

Edgar Filing: Whitestone REIT - Form 10-Q

Whitestone REIT  
Form 10-Q  
July 29, 2016  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

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 76-0594970  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

2600 South Gessner, Suite 500 77063  
Houston, Texas  
(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.  Yes  No

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

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

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Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

Yes  No

As of July 25, 2016, there were 28,588,283 common shares of beneficial interest, \$0.001 par value per share, outstanding.

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PART I - FINANCIAL INFORMATION

Item 1.	<u>Financial Statements.</u>	<u>1</u>
	<u>Consolidated Balance Sheets as of June 30, 2016 (Unaudited) and December 31, 2015</u>	<u>1</u>
	<u>Consolidated Statements of Operations and Comprehensive Income (Loss) (Unaudited) for the Three and Six Months Ended June 30, 2016 and 2015</u>	<u>2</u>
	<u>Consolidated Statement of Changes in Equity (Unaudited) for the Six Months Ended June 30, 2016</u>	<u>4</u>
	<u>Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended June 30, 2016 and 2015</u>	<u>5</u>
	<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	<u>22</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	<u>45</u>
Item 4.	<u>Controls and Procedures.</u>	<u>46</u>

PART II - OTHER INFORMATION

Item 1.	<u>Legal Proceedings.</u>	<u>47</u>
Item 1A.	<u>Risk Factors.</u>	<u>47</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	<u>47</u>
Item 3.	<u>Defaults Upon Senior Securities.</u>	<u>48</u>
Item 4.	<u>Mine Safety Disclosures.</u>	<u>48</u>
Item 5.	<u>Other Information.</u>	<u>48</u>
Item 6.	<u>Exhibits.</u>	<u>49</u>
	<u>Signatures</u>	<u>50</u>
	<u>Exhibit Index</u>	<u>51</u>

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Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## Whitestone REIT and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2016 (unaudited)	December 31, 2015
<b>ASSETS</b>		
Real estate assets, at cost		
Property	\$ 844,807	\$ 835,538
Accumulated depreciation	(99,004 )	(89,580 )
Total real estate assets	745,803	745,958
Cash and cash equivalents	5,927	2,587
Restricted cash	117	121
Marketable securities	467	435
Escrows and acquisition deposits	5,824	6,668
Accrued rents and accounts receivable, net of allowance for doubtful accounts	16,717	15,466
Unamortized lease commissions and loan costs	8,039	8,178
Prepaid expenses and other assets	3,129	2,672
Total assets	\$ 786,023	\$ 782,085
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Notes payable	\$ 500,553	\$ 497,955
Accounts payable and accrued expenses	30,182	24,051
Tenants' security deposits	5,578	5,254
Dividends and distributions payable	8,169	7,834
Total liabilities	544,482	535,094
Commitments and contingencies:	—	—
Equity:		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding as of June 30, 2016 and December 31, 2015, respectively	—	—
Common shares, \$0.001 par value per share; 400,000,000 shares authorized; 28,138,047 and 26,991,493 issued and outstanding as of June 30, 2016 and December 31, 2015, respectively	28	27
Additional paid-in capital	372,650	359,971
Accumulated deficit	(126,300 )	(116,895 )
Accumulated other comprehensive loss	(8,448 )	(129 )
Total Whitestone REIT shareholders' equity	237,930	242,974
Noncontrolling interest in subsidiary	3,611	4,017
Total equity	241,541	246,991
Total liabilities and equity	\$ 786,023	\$ 782,085

See accompanying notes to Consolidated Financial Statements



Table of Contents

## Whitestone REIT and Subsidiaries

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Property revenues				
Rental revenues	\$ 19,649	\$ 17,176	\$ 39,071	\$ 33,641
Other revenues	5,480	4,794	11,493	9,581
Total property revenues	25,129	21,970	50,564	43,222
Property expenses				
Property operation and maintenance	4,683	4,339	9,477	8,422
Real estate taxes	3,304	2,925	6,658	5,829
Total property expenses	7,987	7,264	16,135	14,251
Other expenses (income)				
General and administrative	5,413	4,998	10,249	9,483
Depreciation and amortization	5,521	4,675	10,913	9,239
Interest expense	4,748	3,516	9,552	6,924
Interest, dividend and other investment income	(78 )	(162 )	(175 )	(171 )
Total other expense	15,604	13,027	30,539	25,475
Income from continuing operations before gain on sale or disposal of properties or assets and income taxes	1,538	1,679	3,890	3,496
Provision for income taxes	(11 )	(91 )	(167 )	(174 )
Gain on sale of properties	—	—	2,890	—
Gain (loss) on sale or disposal of assets	(18 )	5	(16 )	(100 )
Income from continuing operations	1,509	1,593	6,597	3,222
Loss from discontinued operations	—	(33 )	—	(41 )
Loss from discontinued operations	—	(33 )	—	(41 )
Net income	1,509	1,560	6,597	3,181
Less: Net income attributable to noncontrolling interests	25	26	116	53
Net income attributable to Whitestone REIT	\$ 1,484	\$ 1,534	\$ 6,481	\$ 3,128

See accompanying notes to Consolidated Financial Statements



Table of Contents

## Whitestone REIT and Subsidiaries

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic Earnings Per Share:				
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	\$0.05	\$0.06	\$0.23	\$0.13
Income from discontinued operations attributable to Whitestone REIT	0.00	0.00	0.00	0.00
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.05	\$0.06	\$0.23	\$0.13
Diluted Earnings Per Share:				
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	\$0.05	\$0.06	\$0.22	\$0.12
Income from discontinued operations attributable to Whitestone REIT	0.00	0.00	0.00	0.00
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.05	\$0.06	\$0.22	\$0.12
Weighted average number of common shares outstanding:				
Basic	26,819	22,869	26,712	22,724
Diluted	27,513	23,401	27,501	23,314
Distributions declared per common share / OP unit	\$0.2850	\$0.2850	\$0.5700	\$0.5700
Consolidated Statements of Comprehensive Income (Loss)				
Net income	\$1,509	\$1,560	\$6,597	\$3,181
Other comprehensive gain (loss)				
Unrealized gain (loss) on cash flow hedging activities	(2,450 )	43	(8,491 )	(276 )
Unrealized gain (loss) on available-for-sale marketable securities	36	(139 )	31	(98 )
Comprehensive income (loss)	(905 )	1,464	(1,863 )	2,807
Less: Comprehensive income (loss) attributable to noncontrolling interests	(16 )	24	(33 )	47
Comprehensive income (loss) attributable to Whitestone REIT	\$(889 )	\$1,440	\$(1,830 )	\$2,760

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	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity	Noncontrolling Interests	Total Equity
	Shares	Amount				Units Dollars	
Balance, December 31, 2015	26,991	\$ 27	\$359,971	\$(116,895)	\$ (129)	\$ 242,974	497 \$4,017 \$246,991
Exchange of noncontrolling interest OP units for common shares	13	—	105	—	(7)	98	(13) (98) —
Issuance of shares under dividend reinvestment plan	4	—	53	—	—	53	— — 53
Issuance of common shares, net of offering costs	736	1	10,599	—	—	10,600	— — 10,600
Repurchase of common shares <sup>(1)</sup>	(139)	—	(1,922)	—	—	(1,922)	— — (1,922)
Share-based compensation	533	—	3,844	—	—	3,844	— — 3,844
Distributions	—	—	—	(15,886)	—	(15,886)	— (276) (16,162)
Unrealized loss on change in value of cash flow hedge	—	—	—	—	(8,342)	(8,342)	— (149) (8,491)
Unrealized gain on change in fair value of available-for-sale marketable securities	—	—	—	—	30	30	— 1 31
Net income	—	—	—	6,481	—	6,481	— 116 6,597
Balance, June 30, 2016	28,138	\$ 28	\$372,650	\$(126,300)	\$ (8,448)	\$ 237,930	484 \$3,611 \$241,541

(1)

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During the six months ended June 30, 2016, the Company acquired common shares held by employees who tendered owned common shares to satisfy the tax withholding on the lapse of certain restrictions on restricted common shares.

See accompanying notes to Consolidated Financial Statements

Table of Contents

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

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income from continuing operations	\$6,597	\$3,222
Net income (loss) from discontinued operations	—	(41 )
Net income	6,597	3,181
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,913	9,239
Amortization of deferred loan costs	784	601
Amortization of notes payable discount	145	149
Gain on sale of marketable securities	—	(44 )
Loss (gain) on sale or disposal of assets and properties	(2,874 )	100
Bad debt expense	763	771
Share-based compensation	3,844	3,359
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	844	(772 )
Accrued rent and accounts receivable	(2,014 )	(1,767 )
Unamortized lease commissions	(1,133 )	(610 )
Prepaid expenses and other assets	459	323
Accounts payable and accrued expenses	(2,537 )	(235 )
Tenants' security deposits	324	267
Net cash provided by operating activities	16,115	14,603
Net cash used in operating activities of discontinued operations	—	(41 )
Cash flows from investing activities:		
Acquisitions of real estate	—	(51,800)
Additions to real estate	(11,055)	(5,009 )
Proceeds from sales of properties	3,957	—
Proceeds from sales of marketable securities	—	496
Net cash used in investing activities	(7,098 )	(56,313)
Net cash used in investing activities of discontinued operations	—	—
Cash flows from financing activities:		
Distributions paid to common shareholders	(15,497)	(13,127)
Distributions paid to OP unit holders	(277 )	(224 )
Proceeds from issuance of common shares, net of offering costs	10,600	49,725
Proceeds from revolving credit facility, net	3,000	9,500
Repayments of notes payable	(1,585 )	(1,336 )
Change in restricted cash	4	—
Repurchase of common shares	(1,922 )	(772 )
Net cash provided by (used in) financing activities	(5,677 )	43,766
Net cash used in financing activities of discontinued operations	—	—
Net increase in cash and cash equivalents	3,340	2,015
Cash and cash equivalents at beginning of period	2,587	4,236
Cash and cash equivalents at end of period	\$5,927	\$6,251

See accompanying notes to Consolidated Financial Statements

5

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Table of Contents

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

	Six Months Ended June 30,	
	2016	2015
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$9,169	\$6,409
Cash paid for taxes	\$284	\$315
Non cash investing and financing activities:		
Disposal of fully depreciated real estate	\$253	\$48
Financed insurance premiums	\$1,060	\$1,057
Value of shares issued under dividend reinvestment plan	\$53	\$47
Value of common shares exchanged for OP units	\$98	\$81
Change in fair value of available-for-sale securities	\$31	\$(98 )
Change in fair value of cash flow hedge	\$8,491	\$(276 )

See accompanying notes to Consolidated Financial Statements

Table of Contents

WHITESTONE REIT AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(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, 2015 are derived from our audited consolidated financial statements as of that date. The unaudited financial statements as of and for the period ended June 30, 2016 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 June 30, 2016, and the results of operations for the three and six month periods ended June 30, 2016 and 2015, the consolidated statements of changes in equity for the six month period ended June 30, 2016 and cash flows for the six month periods ended June 30, 2016 and 2015. 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, 2015.

**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 the 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 June 30, 2016 and December 31, 2015, Whitestone owned and operated 69 and 70 commercial properties, respectively, in and around Austin, Chicago, Dallas-Fort Worth, Houston, Phoenix and San Antonio.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Consolidation.** We are the sole general partner of the Operating Partnership and possess full legal control and authority over the operations of the Operating Partnership. As of June 30, 2016 and December 31, 2015, 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.

7

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Table of Contents

WHITESTONE REIT AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

**Reclassifications.** We have reclassified certain prior period amounts in the accompanying consolidated financial statements in order to be consistent with the current period presentation. During the six months ended June 30, 2016, we reclassified certain deferred financing costs, previously classified as an asset as a direct reduction from the carrying amount of certain debt liabilities for all periods presented. Deferred financing costs related to our unsecured line of credit have not been reclassified. See Note 6 for additional information. These reclassifications had no effect on net income or equity.

**Restricted Cash.** We classify all cash pledged as collateral to secure certain obligations and all cash whose use is limited as restricted cash. During 2015, pursuant to the terms of our \$15.1 million 4.99% Note, due January 6, 2024 (See Note 6), which is collateralized by our Anthem Marketplace property, we were required by the lenders thereunder to establish a cash management account controlled by the lenders to collect all amounts generated by our Anthem Marketplace property in order to collateralize such promissory note. As a result, these amounts are reported in the consolidated statements of cash flows under cash flows from financing activities as change in restricted cash.

**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.

**Derivative Instruments and Hedging Activities.** We utilize derivative financial instruments, principally interest rate swaps, to manage our exposure to fluctuations in interest rates. We have established policies and procedures for risk assessment, and the approval, reporting and monitoring of derivative financial instruments. We recognize our interest rate swaps as cash flow hedges 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. Any ineffective portion of a cash flow hedges' change in fair value is recorded immediately into earnings. 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. As of June 30, 2016, we consider our cash flow hedges to be highly effective.

**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 (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 June 30, 2016, approximately \$105,000 and \$16,000 in interest expense and real estate taxes, respectively, were capitalized, and for the six months ended June 30, 2016, approximately \$132,000 and \$32,000 in interest expense and real estate taxes, respectively, were capitalized. For the three months ended June 30, 2015, approximately \$32,000 and \$21,000 in interest expense and real estate taxes, respectively, were capitalized, and for the six months ended June 30, 2015, approximately \$58,000 and \$37,000 in interest expense and real estate taxes, respectively, were capitalized.



Real Estate Held for Sale and Discontinued Operations. We consider a commercial property to be held for sale when it meets all of the criteria established under ASC 205, "Presentation of Financial Statements." For commercial properties classified as held for sale, assets and liabilities are presented separately for all periods presented.

In accordance with ASC 205, a discontinued operation may include a component of an entity or a group of components of an entity. A disposal of a component of an entity or a group of components of an entity is reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component of an entity or group of components of an entity is classified as held for sale, disposed of by sale or disposed of other than by sale, respectively. In addition, ASC 205 requires us to provide additional disclosures about both discontinued operations and the disposal of an individually significant component of an entity that does not meet the criteria for a discontinued operation.

Table of Contents

WHITESTONE REIT AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

**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 \$1,819,000 and \$1,669,000 in share-based compensation for the three months ended June 30, 2016 and 2015, respectively, and we recognized \$3,844,000 and \$3,343,000 in share-based compensation for the six months ended June 30, 2016 and 2015, 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, 2015 for further discussion on significant accounting policies.

**Recent Accounting Pronouncements.** In April 2015, the FASB issued guidance requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. In August 2015, the FASB issued guidance to clarify that debt issuance costs related to line-of-credit agreements may still be presented as an asset and subsequently amortized ratably over the term of such arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit. This guidance was effective for reporting periods beginning on or after December 15, 2015 and is to be applied retrospectively. We have adopted this guidance for all periods presented.

In February 2016, the FASB issued guidance requiring lessees to recognize a lease liability and a right-of-use asset for all leases. Lessor accounting will remain largely unchanged. The guidance will also require new qualitative and quantitative disclosures to help financial statement users better understand the timing, amount and uncertainty of cash flows arising from leases. This guidance will be effective for reporting periods beginning on or after December 15, 2018, with early adoption permitted. We are currently evaluating the impact of this guidance and its impact on our consolidated financial statements.

In March 2016, the FASB issued guidance simplifying the accounting for share-based payment transactions, including the income tax consequences, balance sheet classification of awards and the classification on the statement of cash flows. This guidance will be effective for reporting periods beginning on or after December 15, 2016, and interim periods within those fiscal years. We are currently evaluating the impact of this guidance and its impact on our consolidated financial statements.

### 3. MARKETABLE SECURITIES

All of our marketable securities were classified as available-for-sale securities as of June 30, 2016 and December 31, 2015. Available-for-sale securities consisted of the following (in thousands):

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	June 30, 2016			
	Amortized Cost	Gains in Accumulated Other Comprehensive Income (Loss)	Losses in Accumulated Other Comprehensive Income (Loss)	Estimated Fair Value
Real estate sector common stock	\$654	\$ —	\$ (187 )	\$ 467
Total available-for-sale securities	\$654	\$ —	\$ (187 )	\$ 467

Table of Contents

## WHITESTONE REIT AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

	December 31, 2015			
	Amortized Cost	Gains in Accumulated Other Comprehensive Income (Loss)	Losses in Accumulated Other Comprehensive Income (Loss)	Estimated Fair Value
Real estate sector common stock	\$654	\$ —	\$ (219 )	\$ 435
Total available-for-sale securities	\$654	\$ —	\$ (219 )	\$ 435

During the three and six months ended June 30, 2016, no available-for-sale securities were sold. During the three and six months ended June 30, 2015, available-for-sale securities were sold for total proceeds of \$496,000. The gross realized gain on these sales during the three months ended June 30, 2015 was \$44,000. For purposes of determining gross realized gains and losses, the cost of securities sold is based on specific identification. A net unrealized holding loss on available-for-sale securities in the amount of \$187,000 and \$232,000 for the six months ended June 30, 2016 and 2015, respectively, has been included in accumulated other comprehensive income (loss).

## 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):

	June 30, 2016	December 31, 2015
Tenant receivables	\$12,832	\$ 10,494
Accrued rents and other recoveries	11,212	11,619
Allowance for doubtful accounts	(7,327 )	(6,647 )
Total	\$16,717	\$ 15,466

## 5. UNAMORTIZED LEASE COMMISSIONS AND LOAN COSTS

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

	June 30, 2016	December 31, 2015
Lease commissions	\$7,921	\$ 7,226
Deferred financing cost	4,070	4,070
Total cost	11,991	11,296
Less: lease commissions accumulated amortization	(3,318 )	(2,960 )
Less: deferred financing cost accumulated amortization	(634 )	(158 )
Total cost, net of accumulated amortization	\$8,039	\$ 8,178

## 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.

Table of Contents

## WHITESTONE REIT AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

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

Description	June 30, 2016	December 31, 2015
Fixed rate notes		
\$10.5 million, LIBOR plus 2.00% Note, due September 24, 2018 <sup>(1)</sup>	\$ 10,100	\$ 10,220
\$50.0 million, 0.84% plus 1.35% to 1.90% Note, due October 30, 2020 <sup>(2)</sup>	50,000	50,000
\$50.0 million, 1.50% plus 1.35% to 1.90% Note, due January 29, 2021 <sup>(3)</sup>	50,000	50,000
\$100.0 million, 1.73% plus 1.65% to 2.25% Note, due October 30, 2022 <sup>(4)</sup>	100,000	100,000
\$37.0 million 3.76% Note, due December 1, 2020	34,661	35,146
\$6.5 million 3.80% Note, due January 1, 2019	6,105	6,190
\$19.0 million 4.15% Note, due December 1, 2024	19,000	19,000
\$20.2 million 4.28% Note, due June 6, 2023	19,876	20,040
\$14.0 million 4.34% Note, due September 11, 2024	14,000	14,000
\$14.3 million 4.34% Note, due September 11, 2024	14,300	14,300
\$16.5 million 4.97% Note, due September 26, 2023	16,412	16,450
\$15.1 million 4.99% Note, due January 6, 2024	15,060	15,060
\$9.2 million, Prime Rate less 2.00% Note, due December 29, 2017 <sup>(5)</sup>	7,878	7,886
\$2.6 million 5.46% Note, due October 1, 2023	2,531	2,550
\$11.1 million 5.87% Note, due August 6, 2016	11,152	11,305
\$1.1 million 2.97% Note, due November 28, 2016	517	—
Floating rate notes		
Unsecured line of credit, LIBOR plus 1.40% to 1.95%, due October 30, 2019	130,600	127,600
Total notes payable principal	502,192	499,747
Less deferred financing costs, net of accumulated amortization	(1,639 )	(1,792 )
Total notes payable	\$ 500,553	\$ 497,955

(1) Promissory note includes an interest rate swap that fixed the interest rate at 3.55% for the duration of the term.

(2) Promissory note includes an interest rate swap that fixed the LIBOR portion of Term Loan 1 (as defined below) at 0.84% through February 3, 2017 and 1.75% beginning February 3, 2017 through October 30, 2020.

(3) Promissory note includes an interest rate swap that fixed the LIBOR portion of Term Loan 2 (as defined below) at 1.50%.

(4) Promissory note includes an interest rate swap that fixed the LIBOR portion of Term Loan 3 (as defined below) at 1.73%.

(5) Promissory note includes an interest rate swap that fixed the interest rate at 5.72% for the duration of the term. As part of our acquisition of Paradise Plaza in August 2012, we recorded a discount on the note of \$1.3 million, which amortizes into interest expense over the life of the loan and results in an imputed interest rate of 4.13%.

On November 7, 2014, we, through our Operating Partnership, entered into an unsecured revolving credit facility (the “2014 Facility”) with the lenders party thereto, with BMO Capital Markets, Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and U.S. Bank, National Association, as co-lead arrangers and joint book runners, and Bank of Montreal, as administrative agent (the “Agent”). The 2014 Facility amended and restated our

previous unsecured revolving credit facility. On October 30, 2015, we, through our Operating Partnership, entered into the First Amendment to the 2014 Facility (the “First Amendment”) with the guarantors party thereto, the lenders party thereto and the Agent. We refer to the 2014 Facility, as amended by the First Amendment, as the “Facility.”

Table of Contents

WHITESTONE REIT AND SUBSIDIARIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2016  
(Unaudited)

Pursuant to the First Amendment, the Company made the following amendments to the 2014 Facility:

- extended the maturity date of the \$300 million unsecured revolving credit facility under the 2014 Facility (the “Revolver”) to October 30, 2019 from November 7, 2018;
- converted \$100 million of outstanding borrowings under the Revolver to a new \$100 million unsecured term loan under the 2014 Facility (“Term Loan 3”) with a maturity date of October 30, 2022;
- extended the maturity date of the first \$50 million unsecured term loan under the 2014 Facility (“Term Loan 1”) to October 30, 2020 from February 17, 2017; and
- extended the maturity date of the second \$50 million unsecured term loan under the 2014 Facility (“Term Loan 2” and together with Term Loan 1 and Term Loan 3, the “Term Loans”) to January 29, 2021 from November 7, 2019.

Borrowings under the Facility accrue interest (at the Operating Partnership's option) at a Base Rate or an Adjusted LIBOR plus an applicable margin based upon our then existing leverage. The applicable margin for Adjusted LIBOR borrowings ranges from 1.40% to 1.95% for the Revolver and 1.35% to 2.25% for the Term Loans. Base Rate means the higher of: (a) the Agent's prime commercial rate, (b) the sum of (i) the average rate quoted by the Agent by two or more federal funds brokers selected by the Agent for sale to the Agent at face value of federal funds in the secondary market in an amount equal or comparable to the principal amount for which such rate is being determined, plus (ii) 1/2 of 1.00%, and (c) the LIBOR rate for such day plus 1.00%. Adjusted LIBOR means LIBOR divided by one minus the Eurodollar Reserve Percentage. The Eurodollar Reserve Percentage means the maximum reserve percentage at which reserves are imposed by the Board of Governors of the Federal Reserve System on eurocurrency liabilities.

We serve as the guarantor for funds borrowed by the Operating Partnership under the Facility. The Facility contains customary terms and conditions, including, without limitation, affirmative and negative covenants such as information reporting requirements, maximum secured indebtedness to total asset value, minimum EBITDA (earnings before interest, taxes, depreciation, amortization or extraordinary items) to fixed charges, and maintenance of a minimum net worth. The Facility also contains customary events of default with customary notice and cure, including, without limitation, nonpayment, breach of covenant, misrepresentation of representations and warranties in a material respect, cross-default to other major indebtedness, change of control, bankruptcy and loss of REIT tax status.

The Facility includes an accordion feature that will allow the Operating Partnership to increase the borrowing capacity to \$700 million, upon the satisfaction of certain conditions. As of June 30, 2016, \$330.6 million was drawn on the Facility, and our remaining borrowing capacity was \$169.4 million. Proceeds from the Facility were used for general corporate purposes, including property acquisitions, debt repayment, capital expenditures, the expansion, redevelopment and retenting of properties in our portfolio and working capital. We intend to use the additional proceeds from the Facility for general corporate purposes, including property acquisitions, debt repayment, capital expenditure, the expansion, redevelopment and re-tenanting of properties in our portfolio and working capital.

As of June 30, 2016, our \$171.1 million in secured debt was collateralized by 20 properties with a carrying value of \$212.6 million. Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and by assignment of the rents and leases associated with those properties. As of June 30, 2016, we were in compliance with all loan covenants.





Table of Contents

## WHITESTONE REIT AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

Scheduled maturities of our outstanding debt as of June 30, 2016 were as follows (in thousands):

Year	Amount Due
2016	\$ 12,722
2017	10,213
2018	12,136
2019	138,649
2020	82,827
Thereafter	245,645
Total	\$502,192

## 7. DERIVATIVES AND HEDGING ACTIVITIES

The fair value of our interest rate swaps is as follows (in thousands):

	Balance Sheet Location	Estimated Fair Value
Interest rate swaps:		
June 30, 2016	Accounts payable and accrued expenses	\$ 8,933
December 31, 2015	Accounts payable and accrued expenses	\$ 617

On November 19, 2015, we, through our Operating Partnership, entered into an interest rate swap with Bank of Montreal that fixed the LIBOR portion of Term Loan 3 under the Facility at 1.725%. In the fourth quarter of 2015, pursuant to the terms of the agreement governing the interest rate swap, Bank of Montreal assigned \$35.0 million of the swap to U.S. Bank, National Association, and \$15.0 million of the swap to SunTrust Bank. See Note 6 for additional information regarding the Facility. The swap began on November 30, 2015 and will mature on October 28, 2022. 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.

On November 19, 2015, we, through our Operating Partnership, entered into an interest rate swap with Bank of Montreal that fixed the LIBOR portion of Term Loan 1 under the Facility at 1.75%. In the fourth quarter of 2015, pursuant to the terms of the agreement governing the interest rate swap, Bank of Montreal assigned \$3.8 million of the swap to Regions Bank, \$6.5 million of the swap to U.S. Bank, National Association, \$14.0 million of the swap to Wells Fargo Bank, National Association, \$14.0 million of the swap to Bank of America, N.A., and \$5.0 million of the swap to SunTrust Bank. See Note 6 for additional information regarding the Facility. The swap will begin on February 3, 2017 and will mature on October 30, 2020. 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.

On November 19, 2015, we, through our Operating Partnership, entered into an interest rate swap with Bank of Montreal that fixed the LIBOR portion of Term Loan 2 under the Facility at 1.50%. In the fourth quarter of 2015,

pursuant to the terms of the agreement governing the interest rate swap, Bank of Montreal assigned \$3.8 million of the swap to Regions Bank, \$6.5 million of the swap to U.S. Bank, National Association, \$14.0 million of the swap to Wells Fargo Bank, National Association, \$14.0 million of the swap to Bank of America, N.A., and \$5.0 million of the swap to SunTrust Bank. See Note 6 for additional information regarding the Facility. The swap began on December 7, 2015 and will mature on January 29, 2021. 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.

Table of Contents

## WHITESTONE REIT AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

A summary of our interest rate swap activity is as follows (in thousands):

	Amount Recognized as Comprehensive Income (Loss)	Location of Loss Recognized in Earnings	Amount of Loss Recognized in Earnings (1)
Three months ended June 30, 2016	\$ (2,450 )	Interest expense	\$ (614 )
Three months ended June 30, 2015	\$ 43	Interest expense	\$ (203 )
Six months ended June 30, 2016	\$ (8,491 )	Interest expense	\$ (1,208 )
Six months ended June 30, 2015	\$ (276 )	Interest expense	\$ (410 )

(1) We did not recognize any ineffective portion of our interest rate swaps in earnings for the three and six months ended June 30, 2016 and 2015.

## 8. EARNINGS PER SHARE

Basic earnings per share for our common shareholders is calculated by dividing income from continuing operations excluding amounts attributable to unvested restricted common shares and the net income attributable to noncontrolling interests by our weighted average common shares outstanding during the period. Diluted earnings per share is computed by dividing the net income attributable to common shareholders excluding amounts attributable to unvested restricted common shares and the net income attributable to noncontrolling interests by the weighted average number of common shares including any dilutive unvested restricted common shares.

Certain of our performance-based restricted common shares are considered participating securities that require the use of the two-class method for the computation of basic and diluted earnings per share. During the three months ended June 30, 2016 and 2015, 484,422 and 390,323 OP units, respectively, were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive, and during the six months ended June 30, 2016 and 2015, 487,722 and 391,455 OP units, respectively, were excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive.

For the three months ended June 30, 2016 and 2015, distributions of \$197,000 and \$172,000, respectively, were made to holders of certain restricted common shares, \$0 and \$9,000, respectively, of which were charged against earnings. For the six months ended June 30, 2016 and 2015, distributions of \$352,000 and \$288,000, respectively, were made to holders of certain restricted common shares, \$0 and \$18,000, respectively, of which were charged against earnings. See Note 11 for information related to restricted common shares under the 2008 Plan.

Table of Contents

## WHITESTONE REIT AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share data)	2016	2015	2016	2015
Numerator:				
Income from continuing operations	\$1,509	\$1,593	\$6,597	\$3,222
Less: Net income attributable to noncontrolling interests	(25 )	(26 )	(116 )	(54 )
Distributions paid on unvested restricted shares	(197 )	(163 )	(352 )	(270 )
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	1,287	1,404	6,129	2,898
Income from discontinued operations	—	(33 )	—	(41 )
Less: Net income attributable to noncontrolling interests	—	—	—	1
Income from discontinued operations attributable to Whitestone REIT	—	(33 )	—	(40 )
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$1,287	\$1,371	\$6,129	\$2,858
Denominator:				
Weighted average number of common shares - basic	26,819	22,869	26,712	22,724
Effect of dilutive securities:				
Unvested restricted shares	694	532	789	590
Weighted average number of common shares - dilutive	27,513	23,401	27,501	23,314
Earnings Per Share:				
Basic:				
Income from continuing operations attributable to Whitestone REIT excluding amounts attributable to unvested restricted shares	\$0.05	\$0.06	\$0.23	\$0.13