | <b>2009</b>     |
| Leasing commissions                                    | \$ 4,971            | \$ 4,601        |
| Deferred financing costs                               | 2,307               | 2,208           |
| <b>Total cost</b>                                      | <b>7,278</b>        | <b>6,809</b>    |
| Less: leasing commissions accumulated amortization     | (2,669)             | (2,246)         |
| Less: deferred financing cost accumulated amortization | (1,011)             | (590)           |
| <b>Total cost, net of accumulated amortization</b>     | <b>\$ 3,598</b>     | <b>\$ 3,973</b> |

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A summary of expected future amortization of deferred costs is as follows (in thousands):

| <b>Years Ended December 31,</b> | <b>Leasing<br/>Commissions</b> | <b>Deferred<br/>Financing<br/>Costs</b> | <b>Total</b>    |
|---------------------------------|--------------------------------|---|-----------------|
| 2011                            | \$ 731                         | \$ 440                                  | \$ 1,171        |
| 2012                            | 568                            | 440                                     | 1,008           |
| 2013                            | 388                            | 364                                     | 752             |
| 2014                            | 251                            | 39                                      | 290             |
| 2015                            | 157                            | 13                                      | 170             |
| Thereafter                      | 207                            |   | 207             |
| <b>Total</b>                    | <b>\$ 2,302</b>                | <b>\$ 1,296</b>                         | <b>\$ 3,598</b> |

**7. FUTURE MINIMUM LEASE INCOME**

We lease the majority of our properties under noncancelable operating leases which provide for minimum base rentals plus, in some instances, contingent rentals based upon a percentage of the tenants' gross receipts.

A summary of minimum future rentals to be received (exclusive of renewals, tenant reimbursements, and contingent rentals) under noncancelable operating leases in existence at December 31, 2010 is as follows (in thousands):

| <b>Years Ended December 31,</b> | <b>Minimum Future Rents</b> |
|---------------------------------|-----------------------------|
| 2011                            | \$ 24,186                   |
| 2012                            | 20,036                      |
| 2013                            | 14,448                      |
| 2014                            | 9,972                       |
| 2015                            | 6,415                       |
| Thereafter                      | 14,536                      |
| <b>Total</b>                    | <b>\$ 89,593</b>            |

**8. DEBT*****Notes payable***

Below is a detailed explanation of notes payable including key terms and maturities (in thousands):

| <b>Description</b>                   | <b>Year Ended<br/>December 31,</b> |             |
|--------------------------------------|------------------------------------|-------------|
|                                      | <b>2010</b>                        | <b>2009</b> |
| Fixed rate notes                     |                                    |             |
| \$10.0 million 6.04% Note, due 2014  | \$ 9,498                           | \$ 9,646    |
| \$1.5 million 6.50% Note, due 2014   | 1,496                              |             |
| \$11.2 million 6.52% Note, due 2015  | 10,908                             | 11,043      |
| \$21.4 million 6.53% Notes, due 2013 | 20,142                             | 20,721      |
| \$24.5 million 6.56% Note, due 2013  | 24,030                             | 24,435      |



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|  |            |            |
|--|------------|------------|
| \$9.9 million 6.63% Notes, due 2014          | 9,498      | 9,757      |
| \$0.5 million 5.05% Notes, due 2011 and 2010 | 13         | 52         |
| Floating rate note                           |            |            |
| \$26.9 million LIBOR + 2.86% Note, due 2013  | 25,356     | 26,128     |
|  | \$ 100,941 | \$ 101,782 |

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Our debt was collateralized by 23 operating properties as of December 31, 2010 with a combined net book value of \$110.1 million and 21 operating properties at December 31, 2009 with a combined net book value of \$108.7 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 the assignment of certain rents and leases associated with those properties.

On September 10, 2010, we executed a promissory note (the **Promissory Note**) in the amount of \$1.5 million (the **New Loan**) payable to MidFirst Bank, a federally chartered savings association (MidFirst), with an applicable interest rate of 6.5% per annum. Monthly payments of \$10,128 began on November 1, 2010 and continue thereafter on the first day of each calendar month until February 1, 2014. The Promissory Note is secured by a second lien deed of trust on our Windsor Park retail facility located in Windcrest, Texas, a first lien deed of trust on our Brookhill office/flex building located in Houston, Texas and a first lien deed of trust on our Zeta office building located in Houston, Texas. The funds from the Promissory Note are being used for capital improvements to Windsor Park.

The loan documents executed in connection with the Promissory Note (the **Loan Documents**) included a Limited Guaranty by us of the Promissory Note until the Windsor Park construction is completed. Following this event, we will remain liable for the deficiency, if any, following a foreclosure of property securing the Promissory Note; provided that upon the occurrence of certain **Full Recourse Events** defined in the Loan Documents, our obligations shall convert to a full guarantee of the New Loan.

In connection with the Promissory Note, the Loan Documents also provided for a modification of our existing loan with MidFirst in the amount of \$10,000,000 (the **Existing Loan**). The Loan Documents provide that the promissory note executed in connection with the Existing Loan is modified to be secured, in part, by second liens on the Brookhill and Zeta Buildings, as well as certain other modifications for the purpose of cross collateralizing and cross-defaulting the two loans. The Existing Loan is also modified by the Modification of Promissory Note which provide that payments of \$61,773 began on October 1, 2010 and continue thereafter on the first day of each calendar month until February 1, 2014. Finally, the Loan Documents included the Modification of Limited Guaranty, which provided that the Limited Guaranty executed in connection with the Existing Loan was only for the deficiency, if any, following the foreclosure of property securing the Existing Loan; provided that upon the occurrence of certain **Full Recourse Events** defined in the Modification of Limited Guaranty, our obligations shall convert to a full guarantee of the Existing Loan.

Our loans are subject to customary financial covenants. As of December 31, 2010, we were in compliance with all loan covenants.

Annual maturities of notes payable as of December 31, 2010 are due during the following years (in thousands):

| <b>Year</b>         | <b>Amount Due<br/>(in thousands)</b> |
|---------------------|--------------------------------------|
| 2011                | \$ 2,459                             |
| 2012                | 2,579                                |
| 2013                | 66,424                               |
| 2014                | 19,209                               |
| 2015                | 10,270                               |
| 2016 and thereafter |                                      |
| <b>Total</b>        | <b>\$ 100,941</b>                    |

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

Certain of Whitestone's performance restricted common shares are considered participating securities which require the use of the two-class method for the computation of basic and diluted earnings per share. During the years ended December 31, 2010, 2009 and 2008, 1,814,569, 1,814,569 and 1,579,962 OP Units, respectively, were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive.

For the year ended December 31, 2010, distributions of \$251,000 were made to the holders of certain restricted common shares, \$224,000 of which were charged against earnings. For the year ended December 31, 2009, distributions of \$277,000 were made to holders of certain restricted common shares, \$250,000 of which were charged against earnings, and no distributions were made on the performance restricted common shares prior to 2009. See Note 13 for information related to restricted common shares under the 2008 Plan.

| <i>(in thousands, except per share data)</i>   | <b>Year Ended December 31,</b> |                 |                 |
|--|--------------------------------|-----------------|-----------------|
|  | <b>2010</b>                    | <b>2009</b>     | <b>2008</b>     |
| <b>Numerator:</b>  |                                |                 |                 |
| Income (loss) from continuing operations   | \$ 1,575                       | \$ 2,075        | \$ (1,676)      |
| Less: Net loss (income) attributable to noncontrolling interests   | (470)                          | (733)           | 627             |
| Dividends paid on unvested restricted shares   | (27)                           | (27)            |                 |
| Undistributed earnings attributable to unvested restricted shares  |                                |                 |                 |
| <b>Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares</b> | <b>1,078</b>                   | <b>1,315</b>    | <b>(1,049)</b>  |
| Income from discontinued operations  |                                |                 | 3,431           |
| Less: Net income attributable to noncontrolling interests  |                                |                 | (1,248)         |
| <b>Income from discontinued operations attributable to Whitestone REIT</b>   |                                |                 | <b>2,183</b>    |
| <b>Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares</b>                           | <b>\$ 1,078</b>                | <b>\$ 1,315</b> | <b>\$ 1,134</b> |
| <b>Denominator:</b>  |                                |                 |                 |
| Weighted average number of common shares - basic   | 4,012                          | 3,236           | 3,277           |
| Effect of dilutive securities:   |                                |                 |                 |
| Unvested restricted shares   | 29                             | 66              |                 |
| <b>Weighted average number of common shares - dilutive</b>   | <b>4,041</b>                   | <b>3,302</b>    | <b>3,277</b>    |
| <b>Basic earnings per common share:</b>  |                                |                 |                 |
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares        | \$ 0.27                        | \$ 0.41         | \$ (0.32)       |
| Income from discontinued operations attributable to Whitestone REIT  |                                |                 | 0.67            |
| <b>Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares</b>                           | <b>\$ 0.27</b>                 | <b>\$ 0.41</b>  | <b>\$ 0.35</b>  |

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**Diluted earnings per common share:**

|   |         |         |           |
|---|---------|---------|-----------|
| Income (loss) from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares | \$ 0.27 | \$ 0.40 | \$ (0.32) |
| Income from discontinued operations attributable to Whitestone REIT   |         |         | 0.67      |

**Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares**

|         |         |         |
|---------|---------|---------|
| \$ 0.27 | \$ 0.40 | \$ 0.35 |
|---------|---------|---------|

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Federal income taxes are not provided because we intend to and believe we qualify as a REIT under the provisions of the Internal Revenue Code 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 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 was \$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.

For federal income tax purposes, the cash dividends distributed to shareholders are characterized as follows for the years ended December 31:

|  | 2010          | 2009          | 2008          |
|--|---------------|---------------|---------------|
| Ordinary income (unaudited)            | 37.8%         | 40.5%         | 3.8%          |
| Return of capital (unaudited)          | 62.2%         | 59.5%         | 67.6%         |
| Capital gain distributions (unaudited) | %             | %             | 28.6%         |
| <b>Total</b>                           | <b>100.0%</b> | <b>100.0%</b> | <b>100.0%</b> |

**11. RELATED PARTY TRANSACTIONS**

*Spoerlein Commons Acquisition.* On January 16, 2009, we, through our Operating Partnership, acquired Spoerlein Commons, a property located in Buffalo Grove, Illinois. Our Operating Partnership acquired Spoerlein Commons pursuant to the terms and conditions of the purchase, sale and contribution agreement dated December 18, 2008, between our Operating Partnership and Bank One Chicago, NA as trustee under a trust agreement dated January 29, 1986 (the Seller). Midwest Development Venture IV (Midwest) is the sole beneficiary of the Seller under the trust agreement.

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An independent appraiser valued Spoerlein Commons at \$9.6 million. In exchange for this property, our Operating Partnership paid the Seller \$5.5 million, received credit for net prorations of \$0.3 million and issued 234,637 OP Units, valued at \$15.45 per unit, or an aggregate of \$3.6 million, for a total purchase price of \$9.4 million.

Midwest, the sole beneficiary of the Seller, was entitled to all earnings and proceeds from the sale of Spoerlein Commons. James C. Mastandrea, our Chairman, President and Chief Executive Officer, is the controlling limited partner in Midwest. Because of Mr. Mastandrea's relationship with the Seller, a special committee of the independent trustees determined the terms of the transaction, which included the use of an independent appraiser to value Spoerlein Commons.

Our OP Units were issued in reliance on the exemption from registration provided by Section 4(2) under the Securities Act of 1933, as amended. The issuance was not effected using any form of general advertising or general solicitation, and the issuance was made to a qualified investor.

The OP Units received by Midwest were convertible on a one-for-one basis into cash or, at our option, our Class A common shares at any time after July 1, 2009 in accordance with the terms of the limited partnership agreement to our Operating Partnership. The Seller was not entitled to any distributions with respect to the OP Units prior to June 30, 2009. The results of Spoerlein Commons are included in our consolidated financial statements as of the date of the acquisition.

*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 the tax on that amount 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.

**12. EQUITY**

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

**Recapitalization, listing and offering of Class B common shares**

On August 24, 2010, we filed with the State Department of Assessments and Taxation of Maryland (the SDAT) amendments to our declaration of trust that (i) changed the name of all of our common shares of beneficial interest, par value \$0.001 to Class A common shares, (ii) effected a 1-for-3 reverse share split of our Class A common shares and (iii) changed the par value of our Class A common shares to \$0.001 per share after the reverse share split. In addition, we filed with the SDAT articles supplementary to our declaration of trust that

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created a new class of common shares of beneficial interest, par value \$0.001, entitled Class B common shares (the Class B common shares and collectively with Class A common shares, the common shares). Share and unit counts and per share and unit amounts have been retroactively restated to reflect our 1-for-3 reverse share split in August 2010.

On August 25, 2010, in connection with the listing of our Class B common shares on the NYSE-Amex, we offered and subsequently issued 2.2 million Class B common shares which resulted in \$23.0 million in net offering proceeds to us. As of December 31, 2010, we had 3,471,187 Class A common shares, 2,200,000 Class B common shares, and 1,814,569 OP Units, not held by us, outstanding. Each Class B common share has the following rights:

the right to vote together with Class A common shareholders on all matters submitted to the Company's shareholders;

one vote on all matters voted upon by the Company's shareholders;

the right to receive dividends equal to any dividends declared on the Class A common shares; and

liquidation rights equal to the liquidation rights of each Class A common share.

**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 December 31, 2010, we owned a 75.4% 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. Subject to certain restrictions, OP Units are not convertible into Class A common shares until the later of one year after acquisition or an initial public offering of the common shares. As of December 31, 2010 and December 31, 2009, there were 7,364,943 and 5,139,541 OP Units outstanding, respectively. We owned 5,550,374 and 3,324,941 OP Units as of December 31, 2010 and December 31, 2009, respectively. The balance of the OP Units is owned by third parties, including certain trustees. Our weighted-average share ownership in the Operating Partnership was approximately 70.18%, 64.67% and 64.62% for the years ended December 31, 2010, 2009 and 2008, respectively.

**Dividends and distributions**

The following tables summarize the cash dividends paid or payable to holders of common shares and distributions paid or payable to holders of noncontrolling OP Units during the years ended December 31, 2010 and 2009 and the quarter ended March 31, 2010.

|                          | Class A Common Shareholders |                   | Class B Common Shareholders |                   | Noncontrolling OP Unit Holders |                   | Total Total Amount Paid |
|--------------------------|-----------------------------|-------------------|-----------------------------|-------------------|--------------------------------|-------------------|-------------------------|
|                          | Dividend Per Common Share   | Total Amount Paid | Dividend Per Common Share   | Total Amount Paid | Distribution Per OP Unit       | Total Amount Paid |                         |
| <b>Quarter Paid 2010</b> |                             |                   |                             |                   |                                |                   |                         |
| 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                   |

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|              |                  |                 |                  |               |                  |                 |                 |
|--------------|------------------|-----------------|------------------|---------------|------------------|-----------------|-----------------|
| <b>Total</b> | <b>\$ 1.2450</b> | <b>\$ 4,320</b> | <b>\$ 0.3810</b> | <b>\$ 838</b> | <b>\$ 1.2450</b> | <b>\$ 2,249</b> | <b>\$ 7,407</b> |
|--------------|------------------|-----------------|------------------|---------------|------------------|-----------------|-----------------|

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| Quarter Paid   | Class A Common Shareholders |                   | Class B Common Shareholders |                   | Noncontrolling OP Unit Holders |                   | Total Total Amount Paid |
|----------------|-----------------------------|-------------------|-----------------------------|-------------------|--------------------------------|-------------------|-------------------------|
|                | Dividend Per Common Share   | Total Amount Paid | Dividend Per Common Share   | Total Amount Paid | Distribution Per OP Unit       | Total Amount Paid |                         |
| <b>2009</b>    |                             |                   |                             |                   |                                |                   |                         |
| Fourth Quarter | \$ 0.3375                   | \$ 1,163          | \$                          | \$                | \$ 0.3375                      | \$ 610            | \$ 1,773                |
| Third Quarter  | 0.3375                      | 1,163             |                             |                   | 0.3375                         | 610               | 1,773                   |
| Second Quarter | 0.3375                      | 1,163             |                             |                   | 0.3375                         | 530               | 1,693                   |
| First Quarter  | 0.3375                      | 1,156             |                             |                   | 0.3375                         | 531               | 1,687                   |
| <b>Total</b>   | <b>\$ 1.3500</b>            | <b>\$ 4,645</b>   | <b>\$</b>                   | <b>\$</b>         | <b>\$ 1.3500</b>               | <b>\$ 2,281</b>   | <b>\$ 6,926</b>         |

**13. INCENTIVE SHARE PLAN**

On July 29, 2008, our shareholders approved the 2008 Long-Term Equity Incentive Ownership Plan (the Plan). On December 22, 2010, our board amended the Plan to allow for the issuance of Class B common shares pursuant to the Plan. The 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 Class A common shares of Whitestone. The maximum aggregate number of Class B common shares that may be issued under the Plan is increased upon each issuance of Class A or Class B common shares by Whitestone (including issuances pursuant to the Plan) so that at any time the maximum number of shares that may be issued under the Plan shall equal 12.5% of the aggregate number of 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 Plan, except with respect to awards to non-employee trustees, for which the 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.

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

A summary of the share-based incentive plan activity as of and for the year ended December 31, 2010 is as follows:

|  | Shares   | Weighted-Average Grant Date Fair Value <sup>(1)</sup> |
|--|----------|---|
| Non-vested at January 1, 2010            | 588,564  | \$ 12.39  |
| Granted                                  | 31,858   | 14.09   |
| Vested                                   | (55,699) | 12.48   |
| Forfeited                                | (42,282) | 12.52   |
| Non-vested at December 31, 2010          | 522,441  | \$ 12.48  |
| Available for grant at December 31, 2010 | 473,814  |   |

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

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A summary of our nonvested and vested shares activity for the years ended December 31, 2010, 2009 and 2008 is presented below:

| Year Ended | Shares Granted              |  | Shares Vested |   |
|------------|-----------------------------|--|---------------|---|
|            | Non-Vested<br>Shares Issued | Weighted-<br>Average Grant-<br>Date Fair Value | Vested Shares | Total Vest-Date<br>Fair Value<br>(in thousands) |
| 2010       | 31,858                      | \$ 14.09                                       | (55,699)      | \$ 695  |
| 2009       | 600,731                     | 12.37  |               |   |
| 2008       |                             |  |               |   |

Total compensation recognized in earnings for share-based payments for the years ended December 31, 2010 and December 31, 2009 was \$0.3 million and \$1.0 million, 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 a result, as of December 31, 2010, there was no unrecognized compensation cost related to outstanding nonvested performance-based shares based on management's current estimates. As of December 31, 2010, there was approximately \$0.2 million in unrecognized compensation cost related to outstanding nonvested time-based shares which are expected to be recognized over a weighted-average period of approximately three years. There was no share-based compensation expense prior to 2009. 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.

**14. GRANTS TO TRUSTEES**

On March 25, 2009, each of our five independent trustees was granted 1,667 restricted Class A common shares which vest in equal installments in 2010, 2011, and 2012. During the year ended December 31, 2010, 3,891 of these restricted shares vested. These restricted shares were granted pursuant to individual grant agreements and were 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 \$40,000 as of December 31, 2010, 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.

**15. COMMITMENTS AND CONTINGENCIES**

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

*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 the tax on that amount

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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.

**16. INVOLUNTARY CONVERSION**

Involuntary conversion was a gain of \$0.6 million for the year ended December 31, 2010. The involuntary conversion gain of \$0.6 million recognized during the year ended December 31, 2010 represents the completion of the repairs to the 31 properties impacted by Hurricane Ike at costs that were lower than we estimated as of December 31, 2009. The estimated costs were sensitive to the scope requirements of our lenders and labor and material costs of our vendors, and the final costs incurred were more favorable than we anticipated.

During the year ended December 31, 2009, we completed a settlement of our insurance claims related to our 31 properties damaged by Hurricane Ike. The settlement was \$7.0 million in its entirety, with \$6.5 million allocated to casualty claims and approximately \$0.5 million allocated to loss of rents claims. For the year ended December 31, 2009, the \$6.5 million in insurance proceeds allocated to casualty losses were offset by accrued repair costs of \$5.1 million resulting in a gain of \$1.4 million. The remaining \$0.1 million in involuntary conversion gain for the year ended December 31, 2009 was realized on an insurance settlement we completed during 2009 on a chiller unit at our Uptown Tower property in Dallas, Texas.

Hurricane Ike-related repair costs of approximately \$0.4 million included in involuntary conversion loss during the year ended December 31, 2008.

**17. SEGMENT INFORMATION**

Our management historically has not differentiated by property types and therefore does not present segment information.

**18. SELECT QUARTERLY FINANCIAL DATA (unaudited)**

The following is a summary of our unaudited quarterly financial information for the years ended December 31, 2010 and 2009 (in thousands, except per share data):

|  | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|--|------------------|-------------------|------------------|-------------------|
| <b>2010</b>  |                  |                   |                  |                   |
| Revenues from continuing operations                                      | \$ 7,709         | \$ 7,832          | \$ 7,933         | \$ 8,059          |
| Net income attributable to Whitestone REIT                               | 217              | 166               | 177              | 545               |
| <b>Earnings per share:</b>   |                  |                   |                  |                   |
| Basic Net income attributable to Whitestone REIT <sup>(1)</sup>          | \$ 0.06          | \$ 0.05           | \$ 0.04          | \$ 0.10           |
| Diluted Net income attributable to Whitestone REIT <sup>(1)</sup>        | \$ 0.06          | \$ 0.05           | \$ 0.04          | \$ 0.10           |
| <b>2009</b>  |                  |                   |                  |                   |
| Revenues from continuing operations                                      | \$ 8,044         | \$ 8,203          | \$ 8,484         | \$ 7,954          |
| Net income (loss) attributable to Whitestone REIT                        | (21)             | 47                | 601              | 715               |
| <b>Earnings per share:</b>   |                  |                   |                  |                   |
| Basic Net income (loss) attributable to Whitestone REIT <sup>(1)</sup>   | \$ (0.01)        | \$ 0.01           | \$ 0.18          | \$ 0.22           |
| Diluted Net income (loss) attributable to Whitestone REIT <sup>(1)</sup> | (0.01)           | 0.01              | 0.18             | 0.21              |

<sup>(1)</sup> The sum of individual quarterly basic and diluted earnings per share amounts may not agree with the year-to-date basic and diluted earnings per share amounts as the result of each period's computation being based on the weighted average number of common shares outstanding

during that period.

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## Whitestone REIT and Subsidiaries

## Schedule II Valuation and Qualifying Accounts

December 31, 2010

| Description                      | (in thousands)                          |                                    |                                | Balance at<br>End of<br>Period |
|----------------------------------|---|------------------------------------|--------------------------------|--------------------------------|
|                                  | Balance at<br>Beginning<br>of<br>Period | Charged to<br>Costs and<br>Expense | Deductions<br>from<br>Reserves |                                |
| Allowance for doubtful accounts: |   |                                    |                                |                                |
| Year ended December 31, 2010     | \$ 894                                  | \$ 536                             | (126)                          | \$ 1,304                       |
| Year ended December 31, 2009     | 1,497                                   | 877                                | (1,480)                        | 894                            |
| Year ended December 31, 2008     | 865                                     | 731                                | (99)                           | 1,497                          |

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| Property Name                  | Initial Cost (in thousands) |                           | Costs Capitalized Subsequent to Acquisition (in thousands) |                | Gross Amount at which Carried at End of Period (in thousands) <sup>(1) (2)</sup> |                           |                  |
|--------------------------------|-----------------------------|---------------------------|--|----------------|--|---------------------------|------------------|
|                                | Land                        | Building and Improvements | Improvements (net)   | Carrying Costs | Land   | Building and Improvements | Total            |
| <b>Retail Properties:</b>      |                             |                           |  |                |  |                           |                  |
| Bellnot Square                 | \$ 1,154                    | \$ 4,638                  | \$ 382   | \$             | \$ 1,154   | \$ 5,020                  | \$ 6,174         |
| Bissonnet Beltway              | 415                         | 1,947                     | 417  |                | 415  | 2,364                     | 2,779            |
| Centre South                   | 481                         | 1,596                     | 453  |                | 481  | 2,049                     | 2,530            |
| Greens Road                    | 354                         | 1,284                     | 137  |                | 354  | 1,421                     | 1,775            |
| Holly Knight                   | 320                         | 1,293                     | 188  |                | 320  | 1,481                     | 1,801            |
| Kempwood Plaza                 | 733                         | 1,798                     | 1,103  |                | 733  | 2,901                     | 3,634            |
| Lion Square                    | 1,546                       | 4,289                     | 976  |                | 1,546  | 5,265                     | 6,811            |
| Providence                     | 918                         | 3,675                     | 802  |                | 918  | 4,477                     | 5,395            |
| Shaver                         | 184                         | 633                       |  |                | 184  | 633                       | 817              |
| South Richey                   | 778                         | 2,584                     | 352  |                | 778  | 2,936                     | 3,714            |
| Spoerlein Commons              | 2,340                       | 7,296                     | 154  |                | 2,340  | 7,450                     | 9,790            |
| SugarPark Plaza                | 1,781                       | 7,125                     | 269  |                | 1,781  | 7,394                     | 9,175            |
| Sunridge                       | 276                         | 1,186                     | 212  |                | 276  | 1,398                     | 1,674            |
| Torrey Square                  | 1,981                       | 2,971                     | 876  |                | 1,981  | 3,847                     | 5,828            |
| Town Park                      | 850                         | 2,911                     | 250  |                | 850  | 3,161                     | 4,011            |
| Webster Point                  | 720                         | 1,150                     | 307  |                | 720  | 1,457                     | 2,177            |
| Westchase                      | 423                         | 1,751                     | 2,734  |                | 423  | 4,485                     | 4,908            |
| Windsor Park                   | 2,621                       | 10,482                    | 1,152  |                | 2,621  | 11,634                    | 14,255           |
|                                | <b>\$ 17,875</b>            | <b>\$ 58,609</b>          | <b>\$ 10,764</b>   | <b>\$</b>      | <b>\$ 17,875</b>   | <b>\$ 69,373</b>          | <b>\$ 87,248</b> |
| <b>Office/Flex Properties:</b> |                             |                           |  |                |  |                           |                  |
| Brookhill                      | \$ 186                      | \$ 788                    | \$ 282   | \$             | \$ 186   | \$ 1,070                  | \$ 1,256         |
| Corporate Park Northwest       | 1,534                       | 6,306                     | 912  |                | 1,534  | 7,218                     | 8,752            |
| Corporate Park West            | 2,555                       | 10,267                    | 786  |                | 2,555  | 11,053                    | 13,608           |
| Corporate Park Woodland        | 652                         | 5,330                     | 484  |                | 652  | 5,814                     | 6,466            |
| Dairy Ashford                  | 226                         | 1,211                     | 98   |                | 226  | 1,309                     | 1,535            |
| Holly Hall                     | 608                         | 2,516                     | 172  |                | 608  | 2,688                     | 3,296            |
| Interstate 10                  | 208                         | 3,700                     | 417  |                | 208  | 4,117                     | 4,325            |
| Main Park                      | 1,328                       | 2,721                     | 485  |                | 1,328  | 3,206                     | 4,534            |
| Plaza Park                     | 902                         | 3,294                     | 876  |                | 902  | 4,170                     | 5,072            |
| West Belt Plaza                | 568                         | 2,165                     | 529  |                | 568  | 2,694                     | 3,262            |
| Westgate                       | 672                         | 2,776                     | 418  |                | 672  | 3,194                     | 3,866            |
|                                | <b>\$ 9,439</b>             | <b>\$ 41,074</b>          | <b>\$ 5,459</b>  | <b>\$</b>      | <b>\$ 9,439</b>  | <b>\$ 46,533</b>          | <b>\$ 55,972</b> |
| <b>Office Properties:</b>      |                             |                           |  |                |  |                           |                  |
| 9101 LBJ Freeway               | \$ 1,597                    | \$ 6,078                  | \$ 1,107   | \$             | \$ 1,597   | \$ 7,185                  | \$ 8,782         |
| Featherwood                    | 368                         | 2,591                     | 482  |                | 368  | 3,073                     | 3,441            |
| Pima Norte                     | 1,086                       | 7,162                     | 800  | 517            | 1,086  | 8,479                     | 9,565            |
| Royal Crest                    | 509                         | 1,355                     | 172  |                | 509  | 1,527                     | 2,036            |
| Uptown Tower                   | 1,621                       | 15,551                    | 2,560  |                | 1,621  | 18,111                    | 19,732           |
| Woodlake Plaza                 | 1,107                       | 4,426                     | 983  |                | 1,107  | 5,409                     | 6,516            |
| Zeta Building                  | 636                         | 1,819                     | 297  |                | 636  | 2,116                     | 2,752            |

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|                                  |                  |                   |                  |               |                  |                   |                   |
|----------------------------------|------------------|-------------------|------------------|---------------|------------------|-------------------|-------------------|
|                                  | \$ 6,924         | \$ 38,982         | \$ 6,401         | \$ 517        | \$ 6,924         | \$ 45,900         | \$ 52,824         |
| <b>Total Operating Portfolio</b> | <b>\$ 34,238</b> | <b>\$ 138,665</b> | <b>\$ 22,624</b> | <b>\$ 517</b> | <b>\$ 34,238</b> | <b>\$ 161,806</b> | <b>\$ 196,044</b> |
| The Citadel                      | \$ 472           | \$ 1,777          | \$ 32            | \$            | \$ 472           | \$ 1,809          | \$ 2,281          |
| Sunnyslope Village               | 1,305            | 5,324             |                  |               | 1,305            | 5,324             | 6,629             |
|                                  | \$ 1,777         | \$ 7,101          | \$ 32            | \$            | \$ 1,777         | \$ 7,133          | \$ 8,910          |
| <b>Grand Totals</b>              | <b>\$ 36,015</b> | <b>\$ 145,766</b> | <b>\$ 22,656</b> | <b>\$ 517</b> | <b>\$ 36,015</b> | <b>\$ 168,939</b> | <b>\$ 204,954</b> |

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| <b>Property Name</b>           | <b>Encumbrances</b> | <b>Accumulated<br/>Depreciation<br/>(in thousands)</b> | <b>Date of<br/>Construction</b> | <b>Date<br/>Acquired</b> | <b>Depreciation<br/>Life</b> |
|--------------------------------|---------------------|--|---------------------------------|--------------------------|------------------------------|
| <b>Retail Properties:</b>      |                     |  |                                 |                          |                              |
| Bellnot Square                 |                     | \$ 1,161   |                                 | 1/1/2002                 | 5-39 years                   |
| Bissonnet Beltway              |                     | 1,029  |                                 | 1/1/1999                 | 5-39 years                   |
| Centre South                   |                     | 784  |                                 | 1/1/2000                 | 5-39 years                   |
| Greens Road                    |                     | 612  |                                 | 1/1/1999                 | 5-39 years                   |
| Holly Knight                   | (3)                 | 655  |                                 | 8/1/2000                 | 5-39 years                   |
| Kempwood Plaza                 | (3)                 | 1,187  |                                 | 2/2/1999                 | 5-39 years                   |
| Lion Square                    | (3)                 | 1,623  |                                 | 1/1/2000                 | 5-39 years                   |
| Providence                     | (3)                 | 1,258  |                                 | 3/30/2001                | 5-39 years                   |
| Shaver                         |                     | 239  |                                 | 12/17/1999               | 5-39 years                   |
| South Richey                   | (3)                 | 896  |                                 | 8/25/1999                | 5-39 years                   |
| Spoerlein Commons              |                     | 379  |                                 | 1/16/2009                | 5-39 years                   |
| SugarPark Plaza                | (3)                 | 1,190  |                                 | 9/8/2004                 | 5-39 years                   |
| Sunridge                       | (3)                 | 383  |                                 | 1/1/2002                 | 5-39 years                   |
| Torrey Square                  | (3)                 | 1,398  |                                 | 1/1/2000                 | 5-39 years                   |
| Town Park                      | (3)                 | 1,296  |                                 | 1/1/1999                 | 5-39 years                   |
| Webster Point                  |                     | 516  |                                 | 1/1/2000                 | 5-39 years                   |
| Westchase                      |                     | 719  |                                 | 1/1/2002                 | 5-39 years                   |
| Windsor Park                   | (4)                 | 1,906  |                                 | 12/16/2003               | 5-39 years                   |
|                                |                     | <b>\$ 17,231</b>                                       |                                 |                          |                              |
| <b>Office/Flex Properties:</b> |                     |  |                                 |                          |                              |
| Brookhill                      | (5)                 | \$ 238   |                                 | 1/1/2002                 | 5-39 years                   |
| Corporate Park Northwest       |                     | 1,950  |                                 | 1/1/2002                 | 5-39 years                   |
| Corporate Park West            | (6)                 | 2,895  |                                 | 1/1/2002                 | 5-39 years                   |
| Corporate Park Woodland        | (7)                 | 2,024  | 11/1/2000                       |                          | 5-39 years                   |
| Dairy Ashford                  |                     | 471  |                                 | 1/1/1999                 | 5-39 years                   |
| Holly Hall                     | (7)                 | 664  |                                 | 1/1/2002                 | 5-39 years                   |
| Interstate 10                  | (7)                 | 1,839  |                                 | 1/1/1999                 | 5-39 years                   |
| Main Park                      | (7)                 | 1,071  |                                 | 1/1/1999                 | 5-39 years                   |
| Plaza Park                     | (7)                 | 1,350  |                                 | 1/1/2000                 | 5-39 years                   |
| West Belt Plaza                | (7)                 | 1,125  |                                 | 1/1/1999                 | 5-39 years                   |
| Westgate                       | (7)                 | 792  |                                 | 1/1/2002                 | 5-39 years                   |
|                                |                     | <b>\$ 14,419</b>                                       |                                 |                          |                              |
| <b>Office Properties:</b>      |                     |  |                                 |                          |                              |
| 9101 LBJ Freeway               | (8)                 | \$ 1,301   |                                 | 8/10/2005                | 5-39 years                   |
| Featherwood                    |                     | 481  |                                 | 1/1/2000                 | 5-39 years                   |
| Pima Norte                     |                     | 529  |                                 | 10/4/2007                | 5-39 years                   |
| Royal Crest                    |                     | 1,008  |                                 | 1/1/2000                 | 5-39 years                   |
| Uptown Tower                   | (8)                 | 2,798  |                                 | 11/22/2005               | 5-39 years                   |
| Woodlake Plaza                 | (8)                 | 1,048  |                                 | 3/14/2005                | 5-39 years                   |
| Zeta Building                  | (5)                 | 707  |                                 | 1/1/2000                 | 5-39 years                   |

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\$ 7,872

**Total Operating Portfolio** \$ **39,522**

|                    |       |           |            |
|--------------------|-------|-----------|------------|
| The Citadel        | \$ 11 | 9/28/2010 | 5-39 years |
| Sunnyslope Village | 23    | 11/1/2010 | 5-39 years |

\$ 34

**Grand Total** \$ **39,556**

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## Whitestone REIT and Subsidiaries

## Schedule III Real Estate and Accumulated Depreciation

December 31, 2010

(1) Reconciliations of total real estate carrying value for the three years ended December 31, follows:

|  | ( in thousands)   |                   |                   |
|--|-------------------|-------------------|-------------------|
|  | 2010              | 2009              | 2008              |
| Balance at beginning of period                 | \$ 192,832        | \$ 180,397        | \$ 172,315        |
| Additions during the period:                   |                   |                   |                   |
| Acquisitions                                   | 8,878             | 9,636             |                   |
| Improvements                                   | 4,142             | 3,770             | 9,402             |
|  | 13,020            | 13,406            | 9,402             |
| Deductions cost of real estate sold or retired | (898)             | (971)             | (1,320)           |
| <b>Balance at close of period</b>              | <b>\$ 204,954</b> | <b>\$ 192,832</b> | <b>\$ 180,397</b> |

(2) The aggregate cost of real estate (in thousands) for federal income tax purposes is \$169,266.

(3) These properties secure a \$21.4 million and a \$9.9 million mortgage notes.

(4) This property secures a \$10.0 million mortgage note.

(5) These properties secure a \$1.5 million mortgage note.

(6) This property secures an \$11.2 million mortgage note.

(7) These properties secure a \$26.9 million mortgage note.

(8) These properties secure a \$24.5 million mortgage note

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Whitestone REIT  
5,000,000  
Class B Common Shares

*Joint Book-running Managers*

BMO Capital Markets JMP Securities Wunderlich Securities

*Lead Manager*

Ladenburg Thalmann & Co. Inc.

*Co-Managers*

J.J.B. Hilliard, W.L. Lyons, LLC Southwest Securities, Inc. Maxim Group LLC

**Table of Contents****Index to Financial Statements****PART II****INFORMATION NOT REQUIRED IN PROSPECTUS****Item 31. Other Expenses of Issuance and Distribution**

The following table sets forth the costs and expenses of the sale and distribution of the securities being registered, all of which are being borne by the Registrant.

|                              |                |
|------------------------------|----------------|
| SEC registration fee         | \$ 10,014      |
| FINRA filing fee             | 9,125          |
| NYSE Amex listing fee        | 45,000         |
| Printing and engraving fees  | 75,000         |
| Legal fees and expenses      | 200,000        |
| Accounting fees and expenses | 50,000         |
| Miscellaneous                | 25,000         |
| <b>Total</b>                 | <b>414,139</b> |

All expenses, except the SEC registration fee, the FINRA filing fee and the NYSE Amex listing fee are estimated.

**Item 32. Sales to Special Parties**

None.

**Item 33. Recent Sales of Unregistered Securities**

None.

**Item 34. Indemnification of Trustees and Officers**

Maryland law permits a Maryland real estate investment trust to include in its declaration of trust a provision limiting the liability of its trustees and officers to the trust and its shareholders for money damages except for liability resulting from (a) actual receipt of an improper benefit or profit in money, property or services or (b) active and deliberate dishonesty established by a final judgment and which is material to the cause of action. Our declaration of trust contains such a provision which eliminates trustees and officers liability to the maximum extent permitted by Maryland law.

Maryland law permits a Maryland real estate investment trust to indemnify and advance expenses to its trustees, officers, employees and agents to the same extent as permitted for directors and officers of Maryland corporations.

Section 2-418 of the Maryland General Corporation Law (MGCL) provides that, in general, a corporation may indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made or threatened to be made by reason of their service in those or other capacities, except for liability (1) where the act or omission of the director or officer was material to the matter giving rise to the proceeding and was committed in bad faith or involved active and deliberate dishonesty; (2) for any transaction from which the director or officer actually received an improper personal benefit in money, property or services; and (3) in the case of a criminal proceeding, if the director or officer had reasonable cause to believe that the act or omission was unlawful. However, under the MGCL, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation or for a judgment of liability on the basis that personal benefit was improperly received, unless in either case a court orders indemnification and then only for expenses.

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In addition, the MGCL permits a corporation to advance reasonable expenses to a director or officer upon the corporation's receipt of (i) a written affirmation by the director or officer of his good faith belief that he has met the standard of conduct necessary for indemnification by the corporation and (ii) a written undertaking by him or on his behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the standard of conduct was not met.

Our declaration of trust authorizes our company, to the maximum extent permitted by Maryland law, to obligate itself to indemnify any present or former trustee or officer or any individual who, while a trustee or officer and at our request, serves or has served another real estate investment trust, corporation, partnership, joint venture, trust, employee benefit plan or other enterprise as a trustee, director, officer, partner, employee or agent, against any claim or liability arising from that status and to pay or reimburse their reasonable expenses in advance of final disposition of a proceeding. Our bylaws obligate us to provide such indemnification and advance of expenses. Our declaration of trust and bylaws also permit us to indemnify and advance expenses to any person who served our predecessor in any of the capacities described above and any employee or agent of us or our predecessor. These provisions do not limit or eliminate our rights or any shareholder to seek non-monetary relief such as an injunction or rescission in the event of a breach of a trustee's duties.

**Item 35. Treatment of Proceeds From Stock Being Registered**

Not applicable.

**Item 36. Financial Statements and Exhibits**

(a) *Financial Statements.* See page F-1 for an index of the financial statements included in the Registration Statement.

(b) *Exhibits.* The exhibits are incorporated by reference to the Exhibit Index attached hereto and a part hereof by reference.

**Item 37. Undertakings**

(a) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to trustees, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a trustee, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such trustee, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

(b) The undersigned Registrant hereby further undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

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**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, as amended, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-11 and has duly caused this amendment to the registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Houston, State of Texas, on the 25th day of April, 2011.

**Whitestone REIT**  
 By: /s/ James C. Mastandrea  
**James C. Mastandrea**  
**Chief Executive Officer and Chairman**  
**(Principal Executive Officer)**

Pursuant to the requirements of the Securities Act of 1933, as amended, this amendment to the registration statement has been signed below by the following persons in the capacities and on the dates indicated.

| Signature   | Title  | Date           |
|---|--|----------------|
| /s/ James C. Mastandrea<br><br><b>James C. Mastandrea</b> | Chief Executive Officer and Chairman (Principal Executive Officer)   | April 25, 2011 |
| /s/ David K. Holeman<br><br><b>David K. Holeman</b>       | Chief Financial Officer (Principal Financial and Accounting Officer) | April 25, 2011 |
| *   | Trustee  | April 25, 2011 |
| <b>Daryl J. Carter</b>                                    |  |                |
| *   | Trustee  | April 25, 2011 |
| <b>Daniel G. DeVos</b>                                    |  |                |
| *   | Trustee  | April 25, 2011 |
| <b>Donald F. Keating</b>                                  |  |                |
| *   | Trustee  | April 25, 2011 |
| <b>Jack L. Mahaffey</b>                                   |  |                |
| * By: /s/ David K. Holeman<br><br><b>Attorney-in-Fact</b> |  |                |

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| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 1.1*               | Form of Underwriting Agreement   |
| 3.1.1              | Articles of Amendment and Restatement 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 December 6, 2006)  |
| 3.1.3              | Articles of Amendment (previously filed 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 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 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 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 October 9, 2008)  |
| 5.1*               | Opinion of Venable LLP, with respect to the legality of the shares being registered  |
| 8.1*               | Opinion of Bass, Berry & Sims PLC with respect to tax matters  |
| 10.1               | Agreement of Limited Partnership of Whitestone REIT Operating Partnership, L.P. (previously filed as and incorporated by reference to Exhibit 10.1 to the Registrant's General Form for Registration of Securities on Form 10, filed on April 30, 2003)  |
| 10.2               | Certificate of Formation of Whitestone REIT Operating Partnership II GP, LLC (previously filed as and incorporated by reference to Exhibit 10.3 to the Registrant's General Form for Registration of Securities on Form 10, filed on April 30, 2003)   |
| 10.3               | Limited Liability Company Agreement of Whitestone REIT Operating Partnership II GP, LLC (previously filed as and incorporated by reference to Exhibit 10.4 to the Registrant's General Form for Registration of Securities on Form 10, filed on April 30, 2003)  |
| 10.4               | Agreement of Limited Partnership of Whitestone REIT Operating Partnership II, L.P. (previously filed as and incorporated by reference to Exhibit 10.6 to the Registrant's General Form for Registration of Securities on Form 10, filed on April 30, 2003)   |
| 10.5               | Form of Amendment to the Agreement of Limited Partnership of Whitestone REIT Operating Partnership, L.P. (previously filed in and incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-11, Commission File No. 333-111674, filed on December 31, 2003)   |
| 10.6               | Promissory Note between HCP REIT Operating Company IV LLC and MidFirst Bank, dated March 1, 2007 (previously filed and incorporated by reference to Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2006, filed on March 30, 2007)  |
| 10.7               | Term Loan Agreement among Whitestone REIT Operating Partnership, L.P., Whitestone Pima Norte LLC, Whitestone REIT Operating Partnership III LP, Hartman REIT Operating Partnership III LP LTD, Whitestone REIT Operating Partnership III GP LLC and KeyBank National Association, dated January 25, 2008 (previously filed as and incorporated by reference to Exhibit 10.29 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007, filed on March 31, 2008) |



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| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 10.8+              | Whitestone REIT 2008 Long-Term Equity Incentive Ownership Plan (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed July 31, 2008)   |
| 10.9               | Promissory Note among Whitestone Corporate Park West, LLC and MidFirst Bank dated August 5, 2008 (previously filed and incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed August 8, 2008)  |
| 10.10              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)                            |
| 10.11              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.2 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)                            |
| 10.12              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.3 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)                            |
| 10.13              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.4 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)                            |
| 10.14              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.5 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)                            |
| 10.15              | Note among Whitestone Offices LLC and Nationwide Life Insurance Company dated October 1, 2008 (previously filed and incorporated by reference to Exhibit 99.6 to the Registrant's Current Report on Form 8-K, filed October 7, 2008)  |
| 10.16              | Floating Rate Promissory Note among Whitestone Industrial-Office LLC and Jackson National Life Insurance Company dated October 3, 2008 (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed October 9, 2008) |
| 10.17              | Restricted Common Share Award Agreement (Performance Vested) (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed January 7, 2009)   |
| 10.18+             | Form of Restricted Common Share Award Agreement (Time Vested) (previously filed and incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed January 7, 2009)  |
| 10.19+             | Form of Restricted Unit Award Agreement (previously filed and incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed January 7, 2009)  |
| 10.20              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated February 3, 2009 (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed February 10, 2009)                         |
| 10.21              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated February 3, 2009 (previously filed and incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed February 10, 2009)                         |
| 10.22              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated February 3, 2009 (previously filed and incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed February 10, 2009)                         |

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| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.23              | Promissory Note among Whitestone Centers LLC and Sun Life Assurance Company of Canada dated February 3, 2009 (previously filed and incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K, filed February 10, 2009)  |
| 10.24              | Purchase, Sale and Contribution Agreement between Whitestone REIT Operating Partnership, L.P. and Bank One, Chicago, NA, as trustee for Midwest Development Venture IV dated December 18, 2008 (previously filed and incorporated by reference to Exhibit 10.8 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009) |
| 10.25+             | Trustee Restricted Common Share Grant Agreement (Time Vested) for Restricted Shares between Whitestone REIT and Daryl J. Carter (previously filed and incorporated by reference to Exhibit 10.9 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009)  |
| 10.26+             | Trustee Restricted Common Share Grant Agreement (Time Vested) for Restricted Shares between Whitestone REIT and Daniel G. DeVos (previously filed and incorporated by reference to Exhibit 10.10 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009)   |
| 10.27+             | Trustee Restricted Common Share Grant Agreement (Time Vested) for Restricted Shares between Whitestone REIT and Donald F. Keating (previously filed and incorporated by reference to Exhibit 10.11 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009)   |
| 10.28+             | Trustee Restricted Common Share Grant Agreement (Time Vested) for Restricted Shares between Whitestone REIT and Jack L. Mahaffey (previously filed and incorporated by reference to Exhibit 10.12 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009)  |
| 10.29+             | Trustee Restricted Common Share Grant Agreement (Time Vested) for Restricted Shares between Whitestone REIT and Chris A. Minton (previously filed and incorporated by reference to Exhibit 10.13 to Registrant's Quarterly Report on Form 10-Q, filed on May 15, 2009)   |
| 10.30              | Promissory Note dated September 10, 2010 between Whitestone REIT Operating Company IV LLC and MidFirst Bank (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed September 16, 2010)  |
| 10.31              | Modification of Promissory Note dated September 10, 2010 between Whitestone REIT Operating Company IV LLC and MidFirst Bank (previously filed and incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed September 16, 2010)  |
| 10.32              | Limited Guaranty dated September 10, 2010 between Whitestone REIT Operating Company IV LLC and MidFirst Bank (previously filed and incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed September 16, 2010)   |
| 10.33+             | First Amendment to Whitestone REIT 2008 Long-Term Equity Incentive Ownership Plan (previously filed and incorporated by reference to Exhibit 10.30 to Registrant's Annual Report on Form 10-K filed on March 1, 2011)  |
| 10.34              | Promissory Note dated March 31, 2011 between Whitestone Featherwood LLC and ViewPoint Bank (previously filed and incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed April 5, 2011)  |
| 21.1               | List of subsidiaries of Whitestone REIT (previously filed and incorporated by reference to Exhibit 21.1 to the Registrant's Annual Report on Form 10-K, filed on March 1, 2011)  |
| 23.1               | Consent of Pannell Kerr Forster of Texas, P.C. (Registrant's independent registered public accounting firm)  |
| 23.2*              | Consent of Venable LLP (included in its opinion filed as Exhibit 5.1 hereto)   |
| 23.3*              | Consent of Bass, Berry & Sims PLC (included in its opinion filed as Exhibit 8.1 hereto)  |
| 24.1*              | Power of attorney (included in the signature page to this Registration Statement)  |

+ Denotes management contract or compensatory plan or arrangement.

\* Previously filed.

