Whitestone REIT
Form 10-Q
November 06, 2013

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

FORM 10-Q

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from ____________ to ____________

Commission file number 001-34855
WHITESTONE REIT
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| Maryland<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 76-0594970<br>(I.R.S. Employer<br>Identification No.) |
| 2600 South Gessner, Suite 500<br>Houston, Texas | 77063 |
| (Address of Principal Executive Offices) | (Zip Code) |

(713) 827-9595
(Registrant's Telephone Number, Including Area Code)

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

Large accelerated filer ¨ Accelerated filer ý
Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

As of November 1, 2013, there were 21,942,702 common shares of beneficial interest, $0.001 par value per share, outstanding.

PART I - FINANCIAL INFORMATION



PART II - OTHER INFORMATION

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
Whitestone REIT and Subsidiaries
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

| | September 30, 2013 (unaudited) | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| Real estate assets, at cost | | |
| Property | $483,379 | $409,669 |
| Accumulated depreciation | (62,737) | (53,920) |
| Total real estate assets | 420,642 | 355,749 |
| Cash and cash equivalents | 9,506 | 6,544 |
| Marketable securities | 873 | 1,403 |
| Escrows and acquisition deposits | 6,129 | 6,672 |
| Accrued rents and accounts receivable, net of allowance for doubtful accounts | 9,169 | 7,947 |
| Related party receivable | — | 652 |
| Unamortized lease commissions and loan costs | 5,564 | 4,160 |
| Prepaid expenses and other assets | 2,749 | 2,244 |
| Total assets | $454,632 | $385,371 |
| | | |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Notes payable | $266,260 | $190,608 |
| Accounts payable and accrued expenses | 13,505 | 13,824 |
| Tenants' security deposits | 3,360 | 3,024 |
| Dividends and distributions payable | 5,109 | 5,028 |
| Total liabilities | 288,234 | 212,484 |
| Commitments and contingencies: | — | — |
| Equity: | | |
| Preferred shares, $0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding as of September 30, 2013 and December 31, 2012 | — | — |
| Common shares, $0.001 par value per share; 400,000,000 shares authorized; 17,341,947 and 16,943,098 issued and outstanding as of September 30, 2013 and December 31, 2012, respectively | 17 | 16 |
| Additional paid-in capital | 231,001 | 224,237 |
| Accumulated deficit | (69,879) | (57,830) |
| Accumulated other comprehensive loss | (68) | (392) |
| Total Whitestone REIT shareholders' equity | 161,071 | 166,031 |
| Noncontrolling interest in subsidiary | 5,327 | 6,856 |
| Total equity | 166,398 | 172,887 |
| Total liabilities and equity | $454,632 | $385,371 |

See accompanying notes to Consolidated Financial Statements

1

Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)
(in thousands, except per share data)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Property revenues | | | | |
| Rental revenues | $12,594 | $8,992 | $35,407 | $25,643 |
| Other revenues | 3,697 | 2,626 | 9,548 | 7,388 |
| Total property revenues | 16,291 | 11,618 | 44,955 | 33,031 |
| | | | | |
| Property expenses | | | | |
| Property operation and maintenance | 4,145 | 2,969 | 10,558 | 8,080 |
| Real estate taxes | 2,673 | 1,629 | 6,483 | 4,442 |
| Total property expenses | 6,818 | 4,598 | 17,041 | 12,522 |
| | | | | |
| Other expenses (income) | | | | |
| General and administrative | 2,722 | 1,888 | 7,682 | 5,392 |
| Depreciation and amortization | 3,450 | 2,683 | 9,783 | 7,256 |
| Interest expense | 2,602 | 2,244 | 7,664 | 6,324 |
| Interest, dividend and other investment income | (26) | (121) | (114) | (274) |
| Total other expenses | 8,748 | 6,694 | 25,015 | 18,698 |
| | | | | |
| Income before loss on sale or disposal of assets and income taxes | 725 | 326 | 2,899 | 1,811 |
| | | | | |
| Provision for income taxes | (90) | (77) | (227) | (212) |
| Loss on sale or disposal of assets | — | (77) | (48) | (105) |
| | | | | |
| Net income | 635 | 172 | 2,624 | 1,494 |
| | | | | |
| Less: Net income attributable to noncontrolling interests | 21 | 9 | 91 | 99 |
| | | | | |
| Net income attributable to Whitestone REIT | $614 | $163 | $2,533 | $1,395 |

See accompanying notes to Consolidated Financial Statements

Table of Contents

Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)
(in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Basic Earnings Per Share: | | | | |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares | $0.04 | $0.01 | $0.15 | $0.11 |
| Diluted Earnings Per Share: | | | | |
| Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares | $0.03 | $0.01 | $0.15 | $0.11 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 17,036 | 13,842 | 16,916 | 12,409 |
| Diluted | 17,331 | 13,961 | 17,156 | 12,526 |
| Distributions declared per common share / OP unit | $0.2850 | $0.2850 | $0.8550 | $0.8550 |
| Consolidated Statements of Comprehensive Income | | | | |
| Net income | $635 | $172 | $2,624 | $1,494 |
| Other comprehensive gain (loss) | | | | |
| Unrealized gain (loss) on cash flow hedging activities | (331) | (9) | 162 | (9) |
| Unrealized gain (loss) on available-for-sale marketable securities | (39) | 92 | 176 | 891 |
| Comprehensive income | 265 | 255 | 2,962 | 2,376 |
| Less: Comprehensive income attributable to noncontrolling interests | 8 | 14 | 103 | 158 |
| Comprehensive income attributable to Whitestone REIT | $257 | $241 | $2,859 | $2,218 |

See accompanying notes to Consolidated Financial Statements

Table of Contents

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

| | Common Shares | Shares Amount | Additional Paid-In Capital | Accumulated Deficit | Accumulated Other Comprehensive Gain (Loss) | Total Shareholders' Equity | Noncontrolling interests Units | Noncontrolling interests Dollars | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance, December 31, 2012 | 16,943 | $16 | $224,237 | $ (57,830 ) | $ (392 ) | $ 166,031 | 685 | $6,856 | $172,887 |
| Exchange of noncontrolling interest OP units for common shares | 113 | 1 | 1,132 | — | (2 ) | 1,131 | (113 ) | (1,131 ) | — |
| Exchange offer costs | — | — | (23 ) | — | — | (23 ) | — | — | (23 ) |
| Issuance of common shares - ATM Program, net of offering costs | 282 | — | 4,184 | — | — | 4,184 | — | — | 4,184 |
| Issuance of shares under dividend reinvestment plan | 5 | — | 72 | — | — | 72 | — | — | 72 |
| Share-based compensation | (1 ) | — | 1,399 | — | — | 1,399 | — | — | 1,399 |
| Distributions | — | — | — | (14,582 ) | — | (14,582 ) | — | (501 ) | (15,083 ) |
| Unrealized gain on change in fair value of available-for-sale marketable securities | — | — | — | — | 170 | 170 | — | 6 | 176 |
| Unrealized gain on change in value of cash flow hedge | — | — | — | — | 156 | 156 | — | 6 | 162 |
| Net income | — | — | — | 2,533 | — | 2,533 | — | 91 | 2,624 |
| | 17,342 | $17 | $231,001 | $ (69,879 ) | $ (68 ) | $ 161,071 | 572 | $5,327 | $166,398 |

Balance,
September 30,
2013

See accompanying notes to Consolidated Financial Statements

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net income | $2,624 | $1,494 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,783 | 7,255 |
| Amortization of deferred loan costs | 823 | 1,064 |
| Amortization of notes payable discount | 387 | 86 |
| Gain on sale of marketable securities | (41) | (110) |
| Loss on sale or disposal of assets | 48 | 105 |
| Bad debt expense | 1,431 | 720 |
| Share-based compensation | 1,501 | 384 |
| Changes in operating assets and liabilities: | | |
| Escrows and acquisition deposits | 886 | 29 |
| Accrued rents and accounts receivable | (2,653) | (1,876) |
| Related party receivable | 652 | — |
| Unamortized lease commissions | (993) | (674) |
| Prepaid expenses and other assets | 336 | 630 |
| Accounts payable and accrued expenses | (393) | 200 |
| Tenants' security deposits | 336 | 614 |
| Net cash provided by operating activities | 14,727 | 9,921 |
| Cash flows from investing activities: | | |
| Acquisitions of real estate | (58,403) | (79,400) |
| Additions to real estate | (3,925) | (9,297) |
| Investments in marketable securities | — | (750) |
| Proceeds from sales of marketable securities | 747 | 5,509 |
| Net cash used in investing activities | (61,581) | (83,938) |
| Cash flows from financing activities: | | |
| Distributions paid to common shareholders | (14,504) | (10,543) |
| Distributions paid to OP unit holders | (528) | (783) |
| Proceeds from issuance of common shares, net of offering costs | 4,184 | 58,679 |
| Payments of exchange offer costs | (23) | (249) |
| Proceeds from notes payable | 47,150 | — |
| Proceeds from revolving credit facility, net | 73,400 | 33,956 |
| Repayments of notes payable | (57,936) | (2,853) |
| Payments of loan origination costs | (1,927) | (1,546) |
| Net cash provided by financing activities | 49,816 | 76,661 |
| Net increase in cash and cash equivalents | 2,962 | 2,644 |
| Cash and cash equivalents at beginning of period | 6,544 | 5,695 |
| Cash and cash equivalents at end of period | $9,506 | $8,339 |

See accompanying notes to Consolidated Financial Statements

Table of Contents

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2013 | 2012 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $6,950 | $5,250 |
| Cash paid for taxes | $237 | $225 |
| Non cash investing and financing activities: | | |
| Disposal of fully depreciated real estate | $194 | $523 |
| Financed insurance premiums | $883 | $856 |
| Value of shares issued under dividend reinvestment plan | $72 | $68 |
| Debt assumed with acquisitions of real estate | $11,100 | $9,166 |
| Interest supplement assumed with acquisition of real estate | $932 | $— |
| Acquired interest rate swap | $— | $1,901 |
| Debt discount on acquired note payable | $— | $(1,329) |
| Accrued offering costs | $15 | $85 |
| Value of common shares exchanged for OP units | $1,132 | $6,224 |
| Change in fair value of available-for-sale securities | $176 | $891 |
| Change in fair value of cash flow hedge | $162 | $(9) |

See accompanying notes to Consolidated Financial Statements

6

Table of Contents
WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(Unaudited)

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

1. INTERIM FINANCIAL STATEMENTS

The consolidated financial statements included in this report are unaudited; however, amounts presented in the consolidated balance sheet as of December 31, 2012 are derived from our audited consolidated financial statements as of that date. The unaudited financial statements as of September 30, 2013 have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information on a basis consistent with the annual audited consolidated financial statements and with the instructions to Form 10-Q.

The consolidated financial statements presented herein reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position of Whitestone and our subsidiaries as of September 30, 2013, and the results of operations for the three and nine month periods ended September 30, 2013 and 2012, the consolidated statements of changes in equity for the nine month period ended September 30, 2013 and cash flows for the nine month periods ended September 30, 2013 and 2012. All of these adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of the results expected for a full year. The statements should be read in conjunction with the audited consolidated financial statements and the notes thereto which are included in our Annual Report on Form 10-K for the year ended December 31, 2012.

Business. Whitestone was formed as a real estate investment trust ("REIT"), pursuant to the Texas Real Estate Investment Trust Act on August 20, 1998. In July 2004, we changed our state of organization from Texas to Maryland pursuant to a merger where we merged directly with and into a Maryland REIT formed for the sole purpose of the reorganization and the conversion of each of our outstanding common shares of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity. We serve as the general partner of Whitestone REIT Operating Partnership, L.P. (the “Operating Partnership”), which was formed on December 31, 1998 as a Delaware limited partnership. We currently conduct substantially all of our operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, we have the exclusive power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of September 30, 2013 and December 31, 2012, Whitestone owned and operated 55 and 51 commercial properties, respectively, in and around Houston, Dallas, San Antonio, Chicago and Phoenix.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation. We are the sole general partner of the Operating Partnership and possess full legal control and authority over the operations of the Operating Partnership. As of September 30, 2013 and December 31, 2012, we owned a majority of the partnership interests in the Operating Partnership. Consequently, the accompanying consolidated financial statements include the accounts of the Operating Partnership. All significant inter-company balances have been eliminated. Noncontrolling interests in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income or loss is allocated to noncontrolling interests based on the weighted average percentage ownership of the Operating Partnership during the period. Issuance of additional common shares of beneficial interest in Whitestone (the "common shares") and units of limited partnership interest in the Operating Partnership that are convertible into cash or, at our option, common shares on a one-for-one basis (the “OP units”) changes the ownership interests of both the noncontrolling interests and Whitestone.

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

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

Reclassifications. We have reclassified certain prior period amounts in the accompanying consolidated financial statements in order to be consistent with the current period presentation. These reclassifications had no effect on net income, total assets, total liabilities or equity. During 2012, we reclassified the amortization of our loan fees, previously classified as depreciation and amortization expenses, to interest expense for all periods presented. As of June 27, 2012, prior period Class A and Class B common shares have been consolidated into a single class of common shares. See Note 10 for additional discussion related to the reclassification of our Class A and Class B common shares.

Marketable Securities. We classify our existing marketable equity securities as available-for-sale in accordance with the Financial Accounting Standards Board's ("FASB") Investments-Debt and Equity Securities guidance. These securities are carried at fair value with unrealized gains and losses reported in equity as a component of accumulated other comprehensive income or loss. The fair value of the marketable securities is determined using Level 1 inputs under FASB Accounting Standards Codification ("ASC") 820, "Fair Value Measurements and Disclosures." Level 1 inputs represent quoted prices available in an active market for identical investments as of the reporting date. Gains and losses on securities sold are based on the specific identification method, and are reported as a component of interest, dividend and other investment income. No available-for-sale marketable securities were sold during the three months ended September 30, 2013, and we recognized gains on the sale of marketable securities of approximately $78,000 during the three months ended September 30, 2012. We recognized gains on the sale of marketable securities of approximately $41,000 and $110,000 for the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, our investment in available-for-sale marketable securities was approximately $873,000, which includes an aggregate unrealized loss of approximately $233,000.

Derivative Instruments and Hedging Activities. On March 8, 2013, we, through our Operating Partnership, entered into an interest rate swap with U.S. Bank National Association that fixed the LIBOR portion of our $50 million term loan under our unsecured credit facility at 0.84%. See Note 6 for additional information regarding our credit facility. The swap will begin on January 7, 2014 and will mature on February 3, 2017. We have designated the interest rate swap as a cash flow hedge with the effective portion of the changes in fair value to be recorded in comprehensive income (loss) and subsequently reclassified into earnings in the period that the hedged transaction affects earnings. The ineffective portion of the change in fair value, if any, will be recognized directly in earnings. As of September 30, 2013, the fair value of our cash flow hedge was $12,000. For the three and nine months ended September 30, 2013, we recognized $314,000 as other comprehensive losses and $11,000 as other comprehensive gains, respectively. For the three and nine months ended September 30, 2013, we did not recognize any portion of the cash flow hedge into earnings because we are not required to make cash settlements until 2014.

On August 8, 2012, as part of our acquisition of Paradise Plaza (see Note 14), we assumed a $9.2 million variable rate note (see Note 6). The note included an interest rate swap that had a fixed interest rate of 5.72%. We have designated the interest rate swap as a cash flow hedge with the effective portion of the changes in fair value recorded in comprehensive income (loss) and subsequently reclassified into earnings in the period that the hedged transaction affects earnings. The ineffective portion of the change in fair value, if any, is recognized directly in earnings. As of September 30, 2013, the fair value of our cash flow hedge was $1.3 million. For the three and nine months ended September 30, 2013, we recognized $17,000 as other comprehensive losses and $151,000 as other comprehensive gains, respectively. For the three and nine months ended September 30, 2013, we recognized $87,000 and $263,000 as interest expense, respectively. For the three and nine months ended September 30, 2012, we recognized $9,000 as other comprehensive losses. We did not recognize any portion of the cash flow hedge into earnings for the three and nine months ended September 30, 2012.

As of September 30, 2013, we consider our cash flow hedges to be highly effective. Our cash flow hedges are determined using Level 2 inputs under ASC 820. Level 2 inputs represent quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; and model-derived valuations whose inputs are observable.

Table of Contents
WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(Unaudited)

Development Properties. Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges and development costs. Carrying charges, primarily interest, real estate taxes, loan fees, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases when the property, or any completed portion, becomes available for occupancy. For the three months ended September 30, 2013, approximately $28,000 and $27,000 in interest expense and real estate taxes, respectively, were capitalized, and for the nine months ended September 30, 2013, approximately $97,000 and $76,000 in interest expense and real estate taxes, respectively, were capitalized. For the three months ended September 30, 2012, approximately $47,000 and $50,000 in interest expense and real estate taxes, respectively, were capitalized, and for the nine months ended September 30, 2012, approximately $135,000 and $113,000 in interest and real estate taxes, respectively, were capitalized.

Share-Based Compensation. From time to time, we award nonvested restricted common share awards or restricted common share unit awards, which may be converted into common shares, to executive officers and employees under our 2008 Long-Term Equity Incentive Ownership Plan (the “2008 Plan”). The vast majority of the awarded shares and units vest when certain performance conditions are met. We recognize compensation expense when achievement of the performance conditions is probable based on management's most recent estimates using the fair value of the shares as of the grant date. We recognized $834,000 and $118,000 in share-based compensation for the three months ended September 30, 2013 and 2012, respectively, and we recognized $1,501,000 and $384,000 in share-based compensation for the nine months ended September 30, 2013 and 2012, respectively.

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

See our Annual Report on Form 10-K for the year ended December 31, 2012 for further discussion on significant accounting policies.

Recent Accounting Pronouncements. In February 2013, the FASB issued guidance requiring entities to disclose certain information relating to amounts reclassified out of accumulated other comprehensive income. This guidance was effective prospectively for reporting periods beginning on or after December 15, 2012. We do not expect the pronouncement to have a significant impact on our consolidated financial statements.

3. MARKETABLE SECURITIES

All of our marketable securities were classified as available-for-sale securities as of September 30, 2013 and December 31, 2012. Available-for-sale securities consisted of the following (in thousands):

| | September 30, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gains in Accumulated Other | Losses in Accumulated Other | Estimated Fair Value |

| | | Comprehensive Income | Comprehensive Income | |
|---|---|---|---|---|
| Real estate sector common stock | $1,106 | $— | $(233 ) | $873 |
| Total available-for-sale securities | $1,106 | $— | $(233 ) | $873 |

9

Table of Contents
WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(Unaudited)

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gains in Accumulated Other Comprehensive Income | Losses in Accumulated Other Comprehensive Income | Estimated Fair Value |
| Real estate sector common stock | $1,811 | $— | $(408) | $1,403 |
| Total available-for-sale securities | $1,811 | $— | $(408) | $1,403 |

During the three months ended September 30, 2013, no available-for-sale securities were sold, and during the three months ended September 30, 2012, available-for-sale securities were sold for total proceeds of $1,583,000. During the nine months ended September 30, 2013, available-for-sale securities were sold for total proceeds of $747,000. The gross realized gains and losses on these sales during the nine months ended September 30, 2013 were $44,000 and $3,000, respectively. During the nine months ended September 30, 2012, available-for-sale securities were sold for total proceeds of $5,509,000. The gross realized gains and losses on the sales during the nine months ended September 30, 2012 totaled $152,000 and $42,000, respectively.

## 4. ACCRUED RENTS AND ACCOUNTS RECEIVABLE, NET

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

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Tenant receivables | $5,892 | $3,536 |
| Accrued rents and other recoveries | 6,788 | 6,696 |
| Allowance for doubtful accounts | (3,511) | (2,285) |
| Total | $9,169 | $7,947 |

## 5. UNAMORTIZED LEASING COMMISSIONS AND LOAN COSTS

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

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Leasing commissions | $6,383 | $5,530 |
| Deferred financing cost | 6,500 | 4,574 |
| Total cost | 12,883 | 10,104 |
| Less: leasing commissions accumulated amortization | (3,452) | (2,899) |
| Less: deferred financing cost accumulated amortization | (3,867) | (3,045) |
| Total cost, net of accumulated amortization | $5,564 | $4,160 |

## 6. DEBT

Certain subsidiaries of Whitestone are the borrowers under various financing arrangements. These subsidiaries are separate legal entities and their respective assets and credit are not available to satisfy the debt of Whitestone or any of its other subsidiaries.

Debt consisted of the following as of the dates indicated (in thousands):

| Description | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Fixed rate notes | | |
| $1.1 million 4.71% Note, due December 31, 2013 | $1,087 | $1,087 |
| $20.2 million 4.2805% Note, due June 6, 2023 (1) | 20,200 | 13,850 |
| $3.0 million 6.00% Note, due March 31, 2021 (2) | 2,914 | 2,943 |
| $10.0 million 6.04% Note, due March 1, 2014 | 8,998 | 9,142 |
| $1.5 million 6.50% Note, due March 1, 2014 | 1,423 | 1,444 |
| $11.2 million 6.52% Note, due September 1, 2015 | 10,487 | 10,609 |
| $21.4 million 6.53% Notes, due October 1, 2013 (3) | — | 18,865 |
| $24.5 million 6.56% Note, due October 1, 2013 (3) | — | 23,135 |
| $9.9 million 6.63% Notes, due March 1, 2014 | 8,690 | 8,925 |
| $9.2 million, Prime Rate less 2.00%, due December 29, 2017 (4) | 7,869 | 7,854 |
| $11.1 million 5.87% Note, due August 6, 2016 | 11,972 | — |
| $16.5 million 4.97% Note, due September 26, 2023 | 16,450 | — |
| $0.9 million 2.97% Note, due November 28, 2013 | 163 | 15 |
| Floating rate notes | | |
| Unsecured credit facility, LIBOR plus 1.75% to 2.50%, due February 3, 2017 (5) | 142,400 | 69,000 |
| $26.9 million, LIBOR plus 2.86% Note, due December 1, 2013 | 23,107 | 23,739 |
| $10.5 million, LIBOR plus 2.00% Note, due September 24, 2018 | 10,500 | — |
| | $266,260 | $190,608 |

(1) Promissory note had an original balance of $14.1 million and an interest rate of 5.695%, due in 2013, which was refinanced in May 2013. See below for further discussion of the Pinnacle Note.

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

(3) This promissory note was paid in full in August 2013.

(4) Promissory note includes an interest rate swap that fixed the interest rate at 5.72% for the duration of the term.

(5) We have entered into an interest rate swap that fixed the LIBOR portion of our $50 million term loan under our unsecured revolving credit facility at 0.84%. The swap will begin on January 7, 2014 and will mature on February 3, 2017.

On September 26, 2013, we, operating through our subsidiary, Whitestone Uptown Tower, LLC, a Delaware limited liability company ("Whitestone Uptown"), entered into a $16.5 million promissory note (the "Uptown Note"), with a fixed interest rate of 4.97% payable to Morgan Stanley Capital Holdings LLC and a maturity of September 26, 2023. Proceeds from the Uptown Note were used to repay a portion of our unsecured revolving credit facility.

Table of Contents
WHITESTONE REIT AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(Unaudited)

On September 24, 2013, we, operating through our subsidiary, Whitestone Terravita Marketplace, LLC, a Delaware limited liability company ("Whitestone Terravita"), entered into a $10.5 million promissory note (the "Terravita Note"), with an applicable interest rate of LIBOR plus 2.00%, payable to Bank of America, N.A. and a maturity of September 24, 2018. Proceeds from the Terravita Note were used to repay a portion of our unsecured revolving credit facility.

The Terravita Note is a non-recourse loan secured by Whitestone Terravita's Terravita Marketplace property, located in Scottsdale, Arizona, and a limited guarantee by the Operating Partnership. In conjunction with the Terravita Note, a deed of trust was executed by Whitestone Terravita that contains customary terms and conditions, including representations, warranties and covenants by Whitestone Terravita that include, without limitation, assignment of rents, warranty of title, insurance requirements and maintenance, use and management of the property.

On June 19, 2013, we assumed a $11.1 million promissory note as part of our acquisition of Mercado at Scottsdale Ranch (see Note 14). The 5.87% fixed interest rate note matures on August 16, 2016. In conjunction with our acquisition, we received an interest rate supplement from the seller in the amount of $932,000, which we will accrete into expense over the life of the note. As a result of the supplement, the imputed interest rate is 3.052%, which we consider to be an appropriate market rate.

On May 31, 2013, we, operating through our subsidiary, Whitestone Pinnacle of Scottsdale, LLC, a Delaware limited liability company ("Whitestone Pinnacle"), refinanced our $14.1 million promissory note, with an applicable interest rate of 5.695% and a maturity of June 1, 2013, with a $20.2 million promissory note (the "Pinnacle Note") payable to Cantor Commercial Real Estate Lending, L.P. with an applicable interest rate of 4.2805%, and a maturity of June 6, 2023.

The Pinnacle Note is a non-recourse loan secured by Whitestone Pinnacle's Pinnacle of Scottsdale property, located in Scottsdale, Arizona, and a limited guarantee by Whitestone. In conjunction with the Pinnacle Note, a deed of trust was executed by Whitestone Pinnacle that contains customary terms and conditions, including representations, warranties and covenants by Whitestone Pinnacle that include, without limitation, assignment of rents, warranty of title, insurance requirements and maintenance, use and management of the property.

As of September 30, 2013, our $123.7 million in secured debt was collateralized by 22 properties with a carrying value of $163.8 million.  Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and by assignment of the rents and leases associated with those properties.  As of September 30, 2013, we were in compliance with all loan covenants.

On February 4, 2013, we, through our Operating Partnership, entered into an unsecured credit facility (the “Facility”) with the lenders party thereto, with BMO Capital Markets and Wells Fargo Securities, LLC, as co-lead arrangers and joint book runners, Bank of Montreal, as administ