

Fellow Shareholders:

Since my last annual letter to shareholders, Americans have experienced significant job and wealth losses in very difficult and volatile market conditions. The national economy contracted in 2008 at a pace consistent with a severe recession. During the fourth quarter of 2008, real gross domestic product (GDP) fell at an annualized rate of 3.8%. Payroll employment dropped by about 3 million workers since the recession began in December 2007, and housing starts decreased 44% during 2008. While we are not yet able to see the light at the end of the tunnel related to the turmoil in the country, we remain solidly focused on the business of Whitestone REIT.

Whitestone, while stable and well positioned, is not immune to external vulnerabilities in this economic environment. Members of our management team and Board of Trustees have survived similar economic storms in the past. However, the current economic crisis and lack of available capital have hampered our leasing activities, slowed our redevelopment efforts and muted our growth. Some of our tenants are facing financial problems, which in turn affect our performance. Trying times such as these strengthen our character, the cornerstone of our foundation.

### **Delivering on Our Promises**

Our leadership team made some difficult decisions in 2008, based on consistent principles that will not change. As a result, we made significant progress toward several key long-term objectives of our strategic business plan, all while maintaining fewer than 50 employee associates. We are operating from a position of strength with the capacity to protect against the rigors of a changed new financial world.

We invested in opportunities that will reap some rewards in the short term, and greater rewards in future years. We delivered on the following promises to our shareholders:

- Concluded 20 months of litigation with a former shareholder that was costly in both time and money. The result included a \$3.6 million gain to Whitestone REIT.
- Improved our balance sheet by replacing short-term debt with longer term mortgage debt having maturities of five to seven years.
- Implemented an equity based, long-term employee incentive ownership plan that was approved by shareholders.
- Added two new trustees to our Board of Trustees, Daryl Carter, Chairman and CEO of Avanath Capital Partners and founder of Capri Capital; and Dan DeVos, an investor, owner, and operator of auto dealerships and sports teams, and a member of the founding family of Amway. Both of our new trustees are nationally recognized with extensive real estate and capital markets experience.
- Aligned our dividend with Funds From Operations, effective the fourth quarter of 2008.
- Completed the Westchase Plaza redevelopment project, adding 5,000 square feet of office space and upgrading the retail plaza.
- Attained shareholder approval for a new Declaration of Trust and changed our Bylaws to provide the foundation for the Company to conform to stock exchange requirements and be ready to list on a stock exchange.



Our **SHAREHOLDER** interests must come first.

Additionally, as promised to shareholders, my personal investment in Whitestone REIT became a reality. Through a partnership, in which I am the majority and controlling partner, I exchanged \$3.6 million in equity in Spoerlein Commons for equity in Whitestone REIT operating partnership units. This investment fulfilled my commitment to share the risk as an owner and work shoulder to shoulder for you, my fellow shareholders.

The acquisition of Spoerlein also facilitated our entry into Chicago and created a platform for further expansion into the Chicago market, progressing toward our goal of geographically diversifying our portfolio.

### Leasing Overview

Our revenues from leasing are the lifeblood of the Company, and our tenants' challenges become our challenge. Small business owners and consumers are the drivers of our tenants' businesses. They are spending more judiciously and overall spending less, and every market segment is affected.

Our business model is to "create communities" in our properties. Our communities are primarily comprised of smaller local business operator tenants. As such, most of our 658 tenants are less susceptible to market downturns. Even so, we had two larger tenants comprising nearly 78,000 square feet leave their mark on cash flow, when Circuit City filed for bankruptcy and 99¢ Only stores announced their intent to exit the Texas market in September 2008. Nonetheless, we completed 199 new and renewal leases during 2008 totalling 0.7 million square feet and \$23.0 million in total lease value ... at a time when tenants who are ready to sign leases are rare.

The year-end occupancy rate in 2008 was 84%, as compared to 85% at year-end 2007. The downturn was primarily due to the vacancy of Circuit City. The majority of the decrease in occupancy occurred at the end of 2008 and did not have a material impact on revenue. We continue to focus on tenant leasing efforts, but expect that raising occupancy levels will be difficult in 2009, given the contracted credit markets and the challenging economy.

### Hurricane Ike

Virtually every one of our Houston properties felt the wind and rain of Hurricane Ike, a particularly nasty storm which ravaged the city in September. With an estimated \$19.3 billion in total damages, Ike was rated the fourth costliest hurricane to effect the USA<sup>1</sup>. Several of our properties had minor to moderate damage from Hurricane Ike, ranging from broken windows and uprooted landscaping; others had more significant issues such as damaged roofing and exterior siding. Six months later, we continue our work with insurance adjusters and contractors to repair the damage in the best interest of our shareholders and tenants.

### Our Acquisition Pipeline

One of Whitestone's strategic goals is to diversify both opportunities and risk by geographically expanding our portfolio outside of our concentration in Houston, especially having recently experienced Hurricane Ike. We have now planted roots in Phoenix and Chicago to complement our presence in Houston, Dallas, and San Antonio, and are positioned to expand in all of our respective markets. These all represent some of the highest growth markets in the United States.

**Investment Criterion:** Our current acquisition focus is in the Phoenix, Chicago, and Dallas markets. We are focusing our acquisition exploration activities most heavily on retail and office properties.

1. Income producing retail and office properties.
2. Value-add potential, such as:
  - Vacancy
  - Growing market rents
  - Vacant land to add buildings
  - Under-managed
3. Good location with easy access and amenities.
4. Renovation potential.
5. Neighborhood Centers greater than 50,000 square feet.
6. Portfolio acquisitions with Joint Venture Partners.
7. Office properties in good locations with quality tenants.

An acquisition pipeline strategy is in place to build critical mass in the greater Phoenix and Chicago markets by adding properties in the same sub-markets as our current properties, using Spoerlein Commons as our foothold in the Chicago market and Pima Norte in Phoenix. With multiple properties in the areas surrounding our current locations, Whitestone REIT will be able to leverage its management and leasing expertise while consolidating expenses as our geographic presence in each market increases.

While we hope to publicly list our shares, listing can only occur when the window of opportunity opens, and institutional investors find Whitestone to be an attractive investment. We cannot control the capital markets, but we can, through intense management and leasing, as well as efficient operations, increase our franchise value and position ourselves as a Company worthy of institutional ownership.

#### **2008 At A Glance**

Revenue increased to \$31.2 million in 2008 from \$29.4 million in 2007, an increase of \$1.8 million or 6%. Funds From Operations (“FFO”) was \$4.2 million for 2008 as compared to \$6.0 million in 2007, a decrease of 30%. FFO for 2008 and 2007, adjusted for non recurring events (litigation fees, Hurricane Ike expenses and fees to extend our corporate revolving credit facility) and excluding discontinued operations was \$6.8 million and \$7.3 million, respectively. Net income was \$1.1 million in 2008 as compared to a loss of (\$0.1 million) in 2007. The primary reason for the increase was a gain from an exchange, with a former shareholder, of two properties for stock and operating partnership units.

#### **A Look to the Future**

We look to the future with cautious optimism and are well positioned to meet our goals and objectives. While we cannot predict what is around those “blind corners,” we can promise that we will make decisions based on what is best for our shareholders, upholding a high standard for the moral fiber of individuals who lead and manage Whitestone REIT. We have a robust strategic growth plan that we are executing and are dedicated to meeting our shareholders expectations.

We expect our success to be measured by our financial accomplishments, whether we exceed or fall short of our goals. Our business will remain fully transparent, with audited financial statements, independent auditors and trustees to whom we hold ourselves accountable. We encourage you to follow our regular updates, news releases and SEC filings. As we steer our way through the uncharted waters ahead in a most challenging economic and political time, we will remain nimble and quick to seize every opportunity that contributes to shareholder value. With this promise for 2009, I wish to thank you for your continued confidence and support.

Sincerely,



James C. Mastandrea  
Chairman and Chief Executive Officer

<sup>1</sup> Source: National Hurricane Center [Tropical Cyclone Report: Hurricane Ike](http://www.nhc.noaa.gov/pdf/TCR-AL092009_Ike.pdf). p. 9 R. Berg. January 23, 2009.



**CHARACTER**.....  
is the foundation stone upon which one must build to win respect.