

Whitestone REIT  
Form 10-Q  
August 14, 2007

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

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2007**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number**

**000-50256**

**WHITESTONE REIT**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**76-0594970**  
(IRS Employer  
Identification No.)

**2600 South Gessner, Suite 500  
Houston, Texas 77063**  
(Address of principal executive offices)

**(713) 827-9595**  
(Registrant's telephone number, including area code)

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

Yes

No o

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

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See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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

Yes

No

The number of the registrant’s Common Shares of Beneficial Interest outstanding at August 14, 2007, was 10,001,269.

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

**WHITESTONE REIT AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	June 30, 2007 (unaudited)	December 31, 2006
Assets		
Real estate		
Land	\$ 32,662	\$ 32,662
Buildings and improvements	140,941	141,196
	173,603	173,858
Less accumulated depreciation	(25,912)	(24,259)
Real estate, net	147,691	149,599
Cash and cash equivalents	11,714	8,298
Escrows and acquisition deposits	308	382
Note receivable	589	604
Receivables		
Accounts receivable, net of allowance for doubtful accounts	2,007	1,727
Accrued rent receivable	3,090	3,035
Other receivables	257	-
Receivables, net	5,354	4,762
Deferred costs, net	2,955	2,890
Prepaid expenses and other assets	749	552
Total assets	\$ 169,360	\$ 167,087

See notes to consolidated financial statements

WHITESTONE REIT AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
(in thousands except share data)

	June 30, 2007 (unaudited)	December 31, 2006
Liabilities and Shareholders' Equity		
Liabilities		
Notes payable	\$ 75,519	\$ 66,363
Accounts payable and accrued expenses	3,014	5,398
Due to affiliates	-	103
Tenants' security deposits	1,525	1,455
Prepaid rent	768	745
Dividends payable	1,532	1,495
Distributions payable	871	905
Total liabilities	83,229	76,464
Minority interests of unit holders in Operating Partnership; 5,808,337 units at June 30, 2007 and December 31, 2006	29,963	31,709
Shareholders' equity		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at June 30, 2007 and December 31, 2006	-	-
Common shares, \$0.001 par value per share; 400,000,000 shares authorized; 10,001,269 and 9,974,362 issued and outstanding at June 30, 2007 and December 31, 2006, respectively	10	10
Additional paid-in-capital	72,273	72,012
Accumulated deficit	(16,115)	(13,108)
Total shareholders' equity	56,168	58,914
Total liabilities and shareholders' equity	\$ 169,360	\$ 167,087

See notes to consolidated financial statements

WHITESTONE REIT AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(unaudited)		(As Restated) (unaudited)	
Revenues				
Rental income	\$ 6,151	\$ 6,157	\$ 12,246	\$ 12,133
Tenants' reimbursements	1,377	1,220	2,732	2,600
Other income	40	117	135	175
<b>Total revenues</b>	<b>7,568</b>	<b>7,494</b>	<b>15,113</b>	<b>14,908</b>
Operating expenses				
Property operation and maintenance	1,127	1,058	2,406	2,075
Real estate taxes	1,049	969	1,912	1,834
Insurance	127	148	299	281
Electricity, water and gas utilities	618	601	1,098	1,113
Property management and asset management fees to an affiliate	-	391	-	804
General and administrative	1,450	288	3,484	738
Depreciation	1,250	1,181	2,614	2,539
Amortization	368	208	615	735
Bad debt expense	199	127	368	118
<b>Total operating expenses</b>	<b>6,188</b>	<b>4,971</b>	<b>12,796</b>	<b>10,237</b>
<b>Operating income</b>	<b>1,380</b>	<b>2,523</b>	<b>2,317</b>	<b>4,671</b>
Other income (expense)				
Interest income	155	88	292	184
Interest expense	(1,357)	(1,403)	(2,632)	(2,710)
Change in fair value of derivative instrument	36	195	15	195
<b>Income (loss) before minority interests</b>	<b>214</b>	<b>1,403</b>	<b>(8)</b>	<b>2,340</b>
Minority interests in (income) loss of Operating Partnership	(81)	(545)	3	(917)
<b>Net income (loss)</b>	<b>\$ 133</b>	<b>\$ 858</b>	<b>\$ (5)</b>	<b>\$ 1,423</b>
<b>Net income (loss) per common share</b>	<b>\$ 0.013</b>	<b>\$ 0.089</b>	<b>\$ (0.001)</b>	<b>\$ 0.151</b>
<b>Weighted-average shares outstanding</b>	<b>10,001</b>	<b>9,603</b>	<b>9,997</b>	<b>9,407</b>



WHITESTONE REIT AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(in thousands except per share data)

	Common Shares		Additional Paid-in Capital		Accumulated Deficit	Total
	Shares	Amount				
Balance, December 31, 2006	9,974	\$ 10	\$ 72,012	\$ (13,108)	\$ 58,914	
Issuance of shares under dividend reinvestment plan at \$9.50 per share	27	-	261	-	261	
Net loss	-	-	-	(5)	(5)	
Dividends	-	-	-	(3,002)	(3,002)	
Balance, June 30, 2007 (unaudited)	10,001	\$ 10	\$ 72,273	\$ (16,115)	\$ 56,168	

See notes to consolidated financial statements



WHITESTONE REIT AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

	Six Months Ended June 30, 2007	2006 (As Restated)
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$ (5)	\$ 1,423
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	2,614	2,539
Amortization	615	735
Minority interests in income (loss) of Operating Partnership	(3)	917
Bad debt expense	368	118
Change in fair value of derivative instrument	(15)	(195)
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	89	893
Receivables	(960)	1
Deferred costs	(533)	(617)
Prepaid expenses and other assets	(197)	(316)
Accounts payable and accrued expenses	(2,384)	(1,822)
Due to affiliates	(103)	114
Tenants' security deposits	70	90
Prepaid rent	23	110
Net cash provided by (used in) operating activities	(421)	3,990
Cash flows from investing activities:		
Additions to real estate	(706)	(785)
Repayment of note receivable	15	8
Net cash used in investing activities	(691)	(777)
Cash flows from financing activities:		
Dividends paid	(2,965)	(3,157)
Distributions paid to OP unit holders	(1,777)	(2,054)
Proceeds from issuance of common shares	261	7,070
Increase in stock offering proceeds escrowed	-	(977)
Proceeds from notes payable	14,469	35,281
Repayments of notes payable	(5,313)	(37,448)
Payments of loan origination costs	(147)	(119)
Net cash provided by (used in) financing activities	4,528	(1,404)
Net increase in cash and cash equivalents	3,416	1,809
Cash and cash equivalents at beginning of period	8,298	849

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Cash and cash equivalents at end of period	\$	11,714	\$	2,658
Supplemental disclosure of cash flow information:				
Cash paid for interest	\$	2,693	\$	2,718

See notes to consolidated financial statements

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

**Note 1 -**

**Summary of Significant Accounting Policies**

The consolidated financial statements included in this report are unaudited; however, amounts presented in the balance sheet as of December 31, 2006 are derived from our audited consolidated financial statements at that date. The unaudited financial statements at June 30, 2007 have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information on a basis consistent with the annual audited consolidated financial statements and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The consolidated financial statements presented herein reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position of Whitestone REIT (“Whitestone”), formerly known as Hartman Commercial Properties REIT, and our subsidiary as of June 30, 2007 and results of operations and cash flows for the three and six month periods ended June 30, 2007. All these adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative of the results expected for a full year. The statements should be read in conjunction with the audited consolidated financial statements and footnotes which are included in our Annual Report on Form 10-K.

Description of business and nature of operations

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”), formerly known as Hartman REIT Operating Partnership L.P., which was formed on December 31, 1998 as a Delaware limited partnership. Whitestone currently conducts substantially all of its operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, Whitestone has the exclusive power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of June 30, 2007 and December 31, 2006, we owned and operated 36 retail, warehouse and office properties in and around Houston, Dallas and San Antonio, Texas.

Basis of consolidation

We are the sole general partner of the Operating Partnership and possess full legal control and authority over the operations of the Operating Partnership. As of June 30, 2007 and December 31, 2006, 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. Minority interest in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income is allocated to minority interests based on the weighted-average percentage ownership of the Operating Partnership during the year. Issuance of additional common shares of beneficial interest in Whitestone (“common shares”) and units of limited partnership interest in the Operating Partnership that are convertible into common shares on a one for one basis (“OP Units”) changes the ownership interests of both the minority interests and Whitestone.

Basis of accounting

Our financial records are maintained on the accrual basis of accounting under which revenues are recognized when earned, and expenses are recorded when incurred.

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

**Note 1 - Summary of Significant Accounting Policies (Continued)**

Cash and cash equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents at June 30, 2007 and December 31, 2006 consist of demand deposits at commercial banks and money market funds.

Escrows and acquisition deposits

Escrow deposits include escrows established pursuant to certain mortgage financing arrangements for real estate taxes, insurance, maintenance and capital expenditures. Acquisition deposits include earnest money deposits on future acquisitions.

Real estate

Real estate properties are recorded at cost, net of accumulated depreciation. Improvements, major renovations, and certain costs directly related to the acquisition, improvement, and leasing of real estate are capitalized. Expenditures for repairs and maintenance are charged to operations as incurred. 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 lease.

Management reviews our properties for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. Management determines 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. We currently are reviewing our properties and therefore have made no adjustment for any potential impairment in the carrying value of our real estate assets as of June 30, 2007.

Deferred costs

Deferred costs consist primarily of leasing commissions paid to Hartman Management L.P., our former adviser, external brokers and in-house leasing agents. Leasing commissions are amortized using the straight-line method over the terms of the related lease agreements. Deferred financing costs are amortized on the straight-line method over the terms of the loans, which approximates the interest method. Costs allocated to in-place leases whose terms differ from market terms related to acquired properties are amortized over the remaining life of the respective leases.

Offering costs

Offering costs include selling commissions, issuance costs, investor relations fees and unit purchase discounts. These costs were incurred in the raising of capital through the sale of common shares and are treated as a reduction of shareholders' equity.

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

**Note 1 - Summary of Significant Accounting Policies (Continued)**

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.

Federal income taxes

We qualify as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986 and are therefore not subject to Federal income taxes provided we meet all conditions specified by the Internal Revenue Code for retaining our REIT status. We believe we have continuously met these conditions since reaching 100 shareholders in 1999 (see Note 9).

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates used by us include the estimated useful lives for depreciable and amortizable assets and costs, and the estimated allowance for doubtful accounts receivable. Actual results could differ from those estimates.

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 entered into an interest rate swap agreement 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.

Changes in the market value of the derivative instruments and in the market value of the hedged items are recorded in earnings each reporting period. For items that are appropriately classified as cash flow hedges in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," changes in the market value of the instrument and in the market value of the hedged item are recorded as other comprehensive income 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 June 30, 2007, the fair value of this instrument is approximately \$0.05 million and is included in prepaid expenses and other assets in the consolidated balance sheet.

Additionally, approximately \$0.04 million and \$0.02 million are included in other income on the consolidated statement of operations for the three and six months ended June 30, 2007 related to the change in fair value of the

derivative instrument.

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

**Note 1 - Summary of Significant Accounting Policies (Continued)**

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.

Recent accounting pronouncements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “*Fair Value Measurements*” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value under U.S. generally accepted accounting principles and requires enhanced disclosures about fair value measurements. It does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are required to adopt SFAS 157 in the first quarter of 2008, and we are currently evaluating the impact that this Statement will have on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*” (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We have not decided if we will choose to measure any eligible financial assets and liabilities at fair value under the provisions of SFAS 159.

Concentration of risk

Substantially all of our revenues are generated 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 occasionally exceed the federally insured limits, although no losses have been incurred in connection with these deposits

Reclassification

We have reclassified certain prior fiscal year amounts in the accompanying financial statements in order to be consistent with the current fiscal year presentation. During the first quarter of 2007, we have reclassified certain amounts due from Hartman Management, LP, the former advisor, from due to affiliates to other receivables. We have also reclassified interest expense from operating expense to other expense and interest income from revenues to other income in the Consolidated Statements of Operations for the three and six months ended June 30, 2007. The reclassification of interest income and expense decreased revenues and operating expenses and increased other income and expense but had no impact on net income.





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

**Note 1 - Summary of Significant Accounting Policies (Continued)**

Restatement

During the quarter ended September 30, 2006, management determined that deferred lease commissions related to an early lease termination on March 28, 2006 were not charged to operations. In accordance with our policy, deferred lease commissions for tenants that pre-maturely vacate a lease are to be charged to amortization expense in the period in which the default occurs. Accordingly the Consolidated Balance Sheets as of March 31, 2006 and June 30, 2006, the Consolidated Statements of Operations for the three and six month periods ended March 31, 2006 and June 30, 2006 and the Consolidated Statements of Cash Flows for the three and six month periods ended March 31, 2006 and June 30, 2006 have been restated.

Comprehensive income

We follow SFAS No. 130, "*Reporting Comprehensive Income*," which establishes standards for reporting and display of comprehensive income and its components. For the periods presented, we did not have significant amounts of other comprehensive income.

**Note 2 - Interest Rate Swap**

Effective March 16, 2006, we executed an interest rate swap used to mitigate the risks associated with adverse movements in interest rates which might affect expenditures. We have not designated this derivative contract as a hedge, and as such, the change in the fair value of the derivative is recognized currently in earnings. This derivative instrument has a total notional amount of \$30 million, is at a fixed rate of 5.09% plus the LIBOR margin, and matures monthly through March 2008. As of June 30, 2007, the fair value of this instrument is approximately \$0.05 million and is included in prepaid expenses and other assets in our consolidated balance sheet. Approximately \$0.04 million and \$0.02 million are included in other expense in our consolidated statement of operations for the three and six months ended June 30, 2007 as a result of a decrease in value from December 31, 2006.

**Note 3 - Real Estate**

We account for real estate acquisitions pursuant to SFAS 141, "*Business Combinations*." Accordingly, we allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, and legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.



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

**Note 3 - Real Estate (Continued)**

On December 1, 2006, we sold Northwest Place II, a 27,974 square foot warehouse building located in Houston, Texas for a sales price of \$1.2 million. A gain of \$0.2 million was generated from this sale, which was reflected in our consolidated financial statements for the year ended December 31, 2006. It is anticipated that the funds received from this sale will be used for future acquisitions and/or capital improvements to existing properties. It was determined that “discontinued operations” classification was not required due to the immateriality of this property to our overall results.

At June 30, 2007, we owned 36 commercial properties in the Houston, Dallas and San Antonio, Texas areas comprising approximately 3,093,000 square feet of gross leasable area.

**Note 4 - Note Receivable**

In January 2003, we partially financed the sale of a property we had previously sold and for which we had taken a note receivable of \$0.4 million as part of the consideration. We advanced \$0.3 million and renewed and extended the balance of \$0.4 million still due from the original sale.

The original principal amount of the note receivable, dated January 10, 2003, is \$0.7 million. The note is payable in monthly installments of \$6,382, including interest at 7% per annum, for the first two years of the note. Thereafter, monthly installments of \$7,489 are due with interest at 10% per annum. The note is fully amortizing with the final payment due January 10, 2018.

**Note 5 - Accounts Receivable, net**

Accounts receivable consists of amounts billed and due from tenants, amounts due from insurance claims and allowance for doubtful accounts as follows (in thousands):

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Tenant receivables	\$ 2,417	\$ 1,941
Allowance for doubtful accounts	(847)	(641)
Insurance claim receivable	437	427
Totals	\$ 2,007	\$ 1,727

**Note 6 - Other Receivables**

Other receivables consist of amounts owed to us by our previous advisor, Hartman Management, and partnerships managed by Hartman Management.

**Note 7 - Debt**

Notes payable

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

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	<b>June 30, 2007</b>		<b>December 31, 2006</b>
Mortgages and other notes payable	\$ 10,294	\$	5,138
Revolving loan secured by properties	65,225		61,225
Totals	\$ 75,519	\$	66,363

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

**Note 7 - Debt (Continued)**

As of June 30, 2007, we have two active loans which are described below:

***Revolving Credit Facility***

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

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

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

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

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

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

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

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

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

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

**Note 7 -**

**Debt (Continued)**

On October 2, 2006, our Board (i) elected not to renew our advisory agreement with Hartman Management, LP; (ii) terminated a certain management agreement with Hartman Management; and (iii) removed Allen R. Hartman from his positions as our President, Secretary and Chief Executive Officer. These actions violated certain covenants in the loan agreement and were events of default thereunder. These events of default have been waived by the lenders.

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

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

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

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

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

Other covenants, tested quarterly, relative to us are as follows:

- We will not permit our total indebtedness to exceed 60% of the fair market value of our real estate assets at the end of any quarter. Total indebtedness is defined as all our liabilities, including this facility and all other secured and unsecured debt, including letters of credit and guarantees. Fair market value of real estate assets is defined as aggregate net operating income for the preceding four quarters, less a \$0.15 per square foot per annum capital expenditure reserve, divided by a 9.25% capitalization rate.
- The ratio of consolidated rolling four-quarter earnings before interest, income tax, depreciation and amortization expenses to total interest expense, including capitalized interest, shall not be less than 2.0 to 1.0.





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

**Note 7 -**

**Debt (Continued)**

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

Within six months of closing, we were required to hedge all variable rate debt above \$40 million until the point at which the ratio of variable rate debt to fixed rate debt is 50% of total debt. Thereafter, we must maintain this type of hedge during any period in which variable rate debt exceeds 50% of total debt. On March 27, 2006, we executed an interest rate swap dated as of March 16, 2006 (see Note 2), for the purpose of hedging variable interest rate exposure, in compliance with the requirements of the loan agreement. The lenders waived the default for not executing the hedge within six months of closing, as required by the loan agreement.

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

***Mortgage Loan on Windsor Park Centre***

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

On March 1, 2007, we obtained a \$10 million loan to pay off the loan obtained upon the acquisition of the Windsor Park property and to provide funds for future acquisitions. The mortgage loan is secured by the Windsor Park property which is owned by Whitestone REIT Operating Company IV LLC ("WROC IV"), a wholly owned subsidiary of the Operating Partnership that was formed to hold title to the Windsor Park property. On March 1, 2007, we conveyed ownership of the Windsor Park property from the Operating Partnership to WROC IV in order to secure the \$10 million mortgage loan.

The note is payable in equal monthly installments of principal and interest of \$60,212, with interest at the rate of 6.04% per annum. The balance of the note is payable in full on March 1, 2014. The loan balance is approximately \$10 million at June 30, 2007.

WHITESTONE REIT AND SUBSIDIARY  
Notes to Consolidated Financial Statements  
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**Note 7 - Debt (Continued)**

Annual maturities of notes payable as of June 30, 2007, including the revolving loan, are as follows (in thousands):

Year Ended June 30,		
2008	\$	65,559
2014		9,960
	\$	75,519

**Note 8 - Earnings Per Share**

Basic earnings per share is computed using net income (loss) available to common shareholders and the weighted average number of common shares outstanding. Diluted earnings per share reflects common shares issuable from the assumed conversion of OP Units. Only those items that have a dilutive impact on basic earnings per share are included in the diluted earnings per share. Accordingly, excluded from the earnings per share calculation for each of the three and six months ended June 30, 2007 and 2006 are 5,808,337 OP Units as their inclusion would be anti-dilutive.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
		<b>(As Restated)</b>		<b>(As Restated)</b>
Basic and diluted earnings per share:				
Net income (loss) (in thousands)	\$ 133	\$ 858	\$ (5)	\$ 1,423
Basic and diluted earnings (loss) per share	\$ 0.013	\$ 0.089	\$ (0.001)	\$ 0.151
Weighted average common shares outstanding (in thousands)	10,001	9,603	9,997	9,407

**Note 9 - Federal Income Taxes**

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

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

**Note 10 -**

**Related-Party Transactions**

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

WHITESTONE REIT AND SUBSIDIARY  
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June 30, 2007

**Note 10 - Related-Party Transactions (Continued)**

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

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

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

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

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

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

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

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

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

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

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

**Note 10 - Related-Party Transactions (Continued)**

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

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

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

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

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

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

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

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

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



WHITESTONE REIT AND SUBSIDIARY  
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June 30, 2007

**Note 11 -**

**Shareholders' Equity**

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

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

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

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

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

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

***Operating Partnership Units***

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

WHITESTONE REIT AND SUBSIDIARY  
Notes to Consolidated Financial Statements  
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## Note 11 -

## Shareholders' Equity (Continued)

*Dividends and distributions*

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

## Whitestone Shareholders

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

## OP Unit Holders Including Minority Unit Holders

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

WHITESTONE REIT AND SUBSIDIARY  
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**Note 12 - Commitments and Contingencies**

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

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

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

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

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

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

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

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

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

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

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WHITESTONE REIT AND SUBSIDIARY  
Notes to Consolidated Financial Statements  
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**Note 12 - Commitments and Contingencies (Continued)**

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

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

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

***Other***

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

**Note 13 - Segment Information**

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

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

### **Forward-Looking Statements**

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

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

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

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

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

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

### ***Overview and Outlook***

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

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

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

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

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

directly related to the management of specific properties.

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



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

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

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

### ***Critical Accounting Policies***

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

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

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

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

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

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

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

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

### *Liquidity and Capital Resources*

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



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

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

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

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

### **Revolving Credit Facility**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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





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

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

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

### **Mortgage Loan on Windsor Park Centre**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### General.

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

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

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

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





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

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

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

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

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

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

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

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

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

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

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

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

**Funds From Operations and Adjusted Funds From Operations**

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

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

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

**Reconciliation of Non-GAAP Financial Measures**

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

### ***Taxes***

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

### ***Inflation***

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

### ***Environmental Matters***

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

### ***Off-Balance Sheet Arrangements***

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

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

## **Item 4T. Controls and Procedures**

### ***Evaluation of Disclosure Controls and Procedures***

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

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

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

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

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

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

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



## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

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

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

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

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

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

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

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

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

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

intervention.

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

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

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

***Other***

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

**Item 1A. Risk Factors**

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

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

***Market Information***

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

***Public Offering Proceeds***

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

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

No shares were offered to investors during the 2<sup>nd</sup> quarter of 2007.

**Item 3. Defaults Upon Senior Securities**

None.

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

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

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

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

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

**Exhibit No. Description**

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

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

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

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

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

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\* Filed herewith.

+ Denotes management contract or compensatory plan or arrangement.

**SIGNATURE**

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

**Whitestone REIT**

Date: August 14, 2007

/s/ James C. Mastandrea  
James C. Mastandrea  
Chief Executive Officer  
(Principal Executive Officer)

Dated August 14, 2007

/s/ David K. Holeman  
David K. Holeman  
Chief Financial Officer  
(Principal Financial Officer)