

PILLARSTONE CAPITAL REIT

Form 10-K/A

September 18, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-K/A

(AMENDMENT NO. 1)

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

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: 001-15409

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PILLARSTONE CAPITAL REIT

(Exact Name of Registrant as Specified in Its Charter)

Maryland

39-6594066

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification No.)

2600 South Gessner, Suite 555, Houston, Texas 77063

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (832) 810-0100

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Shares of Beneficial Interest, par value \$0.01 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 (§232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

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

The aggregate market value of the voting common shares held by nonaffiliates of the registrant as of June 30, 2016 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$448,845 based on the closing price of \$2.50 per common share on the Over-The-Counter Bulletin Board on that date.

As of March 15, 2018, the Registrant had issued 443,299 common shares of beneficial interest and had 405,169 shares outstanding after deducting 38,130 shares held in treasury.

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DOCUMENTS INCORPORATED BY REFERENCE: We incorporate by reference in Part III of this Annual Report on Form 10-K portions of our definitive proxy statement for our 2018 Annual Meeting of Shareholders, which proxy statement was filed on April 15, 2018 for the year ended December 31, 2017.

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## EXPLANATORY NOTE

### Restatement of Consolidated Financial Statements

This Amendment No. 1 on Form 10-K/A (this “Form 10-K/A”) amends and restates certain items noted below in the Annual Report on Form 10-K of Pillarstone Capital REIT (the “Company”) for the fiscal year ended December 31, 2017, as originally filed with the Securities and Exchange Commission (the “SEC”) on March 29, 2018 (the “Original Filing”). This Form 10-K/A restates the Company's consolidated financial statements and related disclosures for the year ended December 31, 2017 to reflect the correction of an accounting error described below.

### Background and Effect of Restatement

As previously disclosed, on December 8, 2016, the Company and Pillarstone Capital REIT Operating Partnership LP, a subsidiary and the operating partnership of the Company (the “Operating Partnership” or “Pillarstone OP”), entered into a Contribution Agreement (the “Contribution Agreement”) with Whitestone REIT Operating Partnership, L.P. (“Whitestone OP”), a subsidiary and the operating partnership of Whitestone REIT (“Whitestone”), both of which are related parties to the Company and the Operating Partnership. Pursuant to the Contribution Agreement, Whitestone OP contributed to the Operating Partnership all of the equity interests in four of its wholly-owned subsidiaries (the “Subsidiaries”): Whitestone CP Woodland Ph. 2, LLC, a Delaware limited liability company; Whitestone Industrial-Office, LLC, a Texas limited liability company; Whitestone Offices, LLC, a Texas limited liability company; and Whitestone Uptown Tower, LLC, a Delaware limited liability company. The Subsidiaries own 14 real estate assets and, in exchange for this contribution, Whitestone OP received aggregate consideration of approximately \$84.0 million, consisting of (i) approximately \$18.1 million of Class A units representing limited partnership interests in the Operating Partnership (“OP Units”), issued at a price of \$1.331 per OP Unit; and (ii) the assumption of approximately \$65.9 million of liabilities by the Operating Partnership (collectively, the “Acquisition”). The Company is the general partner of the Operating Partnership and, immediately after the Acquisition, had an equity ownership interest in the Operating Partnership representing approximately 18.6% and valued at approximately \$4.1 million.

In connection with the Contribution Agreement, on December 8, 2016, the Company, as the general partner of the Operating Partnership, entered into an Amended and Restated Agreement of Limited Partnership of the Operating Partnership (as amended and restated, the “Limited Partnership Agreement”). Pursuant to the Limited Partnership Agreement, subject to certain protective rights of the limited partners described below, the general partner has responsibility and discretion in the management and control of the Operating Partnership, including the ability to cause the Operating Partnership to enter into certain major transactions including a merger of the Operating Partnership or a sale of substantially all of the assets of the Operating Partnership. The limited partners have no power to remove the general partner without the general partner's consent. In addition, pursuant to the Limited Partnership Agreement, the general partner may not conduct any business other than in connection with the ownership, acquisition and disposition of the Operating Partnership's interest and management of its business without the consent of a majority of the limited partners other than in connection with certain actions described therein. As such, the Company was deemed to exercise significant influence but not complete control over the Operating Partnership. As of the date of the Acquisition, the Company determined that it was not the primary beneficiary of the Operating Partnership under the variable interest entity (“VIE”) rules prescribed by U.S. generally accepted accounting principles (“U.S. GAAP”), and thus the Company's investment in the Operating Partnership qualified for usage of the equity method of accounting.

In November 2017, the Company and Whitestone each received a comment letter from the Staff (the “Staff”) of the Division of Corporation Finance of the SEC relating to the Company's and Whitestone's Annual Reports on Form 10-K for the year ended December 31, 2016. In the respective letters, the Staff requested that the Company and Whitestone provide them with an analysis to support the determination that the Operating Partnership is a VIE of which Whitestone is the primary beneficiary. In response to the Staff's comment, Whitestone, on its own behalf and on behalf of the Company, provided the Staff with its analysis of Whitestone's accounting and financial reporting obligations

relating to its interest in the Operating Partnership. After communicating its analysis and conclusions to the Staff and responding to additional questions from the Staff relating to this matter, the Staff did not object to or otherwise take exception to the initial determinations at the time of the consummation of the Acquisition in December 2016 but provided a verbal reminder in that the determination of the primary beneficiary of a VIE should be continually reassessed, and recommended that Whitestone consider pre-clearing future accounting treatment of the Operating Partnership with the Staff of the Office of the Chief Accountant (“OCA”).

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In connection with the preparation and review of its financial statements for the quarter ended March 31, 2018, Whitestone concluded, in accordance with the Staff's recommendation, and after consultation with its outside accounting advisors, that it would be prudent to seek pre-clearance from the OCA of Whitestone's proposed treatment of the Operating Partnership in its financial statements for such quarter. Accordingly, in April 2018, Whitestone submitted a letter to the OCA seeking their concurrence with its determinations that Whitestone maintained its status as the primary beneficiary of the Operating Partnership and, accordingly, should continue to consolidate the Operating Partnership in its financial statements for the quarter ended March 31, 2018 in accordance U.S. GAAP. After further correspondence, including telephonic meetings between Whitestone, its advisors and the OCA, the OCA informed Whitestone that it objected to Whitestone's and the Company's conclusions that Whitestone was the primary beneficiary of the Operating Partnership since the Acquisition in December 2016 and during the subsequent periods. Whitestone and the Company respectfully disagreed with the OCA's determination and Whitestone, on its own behalf and on behalf of the Company, made a formal appeal to the Chief Accountant of the SEC in June 2018.

In July 2018, Whitestone and its advisory team of accounting and legal professionals met with the Chief Accountant, members of the OCA and Division of Corporate Finance. On July 30, 2018, the Chief Accountant of the SEC informed Whitestone that its formal appeal was denied and that the OCA objected to Whitestone's and the Company's presentation of their investments in the Operating Partnership under the VIE accounting guidance since the consummation of the Acquisition in December 2016. As a result, the Company's management has determined that the Company should not have used the equity method of accounting to present its investment in the Operating Partnership in its audited consolidated financial statements for the years ended December 31, 2016 and December 31, 2017 and unaudited consolidated financial statements for the quarters ended March 31, 2017; June 30, 2017; September 30, 2017 and March 31, 2018 (collectively, the "Prior Period Financial Statements"). After consideration of the OCA's objection to Whitestone's original accounting, the Company evaluated its original accounting of the equity method and the materiality of the error quantitatively and qualitatively and concluded that it was material to the Prior Period Financial Statements. The Company will revise its original accounting treatment accordingly in the amended filings. The Company has determined that it is the primary beneficiary of the Operating Partnership through the Company's power to direct the activities that most significantly impact the Operating Partnership's economic performance and the Company's right to receive benefits based on its ownership percentage in the Operating Partnership. Accordingly, the Company will account for the Operating Partnership as a VIE and will fully consolidate it in the Company's financial statements prospectively and in the amended filings. Whitestone OP's 81.4% interest in the Operating Partnership will be accounted for as a non-controlling interest and deducted from the Company's share of net income and equity in the Operating Partnership.

#### Items Amended in This Filing

This Form 10-K/A amends and restates the following indicated parts of the Original Filing:

Part I, Item 2. Properties

Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Part II, Item 9A. Controls and Procedures

Part IV, Item 15. Exhibits and Financial Statement Schedules

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Unless the context otherwise requires, all references in this report to the “Company,” “we,” “us” or “our” are to Pillarstone Capital REIT and its consolidated subsidiaries.

#### Forward-Looking Statements

The following discussion should be read in conjunction with our audited consolidated financial statements and the notes thereto in this Annual Report on Form 10-K/A.

This Annual Report on Form 10-K/A contains forward-looking statements within the meaning of the federal securities laws, including discussion and analysis of our financial condition, anticipated capital expenditures required to complete projects, amounts of anticipated cash distributions to our shareholders in the future and other matters. These forward-looking statements are not historical facts but are the intent, belief or current expectations of our management based on its knowledge and understanding of our business and industry. Forward-looking statements are typically identified by the use of terms such as “may,” “will,” “should,” “potential,” “predicts,” “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates” or the negative of such terms and variations of these words and similar expressions, although not all forward-looking statements include these words. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements.

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

- uncertainties related to the national economy, the real estate industry in general and in our specific markets;
- legislative or regulatory changes;
- adverse economic conditions in Texas;
- adverse changes in governmental rules and fiscal policies;
- increases in interest rates and operating costs;
- availability and terms of capital and financing, both to fund our operations and to refinance our indebtedness as it matures;
- decreases in rental rates or increases in vacancy rates;
- litigation risks;
- lease-up risks, including leasing risks arising from exclusivity and consent provisions in leases with significant tenants;
- our inability to renew tenants or obtain new tenants upon the expiration of existing leases; and
- our inability to generate sufficient cash flows due to market conditions, competition, uninsured losses, changes in tax or other applicable laws.

In addition, an investment in the Company involves numerous risks that potential investors should consider carefully, including, without limitation:

- our cash resources are limited;
- we have a history of losses;
- we have not raised funds through a public equity offering;
- our trustees control a significant percentage of our voting shares;
- shareholders could experience possible future dilution through the issuance of additional shares;
- we are dependent on a small number of key senior professionals who are part-time employees; and



•we currently do not plan to distribute dividends to the holders of our shares.

## PART I

### Item 1. Business.

#### Company Overview

Pillarstone Capital REIT (the “Company,” “Pillarstone,” “we,” “our,” or “us”) is a Maryland real estate investment trust engaged in investing in, owning and operating commercial properties. Future real estate investments may include (i) acquisition and development of retail, office, office warehouse, industrial, multifamily, hotel, and other commercial properties, (ii) acquisition of or merger with a real estate investment trust (“REIT”) or a real estate operating company and (iii) joint venture investments. Excess funds can be invested in cash equivalents depending on market conditions. The Company was formed on March 15, 1994 as a Maryland REIT. The Company operated as a traditional real estate investment trust by buying, selling, owning and operating commercial and residential properties through December 31, 1999. In 2000, the Company purchased a software technology company, resulting in the Company no longer meeting qualifications to be a REIT under the Internal Revenue Code of 1986, as amended (the “Code”). In 2002, the Company discontinued the operations of the technology segment.

From 2003 through 2006, we pursued a value-added business plan primarily focused on acquiring well located, under-performing multi-family residential properties, including affordable housing communities, and repositioning them through renovation, leasing, improved management and branding. In 2006, the Company did not complete a public offering for a portfolio acquisition due to market conditions, and consequently, was not able to meet the listing requirements of the former American Stock Exchange (“Amex”). Accordingly, Pillarstone’s common shares were delisted from the Amex and commenced being quoted on the Over-The-Counter Bulletin Board (“OTC Bulletin Board”) and on the pink sheets under the symbol “PRLE”.

From 2006 until December 2016, the Company continued its existence as a corporate shell filing its quarterly and annual reports with the Securities and Exchange Commission (“SEC”) so that it could be used for future real estate transactions. During this time, the Company was funded by the trustees who contributed \$500,000 in exchange for 125,000 Class C Convertible Preferred Shares and \$197,780 in exchange for convertible notes payable. In 2016, the shareholders of Pillarstone approved changing the Company’s name from Paragon Real Estate Equity and Investment Trust to Pillarstone Capital REIT.

Substantially all of our business is conducted through Pillarstone Capital REIT Operating Partnership, a Delaware limited partnership organized in 2016 (“Pillarstone OP”). We are the sole general partner of Pillarstone OP. As of December 31, 2017, we owned 18.6% of the outstanding equity in Pillarstone OP and fully consolidate it on our financial statements.

On December 8, 2016, Pillarstone and Pillarstone OP entered into a Contribution Agreement (the “Contribution Agreement”) with Whitestone REIT Operating Partnership, L.P. (“Whitestone OP”), a subsidiary and the operating partnership of Whitestone REIT (“Whitestone”), both of which are related parties to Pillarstone and Pillarstone OP. Pursuant to the terms of the Contribution Agreement, Whitestone OP contributed to Pillarstone OP all of the equity interests in four of its wholly-owned subsidiaries: Whitestone CP Woodland Ph. 2, LLC, a Delaware limited liability company (“CP Woodland”); Whitestone Industrial-Office, LLC, a Texas limited liability company (“Industrial-Office”); Whitestone Offices, LLC, a Texas limited liability company (“Whitestone Offices”); and Whitestone Uptown Tower, LLC, a Delaware limited liability company (“Uptown Tower”, and together with CP Woodland, Industrial-Office and Whitestone Offices, the “Entities”) that own 14 real estate assets (the “Real Estate Assets” and, together with the Entities, the “Property”) for aggregate consideration of approximately \$84 million, consisting of (1) approximately \$18.1 million of Class A units representing limited partnership interests in Pillarstone OP (“OP Units”), issued at a price of \$1.331 per OP Unit; and (2) the assumption of approximately \$65.9 million of liabilities by Pillarstone OP, consisting of (a) approximately \$15.5 million of Whitestone OP’s liability under that certain Amended and Restated Credit Agreement, dated as of November 7, 2014, as amended, among the Bank of Montreal, as Administrative Agent (the “Agent”), the lenders party thereto, BMO Capital Markets, Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and U.S. Bank, National Association, Whitestone OP, as borrower, and Whitestone and certain subsidiaries of Whitestone OP, as guarantors (as amended, the “Whitestone Credit Facility”); (b) an approximately \$16.3 million promissory note (the “Whitestone Uptown Tower Promissory Note”) of Uptown Tower issued under that certain Loan Agreement, dated as of September 26, 2013, (as amended, the “Whitestone Uptown Tower Loan Agreement” and, together with the Whitestone Uptown Tower Promissory Note, the “Whitestone Uptown Tower Loan Documents”) between Uptown Tower, as borrower, and U.S. Bank National Association, as successor to Morgan Stanley Mortgage Capital Holdings LLC, as lender, and (c) an approximately \$34.1 million promissory note (the “Whitestone Industrial-Office Promissory Note”) of Industrial-Office issued under that certain Loan Agreement, dated as of November 26, 2013 (the “Whitestone Industrial-Office Loan Agreement” and, together with the Whitestone Industrial-Office Promissory Note, the “Whitestone Industrial-Office Loan Documents”), between Industrial-Office, as borrower, and Jackson National Life Insurance Company, as lender (collectively, the “Acquisition”).

Pursuant to the Contribution Agreement, Pillarstone agreed to file with the SEC on or prior to June 8, 2018, a shelf registration statement to register for sale under the Securities Act of 1933, as amended (the “Securities Act”), the issuance of the common shares of beneficial interest in Pillarstone (the “Common Shares”) that may be issued upon redemption of the OP Units issued pursuant to each of the Contribution Agreement and the OP Unit Purchase Agreement (as defined below) and the offer and resale of such Common Shares by the holders thereof. In addition, pursuant to the Contribution Agreement, in the event of a Change of Control (as defined therein) of Whitestone, Pillarstone OP shall have the right, but not the obligation, to repurchase the OP Units issued thereunder from Whitestone OP at their initial issue price of \$1.331 per OP Unit. Pillarstone and Whitestone agreed to extend the filing of the shelf registration statement to a date not later than June 8, 2019, or the date that the Company closes a public equity offering.

In connection with the Acquisition, (1) with respect to each Real Estate Asset (other than the Real Property Asset owned by Uptown Tower), Whitestone TRS, Inc. (“Whitestone TRS”), a subsidiary of Whitestone, entered into a Management Agreement with the Entity that owns such Real Estate Asset and (2) with respect to Uptown Tower, Whitestone TRS entered into a Management Agreement with Pillarstone OP (collectively, the “Management Agreements”). Pursuant to the Management Agreements with respect to each Real Estate Asset (other than Uptown Tower), Whitestone TRS agreed to provide certain property management, leasing and day-to-day advisory and administrative services to such Real Estate Asset in exchange for (x) a monthly property management fee equal to 5.0% of the monthly revenues of such Real Estate Asset and (y) a monthly asset management fee equal to 0.125% of GAV (as defined in each Management Agreement as, generally, the purchase price of the respective Real Estate Asset based upon the purchase price allocations determined pursuant to the Contribution Agreement, excluding all indebtedness, liabilities or claims of any nature) of such Real Estate Asset. Pursuant to the Management Agreement with respect to Uptown Tower, Whitestone TRS agreed to provide certain property management, leasing and

day-to-day advisory and administrative services to Pillarstone OP in exchange for (x) a monthly property management fee equal to 3.0% of the monthly revenues of Uptown Tower and (y) a monthly asset management fee equal to 0.125% of GAV of Uptown Tower.

As a result of the Acquisition, Whitestone OP owns approximately 81.4% and Pillarstone owns approximately 18.6% of the outstanding equity in Pillarstone OP, which is fully consolidated on Pillarstone's financial statements.

## Competition

We compete for the acquisition of properties with many entities, including, among others, publicly traded REITs, life insurance companies, pension funds, partnerships and individual investors. Many competitors have substantially greater financial resources than us. In addition, certain competitors may be willing to accept lower returns on their investments. If competitors prevent us from buying properties that may be targeted for acquisition, our capital appreciation and valuation may be impacted.

## Employees

As of March 1, 2018, the Company has one full-time and two part-time employees.

## Reports to Security Holders

We file or furnish with the SEC pursuant to Section 13(a), 15(d) or 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports, proxy statements with respect to meetings of our shareholders, as well as Reports on Forms 3, 4 and 5 regarding our officers, trustees or 10% beneficial owners. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC as we do. The website address is <http://www.sec.gov>. Copies of our Audit Committee Charter, Management, Organization and Compensation Committee Charter, Nominating Committee Charter, and Code of Conduct and Ethics are available free of charge through our website ([www.pillarstone-capital.com](http://www.pillarstone-capital.com)). In the event of any changes to these documents, revised copies will also be made available on our website. Materials on our website are not part of our Annual Report on Form 10-K. The contents of these websites are not incorporated into this filing.

## Item 1B. Unresolved Staff Comments.

None.

## Item 2. Properties.

### General Physical and Economic Attributes

Pursuant to the Contribution Agreement, Pillarstone, through Pillarstone OP, acquired an investment portfolio consisting of the Real Estate Assets as described in Item 1. The following table sets forth certain information relating to each of our properties owned as of December 31, 2017.

Pillarstone Capital REIT

Real Estate Assets

As of December 31, 2017

Community Name	Location	Year Built/ Renovated	GLA	Percent Occupied at 12/31/2017		Annualized Base Rental Revenue (in thousands) (1)	Average Base Rental Revenue Per Sq. Ft. (2)	Average Net Effective Annual Base Rent Per Leased Sq. Ft. <sup>(3)</sup>
9101 LBJ Freeway	Dallas	1985	125,874	75	%	\$ 1,311	\$ 13.89	\$ 13.58
Corporate Park Northwest	Houston	1981	174,359	79	%	1,864	13.53	13.76
Corporate Park West	Houston	1999	175,665	78	%	1,540	11.24	11.53
Corporate Park Woodland	Houston	2000	99,937	97	%	1,003	10.35	10.93
Corporate Park Woodland II	Houston	2000	16,220	88	%	167	11.70	15.83
Dairy Ashford	Houston	1981	42,902	37	%	110	6.93	7.62
Holly Hall Industrial Park	Houston	1980	90,000	91	%	642	7.84	7.99
Holly Knight	Houston	1984	20,015	100	%	375	18.74	19.14
Interstate 10 Warehouse	Houston	1980	151,000	86	%	579	4.46	4.74
Main Park	Houston	1982	113,410	79	%	540	6.03	6.91
Plaza Park	Houston	1982	105,530	64	%	636	9.42	9.70
Uptown Tower	Dallas	1982	253,981	81	%	4,144	20.14	20.70
Westbelt Plaza	Houston	1978	65,619	67	%	501	11.40	11.35
Westgate Service Center	Houston	1984	97,225	99	%	720	7.48	7.73
Total / Weighted Average			1,531,737	81	%	\$ 14,132	\$ 11.39	\$ 11.76

Calculated as the tenant's actual December 31, 2017 base rent (defined as cash base rents including abatements) multiplied by 12. Excludes vacant space as of December 31, 2017. Because annualized base rental revenue is not derived from historical results that were accounted for in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"), historical results differ from the annualized amounts. Total abatements for leases in effect as of December 31, 2017 equaled approximately \$51,000 for the month ended December 31, 2017.

(2) Calculated as annualized base rent divided by gross leasable area ("GLA") leased as of December 31, 2017. Excludes vacant space as of December 31, 2017.

Represents (i) the contractual base rent for leases in place as of December 31, 2017, adjusted to a straight-line basis to reflect changes in rental rates throughout the lease term and amortize free rent periods and abatements, but without regard to tenant improvement allowances and leasing commissions, divided by (ii) square footage under commenced leases as of December 31, 2017.

Item 3. Legal Proceedings.

We may from time to time become a party to legal proceedings and claims that arise in the ordinary course of our business. These matters are generally covered by insurance. While the frequency and resolutions of any such matters cannot be predicted with certainty, we believe that occurrence and outcomes of these matters will not have a material effect on our financial position, results of operations or cash flows.

Item 4. Mine Safety Disclosures.

Not applicable.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

#### Market Information

##### Common Shares

Our Common Shares are quoted on the OTC Bulletin Board and on the pink sheets with the symbol "PRLE". The number of holders of record of our Common Shares was 102 as of March 15, 2018, and we estimate we have approximately 304 beneficial holders of Common Shares as of that date. As of March 15, 2018, we had 405,169 Common Shares of beneficial interest outstanding.

The following table sets forth the quarterly high and low sale prices per share of our Common Shares for the years ended December 31, 2017 and 2016 as reported on the OTC Bulletin Board. The quotations shown represent inter-dealer prices without adjustment for retail markups, markdowns or commissions, and may not reflect actual transactions.

#### For the Year Ended December 31, 2017 High Low

First Quarter	\$5.25	\$3.00
Second Quarter	\$3.60	\$3.50
Third Quarter	\$3.50	\$3.24
Fourth Quarter	\$4.05	\$2.78

#### For the Year Ended December 31, 2016 High Low

First Quarter	\$3.00	\$1.40
Second Quarter	\$3.00	\$1.76
Third Quarter	\$2.50	\$2.00
Fourth Quarter	\$5.25	\$1.75

On March 15, 2018, the closing price of our Common Shares reported on the OTC Bulletin Board was \$4.05 per share.

Our Class A Cumulative Convertible Preferred Shares ("Class A Preferred Shares") are quoted on the OTC Bulletin Board with the symbol "PRLEP". The number of holders of record of our Class A Preferred Shares is two. Class A Preferred shareholders have the right to convert their shares into Common Shares, as follows: 95,226 Class A Preferred Shares are each convertible into 0.046 Common Shares and 161,410 Class A Preferred Shares are each convertible into 0.305 Common Shares.

Our Class C Convertible Preferred Shares were issued effective September 29, 2006 to the trustees of the Company who contributed cash and/or services for these shares. The Class C Convertible Preferred Shares are not quoted on an exchange or the OTC Bulletin Board.

#### Dividend Policy

We have not declared or paid dividends on our Common Shares since 1999, and we do not anticipate paying dividends on our Common Shares in the foreseeable future. Declaration or payment of dividends, if any, in the future,



will be at the discretion of the board of trustees and will depend on our then current financial condition, results of operations, capital requirements and other factors deemed relevant by the board of trustees.

#### Preferred Share Conversions

During 2017 and 2016, 0 and 1,600 preferred shares were converted into 0 and 73 Common Shares, respectively.

#### Issuer Purchases of Equity Securities

The Company did not purchase any of its equity securities in 2017.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Overview

Pillarstone Capital REIT (the “Company,” “Pillarstone,” “we,” “our,” or “us”) is a Maryland real estate investment trust engaged in investing in, owning and operating commercial properties. Future real estate investments may include (i) acquisition and development of retail, office, office warehouse, industrial, multifamily, hotel and other commercial properties, (ii) acquisition of or merger with a REIT or real estate operating company, and (iii) joint venture investments. Substantially all of our business is conducted through our operating partnership Pillarstone OP. We are the sole general partner of Pillarstone OP. As of December 31, 2017, we owned approximately 18.6% of the outstanding equity in Pillarstone OP and we fully consolidate it on our financial statements.

As of December 31, 2017, the Company is a smaller reporting company current in its quarterly and annual financial statement filings with the SEC, that may make future real estate investments. There can be no assurance that we will be able to close additional transactions. Even if our management is successful in closing additional transactions, investors may not value the transactions or the Company in the same manner as we do, and investors may not value the transactions as they would value other transactions or alternatives. Failure to obtain additional sources of capital will materially and adversely affect the Company’s ability to continue operations, as well as its liquidity and financial results.

### Brief History

Pillarstone was formed on March 15, 1994 as a Maryland REIT. The Company operated as a traditional real estate investment trust by buying, selling, owning and operating commercial and residential properties through December 31, 1999. In 2000, the Company purchased a software technology company, resulting in the Company not meeting the qualifications to be a REIT under the Code. In 2002, the Company discontinued the operations of the technology segment, and from 2003 through 2006, pursued a value-added business plan primarily focused on acquiring well located, under-performing multi-family residential properties, including affordable housing communities, and repositioning them through renovation, leasing, improved management and branding.

### Recent Developments and Executive Overview

During most of 2016, the Company existed as a corporate shell current in its SEC filings.

On December 8, 2016, Pillarstone and Pillarstone OP entered into the Contribution Agreement with Whitestone OP, a subsidiary and the operating partnership of Whitestone, both of which are related parties to Pillarstone and Pillarstone OP, pursuant to which Whitestone OP contributed to Pillarstone OP all of the equity interests in four of its wholly-owned subsidiaries: CP Woodland; Industrial-Office; Whitestone Offices; and Uptown Tower that own the Real Estate Assets for aggregate consideration of approximately \$84 million, consisting of (1) approximately \$18.1 million of Class A units representing limited partnership interests in Pillarstone OP issued at a price of \$1.331 per OP Unit; and (2) the assumption of approximately \$65.9 million of liabilities by Pillarstone OP (collectively, the “Acquisition”).

### Results of Operations

The following is a discussion of our results of operations and net income for the years ended December 31, 2017 and 2016 and financial condition, including:

• Explanation of changes in the results of operations in the Consolidated Statements of Operations for the year ended December 31, 2017 compared to the year ended December 31, 2016.

Our critical accounting policies and estimates that require our subjective judgment and are important to the presentation of our financial condition and results of operations.

• Our primary sources and uses of cash for the year ended December 31, 2017, and how we intend to generate cash for long-term capital needs.

• Our current income tax status.

## Comparison of the years ended December 31, 2017 and 2016

### Leasing Activity

As of December 31, 2017, we owned 14 properties with 1,531,737 square feet of GLA, which were approximately 81% occupied.

### Revenues from Operations

We had rental income and tenant reimbursements of approximately \$16,768,000 for the year ended December 31, 2017 due to the Acquisition of the Real Estate Assets through Pillarstone OP on December 8, 2016.

### Expenses from Operations

We had property expenses of approximately \$7,701,000 for the year ended December 31, 2017 due to the Acquisition of the Real Estate Assets through Pillarstone OP on December 8, 2016. General and administrative expenses increased approximately \$16,000 for the year ended December 31, 2017 due to an increase in legal and other professional fees related to the Acquisition by Pillarstone OP. Interest expense increased approximately \$2,549,000 as a result of the assumption of \$65.9 million in debt on the Real Estate Assets in December 2016. Depreciation and amortization was approximately \$3,268,000 for the year ended December 31, 2017 due to the Acquisition of the Real Estate Assets through Pillarstone OP on December 8, 2016.

### Liquidity and Capital Resources

During most of 2016, the Company was a corporate shell current in its SEC filings. In December 2016, after the Acquisition, cash was provided by operations, equity transactions, and borrowings from affiliates and lending institutions as the primary sources of liquidity to the Company. During most of 2016, we were dependent on cash provided by loans in 2015 of \$197,780 from five trustees on our board of trustees at that time in exchange for convertible notes payable. The funds were utilized for due diligence costs incurred in connection with the development and execution of the Contribution Agreement and other transaction documents executed in connection with the Acquisition as well as maintaining the Company's status as a smaller reporting company current in its quarterly and annual financial statement filings with the SEC. We have kept the public entity available for value-added real estate opportunities, including (i) acquisition and development of retail, office, office warehouse, industrial, multifamily, hotel, and other commercial properties, (ii) acquisition of or merger with a REIT or real estate operating company, and (iii) joint venture investments. Excess funds can be invested in cash equivalents depending on market conditions.

### Cash Flows

As of December 31, 2017, our unrestricted cash resources were \$2,991,000. We are dependent on cash generated by Pillarstone OP through Pillarstone OP's ownership of the Real Estate Assets acquired in the Acquisition to meet our liquidity needs.

During the year ended December 31, 2017, the Company's cash balance increased by \$1,748,000 from \$1,243,000 at December 31, 2016 to \$2,991,000 at December 31, 2017. This increase in cash was due to cash provided by operating activities of approximately \$5,918,000 offset by cash used in investing and financing activities of \$1,249,000 and \$2,921,000, respectively.

Cash used for continuing operations included general and administrative costs, primarily for legal and professional costs associated with consummating the Contribution Agreement and other transaction documents executed in

connection with the Acquisition, and for keeping Pillarstone current in its SEC filings so that it may be used for additional real estate transactions.

#### Future Obligations

As part of the Acquisition on December 8, 2016, the Operating Partnership assumed approximately \$65.9 million of liabilities related to the 14 real estate assets contributed by Whitestone OP. As the general partner of the Operating Partnership, we are ultimately liable for the repayment of the loans.

#### Long Term Liquidity and Operating Strategies

Historically, we have financed our long term capital needs, including acquisitions, as follows:

- borrowings from new loans;
- additional equity issuances of our common and preferred shares; and
- proceeds from the sales of our real estate, a technology segment, and marketable securities.

From 2006 until December 2016, the Company continued its existence as a corporate shell filing its quarterly and annual reports with the SEC so that it could be used for future real estate transactions or sold to another company. During this time, the Company was funded by the trustees who contributed \$500,000 in exchange for 125,000 Class C Convertible Preferred Shares and \$197,780 in exchange for convertible notes payable.

Subsequent to the Acquisition through which Pillarstone OP acquired the Real Estate Assets, Pillarstone intends to develop strategies for the properties in order to create value for the enterprise and our shareholders. As part of the Acquisition, Pillarstone OP and Whitestone OP have agreed that Pillarstone OP may require Whitestone OP to purchase up to an aggregate of \$3.0 million of additional OP Units from Pillarstone OP at \$1.331 per unit over a two year period ending December 8, 2018. To implement the strategy to create value with the Real Estate Assets, additional capital will need to be raised.

#### Current Tax Status

At December 31, 2017, we have net operating loss carry-forwards of \$777,000. While these losses created a deferred tax asset, a valuation allowance was applied against the asset because of the uncertainty as to whether we will be able to use these loss carry-forwards, which will expire in varying amounts through the year 2037.

#### Interest Rates and Inflation

Interest rates fell during 2008 as the Federal Reserve Bank lowered the discount rate which remained low through 2017. Due to record low interest rates, capital markets were generally not accessible by small real estate companies like Pillarstone from 2009 through 2011, and debt financing was only available to larger creditworthy companies. Financial institutions tightened financial covenant tests, decreased loan-to-value ratios, and charged higher fees for loans, which has reduced the number of real estate transactions. While credit markets have been more active since 2013, Pillarstone did not participate in any transactions to raise capital.

The Company was not significantly affected by inflation during the periods presented in this report due primarily to the relative low nationwide inflation rates and the Company being a corporate shell with minimal expenses.

#### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have, or are likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

#### Application of Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which require us to make certain estimates and assumptions. The following section is a summary of certain estimates that both require our most subjective judgment and are most important to the presentation of our financial condition and results of operations. It is possible that the use of different estimates or assumptions in making these judgments could result in materially different amounts being reported in our consolidated financial statements.

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

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

**Depreciation.** Depreciation is computed using the straight-line method over the estimated useful lives of 5 to 39 years for improvements and buildings, respectively. Tenant improvements are depreciated using the straight-line method over the life of the improvement or remaining term of the lease, whichever is shorter.

**Impairment.** We review our properties for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the property exceeds its fair value. Management has determined that there has been no impairment in the carrying value of our real estate assets as of December 31, 2017.

#### Valuation Allowance of Deferred Tax Asset

We account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the period in which the differences are expected to affect taxable income. At December 31, 2017, we had net operating loss carry-forwards totaling \$777,000.

While these losses together with timing differences created a deferred tax asset of \$490,000, a valuation allowance of \$490,000 was applied against this asset because of the uncertainty of whether we will be able to use these loss carry-forwards, which will expire in varying amounts through the year 2037.



Item 8. Financial Statements and Supplementary Data.

The required audited consolidated financial statements of the Company are included herein commencing on page F-1.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

As previously disclosed in the Company's Current Report on Form 8-K filed on January 20, 2017, upon the recommendation of the Company's Audit Committee, our board of trustees dismissed Boulay PLLP ("Boulay") as the Company's independent registered public accounting firm and engaged Pannell Kerr Forster of Texas, P. C. ("PKF") as the Company's independent registered public accounting firm, beginning with the period ended December 31, 2016.

During the Company's fiscal years ended December 31, 2016 and 2017 and through January 19, 2017 (the "Engagement Date") (1) there were no disagreements with Boulay on any matter of accounting principles or practices, financial statement disclosure or auditing scope and procedure which, if not resolved to the satisfaction of Boulay, would have caused Boulay to make reference to the matter in its reports on the Company's consolidated financial statements for the fiscal years ended December 31, 2014 and December 31, 2015 and (2) there were no "reportable events" as that term is defined in Item 304 of Regulation S-K promulgated under the Exchange Act.

During the Company's two most recent fiscal years, the subsequent interim periods thereto, and through the Engagement Date, neither the Company nor anyone on its behalf consulted PKF regarding either (1) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements; or (2) any matter regarding the Company that was either the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and related instructions to Item 304 of Regulation S-K) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of December 31, 2017, we evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our principal executive officer and principal financial officer concluded as of the evaluation date that our disclosure controls and procedures were not effective as of December 31, 2017, because of the material weakness discussed below.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f), as a process designed by, or under the supervision of, the principal executive and principal financial officers, or persons performing similar functions, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP defined in the Exchange Act and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and disposition of our assets;
- provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of management and/or members of the board of directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of human error and the circumvention or overriding of controls, material misstatements may not be prevented or detected on a timely basis. In addition, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes and conditions or that the degree of compliance with policies or procedures may deteriorate. Accordingly, even internal controls determined to be effective can provide only reasonable assurance that the information required to be disclosed in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized, and represented within the time periods required.

Our management assessed the effectiveness of our internal control over financial reporting at the time the Original Filing was filed on March 29, 2018. To make this assessment, we used the criteria for effective internal control over financial reporting described in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on such assessments, at the time the Original Filing was filed on March 29, 2018, the Chief Executive Officer and Chief Financial Officer concluded that our internal control over financial reporting was effective as of December 31, 2017. Subsequent to this evaluation, the Chief Executive Officer and Chief Financial Officer identified a material weakness in our internal control over financial reporting.

We failed to design controls over the application of ASC 810, Variable Interest Entities; specifically, the recording of the Company's investment in the Operating Partnership. The material weakness was identified by us in connection with our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018.

Pillarstone's independent registered public accounting firm has re-issued an attestation report on the effectiveness of Pillarstone's internal control over financial reporting, which appears in this Annual Report on Form 10-K/A.

#### Management's Plans for Remediation

As soon as management became aware of this material weakness in internal control over financial reporting we began taking immediate actions to remediate the material weakness.

The specific material weakness related to the misapplication of ASC 810 upon the formation of the Company. The Company adjusted its accounting of the Operating Partnership, changing the accounting from the equity method (ASC 323, "Investments - Equity Method and Joint Venture) to consolidation under ASC 810. This change in accounting is a one-time adjustment that effected the first year of reporting after the December 8, 2016 Contribution Agreement (the "Contribution Agreement") with Whitestone REIT Operating Partnership, L.P.

We intend to strengthen our controls around the application of ASC 810 and the adoption of any unique accounting applications by preparing formal written memos for every new standard that is applicable to the Company as opposed to the more material ones as it has historically done. We have taken steps to remediate the material weaknesses described above, including (1) reviewing the processes that identify unique accounting transactions, (2) implementing new control procedures that clearly document how unique transactions will be assessed under U.S. GAAP and use of external resources as necessary and (3) adjusted our communications with the Audit Committee that describe the results of such documentation.

We do not expect to incur material costs to remediate this control and expect to have this material weakness remediated no later than September 30, 2018.

Notwithstanding the existence of the internal control deficiencies, management believes that the consolidated financial statements in this Form 10-K/A fairly present, in all material respects, the Company's financial condition as of December 31, 2017, and results of its operations and cash flows for the year ended December 31, 2017, in conformity with U.S. GAAP.

#### Changes in Internal Control over Financial Reporting

Except as noted in the preceding paragraphs, there have been no significant changes in our internal control over financial reporting during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Item 9B. Other Information.

None.

### PART III

#### Item 10. Trustees, Executive Officers and Corporate Governance.

The information required by Item 10 of Form 10-K is incorporated herein by reference to such information as set forth in the Company's definitive proxy statement pursuant to Regulation 14A, which proxy statement was filed with the SEC on April 5, 2018.

#### Item 11. Executive Compensation.

The information required by Item 11 of Form 10-K is incorporated herein by reference to such information as set forth in the Company's definitive proxy statement pursuant to Regulation 14A, which proxy statement was filed with the SEC on April 5, 2018.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.

The information required by Item 12 of Form 10-K is incorporated herein by reference to such information as set forth in the Company's definitive proxy statement pursuant to Regulation 14A, which proxy statement was filed with the SEC on April 5, 2018.

#### Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by Item 13 of Form 10-K is incorporated herein by reference to such information as set forth in the Company's definitive proxy statement pursuant to Regulation 14A, which proxy statement was filed with the SEC on April 5, 2018.

Item 14. Principal Accountant Fees and Services.

The information required by Item 14 of Form 10-K is incorporated herein by reference to such information as set forth in the Company's definitive proxy statement pursuant to Regulation 14A, which proxy statement was filed with the SEC on April 5, 2018.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

Exhibit Number	Exhibit Description
<u>2.1</u>	<u>Additional Contribution Agreement between the Company and Paragon Real Estate Development, LLC (filed as Exhibit 2.7 to the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference)</u>
<u>2.2</u>	<u>Amendment to Additional Contribution Agreement between the Company, the Board of Trustees and each Trustee individually dated September 29, 2006. (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)</u>
<u>3.1</u>	<u>Articles of Amendment and Restatement of the Declaration of Trust of the Company (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on March 29, 2016 and incorporated herein by reference)</u>
<u>3.2</u>	<u>Third Amended and Restated Amendment No. 2 to the Amended and Restated Bylaws of the Company (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u>
<u>10.1</u>	<u>Employment Agreement of James C. Mastandrea (filed as Exhibit 2.3 to the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) (1)</u>
<u>10.2</u>	<u>Employment Agreement of John J. Dee (filed as Exhibit 2.4 to the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) (1)</u>
<u>10.3</u>	<u>Restricted Share Agreement of James C. Mastandrea (filed as Exhibit 2.5 to the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) (1)</u>
<u>10.4</u>	<u>Restricted Share Agreement of John J. Dee (filed as Exhibit 2.6 to the Company's Current Report on Form 8-K filed on March 5, 2003 and incorporated herein by reference) (1)</u>
<u>10.5</u>	<u>Form of Restricted Share Agreement for Trustees dated September 26, 2006 (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference) (1)</u>
<u>10.6</u>	<u>2004 Share Option Plan of the Company (filed as Exhibit 4.1 to the Company's Registration Statement on Form S-8 filed on July 23, 2004 and incorporated herein by reference)</u>
<u>10.7</u>	<u>Stock Subscription Agreement between James C. Mastandrea and the Company dated as of September 29, 2006 (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)</u>
<u>10.8</u>	<u>Form of Stock Subscription Agreement between Investors and the Company dated as of September 29, 2006 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 3, 2006 and incorporated herein by reference)</u>
<u>10.9</u>	<u>Modification Agreement between the Company and John J. Dee dated April 3, 2006 (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on April 6, 2006 and incorporated herein by reference)</u>
<u>10.10</u>	<u>Modification Agreement between the Company and James C. Mastandrea dated April 3, 2006 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 6, 2006 and incorporated herein by reference)</u>
<u>10.11</u>	<u>Form of First Amendment to Restricted Share Agreement for Trustees dated September 25, 2008 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and incorporated herein by reference)</u>
<u>10.12</u>	<u>First Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 25, 2008 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 and incorporated herein by reference)</u>
<u>10.13</u>	<u>Form of Second Amendment to Restricted Share Agreement for Trustees dated September 21, 2009 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30,</u>

2009 and incorporated herein by reference)

10.14

Second Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 21, 2009 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009 and incorporated herein by reference)

10.15

Form of Third Amendment to Restricted Share Agreement for Trustees dated September 28, 2010 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference)

10.16

Third Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 28, 2010 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 and incorporated herein by reference)

Exhibit Number	Exhibit Description
<a href="#"><u>10.17</u></a>	<a href="#"><u>Form of Fourth Amendment to Restricted Share Agreement for Trustees dated September 29, 2011 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 and incorporated herein by reference)</u></a>
<a href="#"><u>10.18</u></a>	<a href="#"><u>Fourth Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 29, 2011 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 and incorporated herein by reference)</u></a>
<a href="#"><u>10.19</u></a>	<a href="#"><u>Form of Fifth Amendment to Restricted Share Agreement for Trustees dated September 28, 2012 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference)</u></a>
<a href="#"><u>10.20</u></a>	<a href="#"><u>Fifth Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 28, 2012 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference)</u></a>
<a href="#"><u>10.21</u></a>	<a href="#"><u>Form of Sixth Amendment to Restricted Share Agreement for Trustees dated September 30, 2013 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 and incorporated herein by reference)</u></a>
<a href="#"><u>10.22</u></a>	<a href="#"><u>Sixth Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 30, 2013 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 and incorporated herein by reference)</u></a>
<a href="#"><u>10.23</u></a>	<a href="#"><u>Form of Seventh Amendment to Restricted Share Agreement for Trustees dated September 30, 2014 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 and incorporated herein by reference)</u></a>
<a href="#"><u>10.24</u></a>	<a href="#"><u>Seventh Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 30, 2014 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 and incorporated herein by reference)</u></a>
<a href="#"><u>10.25</u></a>	<a href="#"><u>Form of Eighth Amendment to Restricted Share Agreement for Trustees dated September 30, 2015 (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015 and incorporated herein by reference)</u></a>
<a href="#"><u>10.26</u></a>	<a href="#"><u>Eighth Amendment to Stock Subscription Agreement between James C. Mastandrea and the Company dated September 30, 2015 (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015 and incorporated herein by reference)</u></a>
<a href="#"><u>10.27</u></a>	<a href="#"><u>Contribution Agreement among Whitestone REIT Operating Partnership, Pillarstone Capital REIT Operating Partnership LP and the Company dated December 8, 2016 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u></a>
<a href="#"><u>10.28</u></a>	<a href="#"><u>OP Unit Purchase Agreement among Whitestone REIT Operating Partnership, Pillarstone Capital REIT Operating Partnership LP and the Company dated December 8, 2016 (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u></a>
<a href="#"><u>10.29</u></a>	<a href="#"><u>Tax Protection Agreement among Whitestone REIT Operating Partnership, Pillarstone Capital REIT Operating Partnership LP and the Company dated December 8, 2016 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u></a>
<a href="#"><u>10.30</u></a>	<a href="#"><u>Amended and Restated Limited Partnership Agreement of Pillarstone Capital REIT Operating Partnership LP, dated December 8, 2016 (filed as Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u></a>
<a href="#"><u>10.31</u></a>	<a href="#"><u>Form of Management Agreement dated December 8, 2016 (filed as Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u></a>
<a href="#"><u>10.33</u></a>	<a href="#"><u>Second Amendment to Amended and Restated Credit Agreement, Joinder and Reaffirmation of Guaranties, dated December 8, 2016, among Whitestone REIT Operating Partnership, L.P., Whitestone REIT, Pillarstone Capital REIT Operating Partnership LP, et al., as guarantors, the lenders party thereto, and Bank of Montreal, as Administrative Agent (filed as Exhibit 10.6 to the Company's Current Report on</u></a>



Form 8-K filed on December 13, 2016 and incorporated herein by reference)

10.34 Limited Guaranty, dated December 8, 2016, between Pillarstone Capital REIT Operating Partnership LP and Bank of Montreal, as Administrative Agent (filed as Exhibit 10.7 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)

10.35 Loan Agreement, dated September 26, 2013, by and between Whitestone Uptown Tower, LLC and Morgan Stanley Mortgage Capital Holdings LLC, as amended (filed as Exhibit 10.8 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)

10.36 Promissory Note by Whitestone Uptown Tower, LLC to Morgan Stanley Mortgage Capital Holdings LLC, dated September 23, 2013 (filed as Exhibit 10.9 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)

Exhibit Number	Exhibit Description
<u>10.37</u>	<u>Loan Agreement, dated November 26, 2013, by and between Whitestone Industrial-Office LLC and Jackson National Life Insurance Company (filed as Exhibit 10.10 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u>
<u>10.38</u>	<u>Fixed Rate Promissory Note by Whitestone Industrial-Office LLC to Jackson National Life Insurance Company, dated November 26, 2013 (filed as Exhibit 10.11 to the Company's Current Report on Form 8-K filed on December 13, 2016 and incorporated herein by reference)</u>
<u>31.1</u>	<u>Section 302 Certification pursuant to the Sarbanes-Oxley Act of 2002 - Chief Executive Officer (2)</u>
<u>31.2</u>	<u>Section 302 Certification pursuant to the Sarbanes-Oxley Act of 2002 - Chief Financial Officer (2)</u>
<u>32.1</u>	<u>CEO/CFO Certification under Section 906 of Sarbanes-Oxley Act of 2002 (2)</u>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document

\* The following financial information of the Registrant for the years ended December 31, 2017 and 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

(1) Indicates a management contract or compensatory plan or arrangement

(2) Filed or furnished herewith

## SIGNATURES

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### PILLARSTONE CAPITAL REIT

Date: September 18, 2018 By: /s/ James C. Mastandrea  
James C. Mastandrea, Chairman and CEO

### PILLARSTONE CAPITAL REIT

Date: September 18, 2018 By: /s/ John J. Dee  
John J. Dee, CFO

## POWER OF ATTORNEY

KNOW ALL PERSON BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John J. Dee, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorney-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

In accordance with Section 13 or 15(d) of the Securities Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### PILLARSTONE CAPITAL REIT

Signature	Title	Date
/s/ James C. Mastandrea James C. Mastandrea	Trustee, Chief Executive Officer and President (Principal Executive Officer)	September 18, 2018
/s/ John J. Dee John J. Dee	Trustee, Senior Vice President and Chief Financial Officer (Principal Finance and Principal Accounting Officer)	September 18, 2018
/s/ Dennis H. Chookaszian Dennis H. Chookaszian	Trustee	September 18, 2018
/s/ Daniel G. DeVos Daniel G. DeVos	Trustee	September 18, 2018
/s/ Kathy M. Jassem	Trustee	September 18, 2018

Kathy M. Jassem

/s/ Paul T. Lambert  
Paul T. Lambert

Trustee

September 18, 2018

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Trustees and Shareholders of

Pillarstone Capital REIT:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Pillarstone Capital REIT and subsidiaries (the “Company”) as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in equity (deficit), and cash flows for each of the years in the two-year period ended December 31, 2017, and the related notes and schedules (collectively referred to as the “Consolidated Financial Statements”).

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

Restatement of Previously Issued Financial Statements

As discussed in Note 2 to the Consolidated Financial Statements, the December 31, 2017 Consolidated Financial Statements have been restated to correct a misstatement.

Basis for Opinion

These Consolidated Financial Statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s Consolidated Financial Statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the Consolidated Financial Statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. Our audits included performing procedures to assess the risks of material misstatement of the Consolidated Financial Statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the Consolidated Financial Statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company’s auditor since 2016.

/s/ Pannell Kerr Forster of Texas, P.C.

Houston, Texas

March 29, 2018, except for the effects of the restatement as discussed in Note 2 to the Consolidated Financial statements, as to which the date is September 18, 2018.

Pillarstone Capital REIT and Subsidiaries  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except per share data)

	December 31,	
	2017	2016
	Restated	
<b>ASSETS<sup>(1)</sup></b>		
Real estate assets, at cost		
Property	\$83,144	\$80,564
Accumulated depreciation	(2,934 )	(150 )
Total real estate assets	80,210	80,414
Cash and cash equivalents	2,991	1,243
Escrows and acquisition deposits	2,188	2,274
Accrued rents and accounts receivable, net of allowance for doubtful accounts	798	213
Receivable due from related party	1,304	2,818
Unamortized lease commissions and deferred legal costs, net	1,265	1,150
Prepaid expenses and other assets	160	149
Total assets	\$88,916	\$88,261
<b>LIABILITIES AND EQUITY (DEFICIT)<sup>(2)</sup></b>		
Liabilities:		
Notes payable	\$64,313	\$65,474
Accounts payable and accrued expenses	3,586	3,509
Payable due to related party	1,005	265
Convertible notes payable - related parties	198	198
Accrued interest payable	42	22
Tenants' security deposits	1,191	996
Total liabilities	70,335	70,464
Commitments and contingencies	—	—
Shareholders' Equity (Deficit):		
Preferred A Shares - \$0.01 par value, 1,518,000 authorized: 256,636 Class A cumulative convertible shares issued and outstanding at December 31, 2017 and 2016, \$10.00 per share liquidation preference	3	3
Preferred C Shares - \$0.01 par value, 300,000 authorized: 244,444 Class C cumulative convertible shares issued and outstanding at December 2017 and 2016, \$10.00 per share liquidation preference	2	2
Common Shares - \$0.01 par value, 400,000,000 authorized: 443,299 shares issued and 405,169 outstanding at December 31, 2017 and 2016	4	4
Additional paid-in capital	28,147	28,147
Accumulated deficit	(27,635 )	(27,850 )
Treasury stock, at cost, 38,130 shares	(801 )	(801 )
Total Pillarstone Capital REIT shareholders' deficit	(280 )	(495 )
Noncontrolling interest in subsidiary	18,861	18,292
Total equity	18,581	17,797
Total liabilities and equity	\$88,916	\$88,261

The accompanying notes are an integral part of the consolidated financial statements.





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Pillarstone Capital REIT and Subsidiaries  
CONSOLIDATED BALANCE SHEETS - Continued  
(in thousands)

	December 31,	
	2017	2016
	Restated	
(1) Assets of consolidated Variable Interest Entity included in the total assets above:		
Real estate assets, at cost		
Property	\$83,141	\$80,564
Accumulated depreciation	(2,934 )	(150 )
Total real estate assets	80,207	80,414
Cash and cash equivalents	2,812	1,236
Escrows and acquisition deposits	2,188	2,274
Accrued rents and accounts receivable, net of allowance for doubtful accounts	798	213
Receivable due from related party	1,304	2,818
Unamortized lease commissions and deferred legal costs, net	1,265	1,150
Prepaid expenses and other assets	150	134
Total assets	\$88,724	\$88,239
(2) Liabilities of consolidated Variable Interest Entity included in the total liabilities above:		
Notes payable	\$64,313	\$65,474
Accounts payable and accrued expenses	3,494	3,481
Payable due to related party	1,005	265
Tenants' security deposits	1,191	996
Total liabilities	\$70,003	\$70,216

The accompanying notes are an integral part of the consolidated financial statements.

Pillarstone Capital REIT and Subsidiaries  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except share and per share data)

	Year Ended December 31, 2017      2016 Restated	
Property revenues		
Rental revenues	\$14,218	\$983
Other revenues	2,550	157
Total property revenues	16,768	1,140
Property expenses		
Property operation and maintenance	5,029	397
Real estate taxes	2,672	174
Total property expenses	7,701	571
Other expenses		
General and administrative	508	492
Depreciation and amortization	3,268	163
Interest expense	2,725	176
Total other expense	6,501	831
Income (loss) before loss on disposal of assets and income taxes	2,566	(262 )
Loss on disposal of assets	(31 )	—
Provision for income taxes	(88 )	—
Net income (loss)	2,447	(262 )
Less: noncontrolling interest in subsidiary	2,232	203
Net income (loss) attributable to Common Shareholders	\$215	(465 )
Earnings (Loss) Per Share:		
Basic income (loss) per Common Share:		
Net income (loss) available to Common Shareholders	\$0.53	\$(1.15 )
Diluted income (loss) per Common Share:		
Net income (loss) available to Common Shareholders	\$0.07	\$(1.15 )
Weighted average number of Common Shares outstanding:		
Basic:	405,169	405,169
Diluted:	2,903,219	405,169

The accompanying notes are an integral part of the consolidated financial statements.



## Pillarstone Capital REIT and Subsidiaries

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIT)

(in thousands, except per share data)

	Class A	Class C	Additional			Cost of	Total	Total	
	Preferred	Preferred	Common	Paid-in	Accumulated	Shares held in Treasury	Shareholder	Noncontrolling	Equity
	Shares	Shares	Shares	Capital	Deficit		Deficit	Interest	(Deficit)
Balance, December 31, 2015	\$ 3	\$ 2	\$ 4	\$28,147	\$ (27,385 )	\$ (801 )	\$ (30 )	\$ —	\$(30 )
Contributions in Operating Partnership	—	—	—	4,121	—	—	4,121	18,089	22,210
Distributions in kind	—	—	—	(4,121 )	—	—	(4,121 )	—	(4,121 )
Net loss	—	—	—	—	(465 )	—	(465 )	203	(262 )
Balance, December 31, 2016	3	2	4	28,147	(27,850 )	(801 )	(495 )	18,292	17,797
Distributions to operating partnership limited partner (restated)	—	—	—	—	—	—	—	(1,663 )	(1,663 )
Net income (restated)	—	—	—	—	215	—	215	2,232	2,447
Balance, December 31, 2017 (restated)	\$ 3	\$ 2	\$ 4	\$28,147	\$ (27,635 )	\$ (801 )	\$ (280 )	\$ 18,861	\$18,581

The accompanying notes are an integral part of the consolidated financial statements.

Pillarstone Capital REIT and Subsidiaries  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

	Year Ended December 31, 2017    2016 Restated	
Cash flows from operating activities:		
Net income (loss)	\$2,447	\$(262 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,268	163
Deferred loan costs	97	—
Loss on disposal of assets	31	—
Bad debt expense	412	127
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	86	—
Accrued rent and accounts receivable	(997 )	(340 )
Receivable from related party	120	(1,542 )
Unamortized lease commissions and deferred legal costs	(567 )	(7 )
Prepaid expenses and other assets	(11 )	(8 )
Accounts payable and accrued expenses	97	1,200
Accounts payable due to related party	740	265
Tenants' security deposits	195	61
Net cash provided by (used in) operating activities	5,918	(343 )
Cash flows from investing activities:		
Additions to real estate	(1,249 )	—
Net cash used in investing activities	(1,249 )	—
Cash flows from financing activities:		
Proceeds from issuance of OP units, net of offering costs	—	1,412
Distributions paid to noncontrolling interest in Consolidated Partnership	(1,663 )	—
Repayments of notes payable	(1,258 )	—
Net cash provided by (used in) financing activities	(2,921 )	1,412
Net increase in cash and cash equivalents	1,748	1,069
Cash and cash equivalents at beginning of period	1,243	174
Cash and cash equivalents at end of period	\$2,991	\$1,243
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$2,611	\$—
Non cash investing and financing activities:		
Disposal of fully depreciated real estate	\$20	\$—
Investment in Pillarstone Capital REIT Operating Partnership LP	\$—	\$4,121
Distribution in kind from Pillarstone Capital REIT Operating Partnership LP	\$—	\$(4,121 )
Debt assumed with acquisitions of real estate	\$—	\$65,937
Value of OP units exchanged for real estate	\$—	\$16,667
Fair value of assets acquired	\$—	\$(82,614)
Additions to real estate contributed by related party	\$1,394	\$—

The accompanying notes are an integral part of the consolidated financial statements.

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PILLARSTONE CAPITAL REIT  
Notes to Consolidated Financial Statements  
December 31, 2017

## 1. ORGANIZATION

Pillarstone Capital REIT (the “Company,” “Pillarstone,” “we,” “our,” or “us”) is a Maryland real estate investment trust (“REIT”) engaged in investing in, owning and operating commercial properties. In 2016, the shareholders of Pillarstone approved changing the Company's name from Paragon Real Estate Equity and Investment Trust to Pillarstone Capital REIT. Future real estate investments may include (i) acquisition and development of retail, office, office warehouse, industrial, multifamily, hotel, and other commercial properties, (ii) acquisition of or merger with a real estate investment trust (“REIT”) or real estate operating company and (iii) joint venture investments. We serve as the general partner of Pillarstone Capital REIT Operating Partnership LP (the “Operating Partnership” or “Pillarstone OP”), which was formed on September 23, 2016 as a Delaware limited partnership. We currently conduct substantially all operations and activities through Pillarstone OP. As the general partner of Pillarstone OP, we have the exclusive power to manage and conduct the business of Pillarstone OP, subject to certain customary exceptions.

## 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

In November 2017, the Company and Whitestone each received a comment letter from the Staff (the “Staff”) of the Division of Corporation Finance of the SEC relating to the Company’s and Whitestone’s Annual Reports on Form 10-K for the year ended December 31, 2016. In the respective letters, the Staff requested that the Company and Whitestone provide them with an analysis to support the determination that the Operating Partnership is a variable interest entity (“VIE”) of which Whitestone is the primary beneficiary. In response to the Staff’s comment, Whitestone, on its own behalf and on behalf of the Company, provided the Staff with its analysis of Whitestone’s accounting and financial reporting obligations relating to its interest in the Operating Partnership. After communicating its analysis and conclusions to the Staff and responding to additional questions from the Staff relating to this matter, the Staff did not object to or otherwise take exception to the initial determinations at the time of the consummation of the acquisition in December 2016 but provided a verbal reminder in that the determination of the primary beneficiary of a VIE should be continually reassessed, and recommended that Whitestone consider pre-clearing future accounting treatment of the Operating Partnership with the Staff of the Office of the Chief Accountant (“OCA”).

In connection with the preparation and review of its financial statements for the quarter ended March 31, 2018, Whitestone concluded, in accordance with the Staff’s recommendation, and after consultation with its outside accounting advisors, that it would be prudent to seek pre-clearance from the OCA of Whitestone's proposed treatment of the Operating Partnership in its financial statements for such quarter. Accordingly, in April 2018, Whitestone submitted a letter to the OCA seeking their concurrence with its determinations that Whitestone maintained its status as the primary beneficiary of the Operating Partnership and, accordingly, should continue to consolidate the Operating Partnership in its financial statements for the quarter ended March 31, 2018 in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”). After further correspondence, including telephonic meetings between Whitestone, its advisors and the OCA, the OCA informed Whitestone that it objected to Whitestone’s and the Company’s conclusions that Whitestone was the primary beneficiary of the Operating Partnership since the Acquisition in December 2016 and during the subsequent periods. Whitestone and the Company respectfully disagreed with the OCA’s determination and Whitestone, on its own behalf and on behalf of the Company, made a formal appeal to the Chief Accountant of the SEC in June 2018.

In July 2018, Whitestone and its advisory team of accounting and legal professionals met with the Chief Accountant, members of the OCA and Division of Corporate Finance. On July 30, 2018, the Chief Accountant of the SEC

informed Whitestone that its formal appeal was denied and that the OCA objected to Whitestone's and the Company's presentation of their investments in the Operating Partnership under the VIE accounting guidance since the consummation of the acquisition in December 2016. As a result, the Company's management has determined that the Company should not have used the equity method of accounting to present its investment in the Operating Partnership in each of the Forms 10-K for the years ended December 31, 2016 and December 31, 2017 and the Forms 10-Q for the quarters ended March 31, 2017; June 30, 2017; September 30, 2017 and March 31, 2018 (the "Prior Period Financial Statements"). After consideration of the OCA's objection to Whitestone's original accounting, the Company evaluated its original accounting of the equity method and the materiality of the error quantitatively and qualitatively and concluded that it was material to the Prior Period Financial Statements. The Company will revise its original accounting treatment accordingly in the amended filings. The Company has determined that it is the primary beneficiary of the Operating Partnership through the Company's power to direct the activities that most significantly impact the Operating Partnership's economic performance and the Company's right to receive benefits based on its ownership percentage in the Operating Partnership. Accordingly, the Company will account for the Operating Partnership as a VIE and fully consolidate it in the Company's financial statements prospectively and in the amended filings. Whitestone OP's 81.4% interest in the Operating Partnership will be accounted for as a non-controlling interest and deducted from the Company's share of net income and equity in the Operating Partnership.

The following table presents the effects of the restatement on the consolidated balance sheet as of December 31, 2017 (in thousands):

	December 31, 2017		
	As Reported	Effect of Restatement	As Restated
Real estate assets, at cost			
Property	\$3	\$ 83,141	\$83,144
Accumulated depreciation	—	(2,934 )	(2,934 )
Total real estate assets	3	80,207	80,210
Cash and cash equivalents	179	2,812	2,991
Escrows and acquisition deposits	—	2,188	2,188
Accrued rents and accounts receivable, net of allowance for doubtful accounts	—	798	798
Receivable due from related party	—	1,304	1,304
Unamortized lease commissions and deferred legal costs, net	—	1,265	1,265
Prepaid expenses and other assets	10	150	160
Total assets	\$192	\$ 88,724	\$88,916



PILLARSTONE CAPITAL REIT  
Notes to Consolidated Financial Statements  
December 31, 2017

	December 31, 2017		
	As Reported	Effect of Restatement	As Restated
Notes payable	\$—	\$ 64,313	\$64,313
Accounts payable and accrued expenses	92	3,494	3,586
Accounts payable - related party	316	689	1,005
Convertible notes payable - related parties	198	—	198
Accrued interest payable	42	—	42
Tenants' security deposits	—	1,191	1,191
Negative equity investment in Pillarstone Capital REIT LP	88	(88 )	—
Total liabilities	736	69,599	70,335
Commitments and contingencies	—	—	—
Shareholders' Equity (Deficit):			
Preferred A Shares - \$0.01 par value, 1,518,000 authorized: 256,636 Class A cumulative convertible shares issued and outstanding at December 31, 2017 and 2016, \$10.00 per share liquidation preference	3	—	3
Preferred C Shares - \$0.01 par value, 300,000 authorized: 244,444 Class C cumulative convertible shares issued and outstanding at December 31, 2017 and 2016, \$10.00 per share liquidation preference	2	—	2
Common Shares - \$0.01 par value, 400,000,000 authorized: 443,299 shares issued and 405,169 outstanding at December 31, 2017 and 2016	4	—	4
Additional paid-in capital	28,147	—	28,147
Accumulated deficit	(27,899)	264	(27,635 )
Treasury stock, at cost, 38,130 shares	(801 )	—	(801 )
Total Pillarstone Capital REIT shareholders' deficit	(544 )	264	(280 )
Noncontrolling interest in subsidiary	—	18,861	18,861
Total equity (deficit)	(544 )	19,125	18,581
Total liabilities and equity	\$ 192	\$ 88,724	\$88,916

PILLARSTONE CAPITAL REIT  
Notes to Consolidated Financial Statements  
December 31, 2017

The following table presents the effects of the restatement on the consolidated statement of operations for the year ended December 31, 2017 (in thousands, except per share data):

	Year Ended December 31, 2017		
	As Reported	Effect of Restatement	As Restated
Property revenues			
Rental revenues	\$—	\$ 14,218	\$14,218
Other revenues	—	2,550	2,550
Total property revenues	—	16,768	16,768
Property expenses			
Property operation and maintenance	—	5,029	5,029
Real estate taxes	—	2,672	2,672
Total property expenses	—	7,701	7,701
Other expenses			
General and administrative	273	235	508
Depreciation and amortization	—	3,268	3,268
Interest expense	19	2,706	2,725
Total other expense	292	6,209	6,501
Income (loss) before loss on disposal of assets and income taxes	(292 )	2,858	2,566
Loss on disposal of assets	—	(31 )	(31 )
Equity in income of Pillarstone Capital REIT Operating Partnership LP	275	(275 )	—
Provision for income taxes	—	(88 )	(88 )
Net income (loss)	(17 )	2,464	2,447
Less: non-controlling interest in subsidiary	—	2,232	2,232
Net income (loss) attributable to Common Shareholders	\$(17 )	\$ 232	\$215
Net income (loss) attributable to Common Shareholders per Common Share:			
Basic	\$(0.04)	\$ 0.57	\$0.53
Diluted	\$(0.04)	\$ 0.11	\$0.07

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3. BASIS OF PRESENTATION

Basis of consolidation. We have prepared the consolidated financial statements pursuant to the rules and regulations of the SEC and U.S. GAAP. In our opinion, all adjustments (consisting solely of normal recurring items) necessary for a fair presentation of our financial position as of December 31, 2017 and 2016, the results of our operations for the years ended December 31, 2017 and 2016, and of our cash flows for the years ended December 31, 2017 and 2016 have been included. We also consolidate a VIE when we are determined to be the primary beneficiary. Determination of the primary beneficiary is based on whether an entity has (1) the power to direct activities that most significantly impact the economic performance of the VIE and (2) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. Our determination of the primary beneficiary considers all relationships between us and the VIE, including management and other contractual agreements. Consequently, the accompanying consolidated financial statements include the accounts of Pillarstone OP and a wholly-owned subsidiary that discontinued operations in 2002. See Note 5 for additional disclosure on our VIE.

Noncontrolling interest in the accompanying consolidated financial statements represents the share of equity and earnings of Pillarstone OP allocable to holders of partnership interests other than us. Net income or loss is allocated to noncontrolling interest based on the weighted-average percentage ownership of Pillarstone OP during the year. Issuance of additional units of limited partnership interest in Pillarstone OP changes the percentage of ownership interests of both the noncontrolling interest and Pillarstone.

Going concern. The financial statements have been prepared assuming the Company will continue as a going concern, which contemplates continued operations as a public company and paying liabilities in the normal course of business. The Company, through Pillarstone OP, acquired 14 real estate assets in December 2016 and its distributions of cash from Pillarstone OP are expected to be sufficient for the Company to continue as a going concern.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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. In order to conform with U.S. GAAP, management, in preparation of our consolidated financial statements, is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of December 31, 2017 and 2016, and the reported amounts of revenues and expenses for the years ended December 31, 2017 and 2016. Actual results could differ from those estimates. Significant estimates include deferred taxes and the related valuation allowance for deferred taxes, and these significant estimates, as well as other estimates and assumptions, may change in the near term.

Cash and cash equivalents. We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents as of December 31, 2017 and 2016 consisted of demand deposits at commercial banks and brokerage accounts. We maintain our cash in bank accounts that are federally insured.

Acquired Properties and Acquired Lease Intangibles. We allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values at the time of purchase. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our

analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.

Depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of 5 to 39 years for improvements and buildings, respectively. Tenant improvements are depreciated using the straight-line method over the life of the improvement or remaining term of the lease, whichever is shorter.

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PILLARSTONE CAPITAL REIT  
Notes to Consolidated Financial Statements  
December 31, 2017

**Impairment.** We review our properties for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the property exceeds its fair value. Management has determined that there has been no impairment in the carrying value of our real estate assets as of December 31, 2017.

**Accrued Rents and Accounts Receivable.** Included in accrued rent and accounts receivable are base rents, tenant reimbursements and receivables attributable to recording rents on a straight-line basis. An allowance for the uncollectible portion of accrued rents and accounts receivable is determined based upon customer credit-worthiness (including expected recovery of our claim with respect to any tenants in bankruptcy), historical bad debt levels, and current economic trends. As of December 31, 2017 and 2016, we had an allowance for uncollectible accounts of \$539,000 and \$125,000, respectively, and bad debt expense of \$412,000 and \$127,000, respectively.

**Unamortized Lease Commissions and Deferred Legal Costs.** Leasing commissions and deferred legal costs are amortized using the straight-line method over the terms of the related lease agreements. Loan costs are amortized on the straight-line method over the terms of the loans, which approximates the interest method. Costs allocated to in-place leases whose terms differ from market terms related to acquired properties are amortized over the remaining life of the respective leases.

**Prepays and Other assets.** Prepays and other assets include escrows established pursuant to certain mortgage financing arrangements for real estate taxes and insurance.

**Noncontrolling Interests.** Noncontrolling interests are 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 interest in equity on the consolidated balance sheets but separate from Pillarstone's equity. On the consolidated statements of operations, subsidiaries are reported at the consolidated amount, including both the amount attributable to Pillarstone and noncontrolling interest. Consolidated statements of changes in equity are included for both quarterly and annual financial statements, including beginning balances, activity for the period and ending balances for shareholders' equity, noncontrolling interest and total equity.

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

**Stock-based compensation.** The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation - Stock Compensation," which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the

issuance of such equity instruments. ASC 718 generally requires that these transactions be accounted for using a fair-value-based method. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards.

Income taxes. Because we have not elected to be taxed as a REIT for federal income tax purposes, we account for income taxes using the liability method under which deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the period in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

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The Company evaluates potential uncertain tax positions on an annual basis in conjunction with the board of trustees and its tax accountants. Authoritative literature provides a two-step approach to recognize and measure tax benefits when realization of the benefits is uncertain. The first step is to determine whether the benefit meets the more-likely-than-not condition for recognition and the second step is to determine the amount to be recognized based on the cumulative probability that exceeds 50%. The Company has no uncertain tax positions that required adjustments to our consolidated financial statements in 2017 or 2016.

At December 31, 2017, we have net operating loss carry-forwards totaling \$777,000. While these losses created a deferred tax asset, a valuation allowance was applied against the asset because of the uncertainty of whether we will be able to use these loss carry-forwards, which will expire in varying amounts through the year 2037.

**Fair Value of Financial Instruments.** Our financial instruments consist primarily of cash, cash equivalents, accounts receivable, accounts and notes payable and investments in marketable securities. The carrying value of cash, cash equivalents, accounts receivable and accounts payable are representative of their respective fair values due to their short-term nature. The fair value of our long-term debt, consisting of fixed rate secured notes aggregate to approximately \$65.1 million and \$65.9 million as compared to the book value of approximately \$64.7 million and \$65.9 million as of December 31, 2017 and 2016, respectively. The fair value of our long-term debt is estimated on a Level 2 basis (as provided by ASC 820, "Fair Value Measurements and Disclosures"), using a discounted cash flow analysis based on the borrowing rates currently available to us for loans with similar terms and maturities, discounting the future contractual interest and principal payments.

Disclosure about fair value of financial instruments is based on pertinent information available to management as of December 31, 2017 and 2016. Although management is not aware of any factors that would significantly affect the fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since December 31, 2017 and current estimates of fair value may differ significantly from the amounts presented herein.

**Concentration of Risk.** Substantially all of our revenues are obtained from office and warehouse locations in the Dallas-Fort Worth and Houston metropolitan areas. We maintain cash accounts in major U.S. financial institutions. The terms of these deposits are on demand to minimize risk. The balances of these accounts sometimes exceed the federally insured limits, although no losses have been incurred in connection with these deposits.

**Recent accounting pronouncements.** 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 with the exception of changes related to costs which qualify as initial direct costs. 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 will adopt this guidance on a modified retrospective basis beginning January 1, 2019, and such adoption will result in certain costs (primarily legal costs related to lease negotiations) being expensed rather than capitalized. We capitalized \$47,000 in legal related costs for the year ended December 31, 2017. We had no capitalized legal related costs for the year ended December 31, 2016.

In November 2016, the FASB issued guidance requiring that the statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be

included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance will become effective for the reporting periods beginning on or after December 15, 2017, and interim periods within those fiscal years. We adopted this guidance effective January 1, 2018, and we have reconciled cash and cash equivalents and restricted cash and restricted cash equivalents on a retrospective basis, whereas under the previous guidance, we reported restricted cash and restricted cash equivalents under cash flows from financing activities.

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In January 2017, the FASB issued guidance clarifying the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This guidance will become effective for the reporting periods beginning on or after December 15, 2017, and interim periods within those fiscal years. We adopted this guidance on a prospective basis beginning January 1, 2018 and believe the majority of our future acquisitions will qualify as asset acquisitions and the associated transaction costs will be capitalized as opposed to expensed under previous guidance.

In February 2017, the FASB issued guidance clarifying the scope of asset derecognition guidance, added guidance for partial sales of nonfinancial assets and clarified recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. This guidance will become effective for the reporting periods beginning on or after December 15, 2017, and interim periods within those fiscal years. We adopted this guidance on a modified retrospective basis beginning January 1, 2018, and the adoption of this guidance did not have a material impact on our consolidated financial statements.

## 5. VARIABLE INTEREST ENTITIES

On December 8, 2016, Pillarstone and Pillarstone OP, entered into a Contribution Agreement (the “Contribution Agreement”) with Whitestone REIT Operating Partnership, L.P. (“Whitestone OP”), a subsidiary and the operating partnership of Whitestone, both of which are related parties to Pillarstone and Pillarstone OP, pursuant to which Whitestone OP contributed to Pillarstone OP all of the equity interests in four of its wholly-owned subsidiaries (the “Subsidiaries”): Whitestone CP Woodland Ph. 2, LLC, a Delaware limited liability company; Whitestone Industrial-Office, LLC, a Texas limited liability company; Whitestone Offices, LLC, a Texas limited liability company; and Whitestone Uptown Tower, LLC, a Delaware limited liability company (“Uptown Tower”). The Subsidiaries own 14 real estate assets (the “Real Estate Assets” and, together with the Subsidiaries, the “Property”) for aggregate consideration of approximately \$84 million, consisting of (1) approximately \$18.1 million of Class A units representing limited partnership interests in Pillarstone OP (“OP Units”), issued at a price of \$1.331 per OP Unit; and (2) the assumption of approximately \$65.9 million of liabilities by Pillarstone OP. Pursuant to the Contribution Agreement, Pillarstone became the general partner of Pillarstone OP with an equity ownership interest in Pillarstone OP totaling approximately a 18.6% valued at \$4.1 million as of the date of the agreement.

In connection with the Contribution Agreement, on December 8, 2016, the Company, as the general partner of Pillarstone OP, entered into an Amended and Restated Agreement of Limited Partnership of Pillarstone OP (as amended and restated, the “Amended and Restated Agreement of Limited Partnership”). Pursuant to the Amended and Restated Agreement of Limited Partnership, subject to certain protective rights of the limited partners described below, the general partner has full, exclusive and complete responsibility and discretion in the management and control of Pillarstone OP, including the ability to cause Pillarstone OP to enter into certain major transactions including a merger of Pillarstone OP or a sale of substantially all of the assets of Pillarstone OP. The limited partners have no power to remove the general partner without the general partner's consent. In addition, pursuant to the Amended and Restated Agreement of Limited Partnership, the general partner may not conduct any business without the consent of a majority of the limited partners other than in connection with certain actions described therein. The Company is deemed to exercise significant influence over Pillarstone OP as it has the power to direct the activities that most significantly impact Pillarstone OP's economic performance and the Company's right to receive benefits based on its ownership percentage in Pillarstone OP. Accordingly, the Company accounts for Pillarstone OP as a VIE.

The Amended and Restated Agreement of Limited Partnership designates two classes of units of limited partnership interest in Pillarstone OP: the OP Units and LTIP units. In general, LTIP units are similar to the OP Units and will receive the same quarterly per-unit profit distributions as the OP Units. The rights, privileges, and obligations related to each series of LTIP units will be established at the time the LTIP units are issued. As profits interests, LTIP units initially will not have full parity, on a per-unit basis, with OP Units with respect to liquidating distributions. Upon the occurrence of specified events, LTIP units can over time achieve full parity with the OP Units and therefore accrete to an economic value for the holder equivalent to OP Units. If such parity is achieved, vested LTIP units may be converted on a one-for-one basis into OP Units, which in turn are redeemable by the holder for cash or, at the Company's election, exchangeable for Common Shares on a one-for-one basis.

During the period from December 8, 2016 through December 31, 2016, Pillarstone received a distribution in kind equal to the value of the original investment of \$4.1 million.

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The carrying amounts and classification of certain assets and liabilities for Pillarstone OP in our consolidated balance sheet as of December 31, 2017 and 2016 consists of the following (in thousands):

	December 31,	
	2017	2016
Real estate assets, at cost		
Property	\$83,141	\$80,564
Accumulated depreciation	(2,934 )	(150 )
Total real estate assets	80,207	80,414
Cash and cash equivalents	2,812	1,236
Escrows and acquisition deposits	2,188	2,274
Accrued rents and accounts receivable, net of allowance for doubtful accounts <sup>(1)</sup>	798	213
Receivable due from related party	1,304	2,818
Unamortized lease commissions and deferred legal costs, net	1,265	1,150
Prepaid expenses and other assets	150	134
Total assets	\$88,724	\$88,239
Liabilities		
Notes payable	64,313	65,474
Accounts payable and accrued expenses	3,494	3,481
Payable due to related party	1,005	265
Tenants' security deposits	1,191	996
Total liabilities	\$70,003	\$70,216

<sup>(1)</sup> Excludes approximately \$0.3 million in accounts receivable due from Pillarstone that was eliminated in consolidation as of December 31, 2017 and 2016.

## 6. REAL ESTATE

As of December 31, 2017, Pillarstone OP owned 14 commercial properties in the Dallas and Houston areas comprised of approximately 1.5 million square feet of gross leasable area.

Unaudited pro forma results of operations. Revenue and net income attributable to the Property of \$16.8 million and \$2.7 million, respectively, have been included in our results of operations for the year ended December 31, 2017. The following unaudited pro forma results summarized below reflect our consolidated results of operations as if the Contribution Agreement had occurred on January 1, 2016. The unaudited consolidated pro forma results of operations is not necessarily indicative of what the actual results of operations would have been, assuming the transactions had been completed as set forth above, nor do they purport to represent our results of operations for future periods.

	Year Ended	
	December 31,	
	2017	2016
(in thousands, except per share data)	(Restated)	(Unaudited)
Total property revenues	\$16,768	\$ 15,323
Net income	\$2,447	\$ 2,148
Net income attributable to Common Shareholders	\$215	\$ (19 )

Basic earnings per share:	\$0.53	\$ (0.05	)
Diluted earnings per share:	\$0.07	\$ (0.05	)

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## 7. 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):

	December 31,	
	2017	2016
Tenant receivables	\$680	\$293
Accrued rents and other recoveries	657	45
Allowance for doubtful accounts	(539 )	(125 )
Total	\$798	\$213

## 8. UNAMORTIZED LEASE COMMISSIONS AND DEFERRED LEGAL COSTS, NET

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

	December 31,	
	2017	2016
Leasing commissions	\$1,577	\$1,163
Deferred legal costs	47	—
Total cost	1,624	1,163
Less: leasing commissions accumulated amortization	(350 )	(13 )
Less: deferred legal costs accumulated amortization	(9 )	—
Total cost, net of accumulated amortization	\$1,265	\$1,150

A summary of expected future amortization of deferred costs is as follows (in thousands):

Years Ended December 31,	Leasing Commissions	Deferred Legal Costs	Total
2018	\$ 380	\$ 11	\$391
2019	272	9	281
2020	222	7	229
2021	155	5	160
2022	100	4	104
Thereafter	98	2	100
Total	\$ 1,227	\$ 38	\$1,265

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## 9. FUTURE MINIMUM LEASE INCOME

We lease the majority of our properties under noncancelable operating leases, which provide for minimum base rents plus, in some instances, contingent rents based upon a percentage of the tenants' gross receipts. A summary of minimum future rents to be received (exclusive of renewals, tenant reimbursements and contingent rents) under noncancelable operating leases in existence as of December 31, 2017 is as follows (in thousands):

Years Ended December 31,	Minimum Future Rents
2018	\$ 11,532
2019	8,568
2020	6,839
2021	4,429
2022	2,584
Thereafter	13,160
Total	\$ 47,112

## 10. DEBT

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

Description	December 31,	
	2017	2016
Fixed rate notes		
\$37.0 million 3.76% Note, due December 1, 2020	\$33,148	\$34,166
\$16.5 million 4.97% Note, due September 26, 2023	16,058	16,298
Floating rate notes		
Related party Note, LIBOR plus 1.40% to 1.95%, due December 8, 2018	15,473	15,473
Total notes payable principal	64,679	65,937
Less deferred financing costs, net of accumulated amortization	(366 )	(463 )
Total notes payable	\$64,313	\$65,474

Our mortgage debt was collateralized by 10 operating properties as of December 31, 2017 and 2016 with a combined net book value of \$63.0 million and \$62.9 million, respectively. Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and the assignment of certain rents and leases associated with those properties. Certain other of our loans are subject to customary covenants. As of December 31, 2017, we were in compliance with all loan covenants.

Annual maturities of notes payable as of December 31, 2017 are due during the following years:

Year	Amount Due (in thousands)
2018	\$ 16,817
2019	1,376
2020	31,286
2021	308

2022	323
Thereafter	14,569
Total	\$ 64,679

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## 11. CONVERTIBLE NOTES PAYABLE - RELATED PARTIES

On November 20, 2015, five trustees on our board of trustees loaned \$197,780 to the Company in exchange for convertible notes payable. The convertible notes payable accrue interest at 10% per annum and mature on November 20, 2018. The convertible notes payable can be converted by the noteholders into Common Shares at the rate of \$1.331 per Common Share at any time. After six months, the Company can convert the notes payable into Common Shares. At maturity or when the Company chooses to convert the convertible notes payable into Common Shares, the noteholders have the option to receive cash plus accrued interest or convert the convertible notes payable into Common Shares.

## 12. SHAREHOLDERS' EQUITY

**Operating partnership units.** Substantially all of our business is conducted through Pillarstone OP and we are the sole general partner. As of December 31, 2017, we owned a 18.6% interest in Pillarstone OP. At any time on or after six months following the date of the initial issuance thereof, limited partners in Pillarstone OP holding OP units have the right to convert their OP units for cash, or at our option, Common Shares of Pillarstone. As of December 31, 2017, there were 16,688,167 OP units outstanding.

**Recent developments.** Our common shareholders, Preferred Class A shareholders, and Preferred Class C shareholders approved changes to our declaration of trust, as amended and restated, in March 2016. We presently have authority to issue up to 450,000,000 shares of beneficial interest, \$0.01 par value per share, of which 400,000,000 are classified as Common Shares of beneficial interest, \$0.01 par value per share and 50,000,000 are classified as preferred shares of beneficial interest, \$0.01 par value per share. Of the 50,000,000 preferred shares of beneficial interest, 1,518,000 shares are designated as Preferred Class A Shares and 300,000 shares are designated as Preferred Class C Shares. Previously, we had authority to issue up to 110,000,000 shares of beneficial interest, \$0.01 par value per share, of which 100,000,000 were classified as Common Shares of beneficial interest, \$0.01 par value per share, and 10,000,000 were classified as preferred shares of beneficial interest, \$0.01 par value per share, with 1,518,000 shares designated as Preferred Class A Shares and 300,000 shares designated as Preferred Class C Shares.

**Preferred shares.** The Company has outstanding 95,226 Class A Cumulative Convertible Preferred Shares ("Class A Preferred Shares") that were issued to the public. The Class A Preferred Shares bear a liquidation value of \$10.00 per share. The Class A Preferred Shares are each convertible into 0.046 Common Shares subject to certain formulas. We have the right to redeem the Class A Preferred Shares.

Effective June 30, 2003, we issued 696,078 Class A Preferred Shares valued at approximately \$2.4 million to James C. Mastandrea, our Chairman, Chief Executive Officer and President, and John J. Dee, our Chief Financial Officer and Senior Vice President, pursuant to separate restricted share agreements. Under each restricted share agreement, the restricted shares vest upon the later of the following dates:

- the date our gross assets exceed \$50 million, or

- 50% of the restricted shares on March 4, 2004; 25% of the shares on March 4, 2005 and the remaining 25% of the shares on March 4, 2006.

The Company has not vested any of the above shares. While the Company's gross assets exceed \$50 million, when considering its 18.6% ownership of Pillarstone OP, its effective ownership of gross assets is less than \$50 million.



In conjunction with a one-time incentive exchange offer for Class A Preferred shareholders, Messrs. Mastandrea and Dee exchanged 534,668 of these restricted Class A Preferred Shares into 163,116 restricted Common Shares. The restrictions described above are also applicable to their Common Shares. The remaining 161,410 restricted Class A Preferred Shares held by Messrs. Mastandrea and Dee can each be converted into 0.305 restricted Common Shares. The market value of 161,410 restricted Class A Preferred Shares and 163,116 restricted Common Shares is approximately \$590,000 at December 31, 2017 and there is limited trading volume of the Common Shares on OTC Bulletin Board.

The number of Common Shares and the conversion factor have been revised to reflect the 1-for-75 reverse split of the Common Shares that occurred in July 2006.

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During 2017, no Class A Preferred Shares were converted into Common Shares, and during 2016, 1,600 Class A Preferred Shares were converted into 73 Common Shares.

Effective September 29, 2006, Pillarstone filed articles supplementary to its Declaration of Trust, as amended, restated and supplemented with the State Department of Assessment and Taxation of Maryland designating 300,000 Class C Convertible Preferred Shares ("Class C Preferred Shares"). The Class C Preferred Shares have voting rights equal to the number of Common Shares into which they are convertible. Each Class C Preferred Share is convertible into Common Shares by dividing by the sum of \$10.00 and any accrued but unpaid dividends on the Class C Preferred Shares by the conversion price of \$1.00. The Class C Preferred Shares have a liquidation preference of \$10.00 per share, plus any accrued but unpaid dividends, and can be redeemed by the board of trustees at any time, with notice, at the same price per share.

Effective September 29, 2006, three independent trustees of Pillarstone signed subscription agreements to purchase 125,000 Class C Preferred Shares for an aggregate contribution of \$500,000 to maintain Pillarstone as a corporate shell current in its SEC filings.

In addition, on September 29, 2006, Mr. Mastandrea signed a subscription agreement to purchase 44,444 restricted shares of Class C Preferred Shares. The consideration for the purchase was Mr. Mastandrea's services as an officer of Pillarstone for the period beginning September 29, 2006 and ending September 29, 2008. The Class C Preferred Shares are subject to forfeiture and are restricted from being sold by Mr. Mastandrea until the latest to occur of a public offering by Pillarstone sufficient to liquidate the Class C Preferred Shares, an exchange of Pillarstone's existing shares for new shares, or September 29, 2008. These shares were fully amortized by the original date in 2008. Each of the trustees of Pillarstone signed a restricted share agreement with Pillarstone, dated September 29, 2006, to receive a total of 12,500 restricted Class C Preferred Shares in lieu of receiving fees in cash for service as a trustee for the two years ending September 29, 2008. The restrictions on the Class C Preferred Shares were to be removed upon the latest to occur of a public offering by Pillarstone sufficient to liquidate the Class C Preferred Shares, an exchange of Pillarstone's existing shares for new shares, or September 29, 2008. These shares were fully amortized by the original date in 2008.

Shares held in treasury. On October 1, 2003, we completed the sale of our 92.9% general partnership interest in our four commercial properties. A portion of the proceeds from the sale was paid in 38,130 of our Common Shares at an average closing price for the 30 calendar days prior to June 27, 2003 of \$21.00 or approximately \$801,000. These shares are recorded at cost in the accompanying consolidated balance sheets under treasury shares.

Restricted Common Shares. The following table summarizes the activity of our unvested restricted Common Shares for the years ended December 31, 2017 and 2016:

	Unvested Restricted Common Shares	Weighted-Average Number of Grant-Date Shares Fair Value
Unvested at December 31, 2015	168,449	\$11.44
Vested	—	—
Unvested at December 31, 2016	168,449	\$11.44
Vested	—	—

Unvested at December 31, 2017 168,449 \$11.44

In the above table, 163,116 restricted shares vest upon meeting performance goals as discussed under “Preferred Shares.” Since the grant date, we have determined that meeting these performance goals is not probable and no compensation expense has been recognized related to this grant. The grant date fair value of \$1,847,000 would be recognized at the point we deem it probable that we would meet the performance goals. The balance of 5,333 restricted shares had grant date fair values totaling \$79,000, which was recognized in prior periods though the restrictions remain on the shares.

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On June 30, 2003, our shareholders approved the issuance of an agreement to issue additional Common Shares to Paragon Real Estate Development, LLC of which Mr. Mastandrea is the managing member, and Mr. Dee is a member. In September 2006, Pillarstone amended this agreement to include each of the trustees to the agreement so that if a trustee brings a new transaction to Pillarstone, he would receive additional Common Shares of Pillarstone in accordance with a formula in the agreement. In January 2016, the non-employee trustees and Mr. Mastandrea agreed to make this agreement for only non-employee trustees. The agreement is intended to serve as an incentive for our trustees to increase the asset base, net operating income, funds from operations, and share value of Pillarstone. The exact number of Common Shares that would be issued will be calculated in accordance with a formula in the agreement based on future acquisition, development or redevelopment transactions. Any of these transactions would be subject to approval by the members of our board of trustees who are not receiving the additional Common Shares. We would issue our Common Shares only upon the closing of a transaction. The maximum number of Common Shares a trustee may receive under the additional contribution agreement is limited to a total value of \$26 million based on the average closing price of our Common Shares for 30 calendar days preceding the closing of any acquisition transaction. The Common Shares will be restricted until we achieve the five years-year pro forma income target for the acquisition, as approved by the board of trustees, and an increase of 5% in Pillarstone's net operating income and funds from operations. The restricted shares would vest immediately upon any "shift in ownership," as defined in the agreement.

Options. On November 16, 1998, we adopted the 1998 Share Option Plan. In 2004 the board of trustees unanimously recommended and the shareholders approved amendments to our 1998 Share Option Plan to increase the number of shares available for grant from 42,222 to 46,666 and to conform with current tax regulations ("2004 Plan"). The 2004 Plan expired in 2014; the one outstanding grant of 667 options remains effective until 90 days after the term ends of the individual trustee.

The following table summarizes the activity for outstanding stock options:

	Options Outstanding		Weighted-Average Remaining	
	Weighted-Average		Contractual Term	
	Number of Shares	Exercise Price	(in years)	Aggregate Intrinsic Value <sup>(1)</sup>
Balance at December 31, 2015	667	\$ 33.75	1.3	\$ —
Granted	—	—		
Exercised	—	—		
Canceled / forfeited / expired	—	\$ —		
Balance at December 31, 2016	667	\$ 33.75	1.25	\$ —
Granted	—	—		
Exercised	—	—		
Canceled / forfeited / expired	—	—		
Balance at December 31, 2017	667	\$ 33.75	1.25	\$ —
Vested and exercisable as of December 31, 2017	—	\$ —	—	\$ —

<sup>(1)</sup> The aggregate intrinsic value is calculated as approximately the difference between the weighted average exercise price of the underlying awards and the Company's estimated current fair market value at December 31, 2017.

Because the weighted average exercise price exceeds fair market value at December 31, 2017, there is no aggregate intrinsic value for the options.

The Company did not recognize any stock-based compensation expense during the years ending December 31, 2017 and 2016. As of December 31, 2017 and 2016, there was no remaining unrecognized cost related to stock options.

### 13. INCENTIVE EQUITY PLAN

At the 2016 Annual Meeting of Shareholders, our shareholders approved the 2016 Equity Plan (“2016 Plan”).

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The 2016 Plan provides that awards may be made in Common Shares of the Company or units in the Company's operating partnership, which may be converted into Common Shares. Subject to adjustment as provided by the terms of the 2016 Plan, the maximum aggregate number of Common Shares with respect to which awards may be granted under the 2016 Plan will be increased based on future issuances of Common Shares and units of the operating partnership, including issuances pursuant to the 2016 Plan, so that at any time the maximum number of shares that may be issued under the 2016 Plan shall equal 12.5% of the aggregate number of Common Shares and units of the operating partnership issued and outstanding (other than treasury shares and/or units issued to or held by the Company).

The Management, Organization and Compensation Committee (the "Committee") administers the 2016 Plan, except with respect to awards to non-employee trustees, for which the 2016 Plan is administered by the board of trustees. Subject to the terms of the 2016 Plan, the Committee is authorized to select participants, determine the type and number of awards to be granted, determine and later amend (subject to certain limitations) the terms and conditions of any award, interpret and specify the rules and regulations relating to the 2016 Plan, and make all other determinations which may be necessary or desirable for the administration of the 2016 Plan. The 2016 Plan includes the types of awards for grants and the types of financial performance measures.

As of December 31, 2017, the maximum number of Common Shares or OP Units available to be granted is 2,356,426 and no grants have been issued under the 2016 Plan.

#### 14. EARNINGS (LOSS) PER SHARE

The Company applies the guidance of ASC 260, "Earnings Per Share," for all periods presented herein. Net earnings (loss) per weighted average Common Share outstanding, basic and diluted, is computed based on the weighted average number of Common Shares outstanding for the period. The following table shows the weighted average number of Common Shares outstanding and reconciles the numerator and denominator of both earnings (loss) per Common Share calculations for the years ended December 31, 2017 and 2016.

For the year ended December 31, 2016, Class A Preferred Shares and Class C Preferred Shares were not included in net income (loss) per weighted average Common Share outstanding-diluted as they would be anti-dilutive. During the years ended December 31, 2017 and 2016, the Company had \$197,780 of convertible notes payable as discussed in Note 11. The convertible notes payable were not included in the computation of diluted earnings per share because the effect of conversion would be anti-dilutive.

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December 31, 2017

	For the year ended December 31, 2017 2016 (Restated)	
(in thousands, except share and per share data)		
Numerator:		
Net income (loss) available to Common Shareholders	\$215	\$(465 )
Dilutive effect of interest from convertible notes payable	—	—
Net income (loss) available to Common Shareholders with assumed conversion	\$215	\$(465 )
Denominator:		
Weighted average number of Common Shares - basic	405,169	405,169
Effect of dilutive securities:		
Assumed conversion of Preferred A Shares	53,610	—
Assumed conversion of Preferred C Shares	2,444,440	
Assumed conversion of convertible notes payable	—	—
Weighted average number of Common Shares - dilutive	2,903,219	2,405,169
Earnings (Loss) Per Share:		
Basic income (loss) per Common Share:		
Net income (loss) available to Common Shareholders	\$0.53	\$(1.15 )
Diluted income (loss) per Common Share:		
Net income (loss) available to Common Shareholders	\$0.07	\$(1.15 )

## 15. DIVIDENDS AND DISTRIBUTIONS

No cash distributions were declared during 2017 and 2016 with respect to the common or preferred shares.

## 16. INCOME TAXES

For financial reporting purposes, income before federal income taxes attributable to Common Shareholders includes the following components (in thousands):

	For the year ended December 31, 2017 2016	
Net income (loss)	\$2,447	\$(262 )
Less: noncontrolling interest in subsidiary	2,232	203
Net income (loss) attributable to Common Shareholders	\$215	\$(465 )

The Company follows the provisions of ASC Topic 740 which provides for recognition of deferred tax assets and liabilities for deductible temporary timing differences, net of a valuation allowance for any asset for which it is more-likely-than-not will not be realized in the Company's tax return.

Income tax provisions were \$88,000 and \$0 for the years ended December 31, 2017 and 2016, respectively.

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The income tax expense (benefit) included in the consolidated statements of operations for the years ended December 31, 2017 and 2016 was comprised of the following components (in thousands):

	For the year ended December 31, 2017 2016	
Federal:		
Deferred	\$ 46	\$ 8
Change in deferred rate from 34% to 21% for 2017 and 40% to 34% for 2016	331	156
Change in valuation allowance	(377)	(164)
	\$ —	\$ —
State:		
Current	\$ 88	\$ —
	\$ 88	\$ —
Total tax expense	\$ 88	\$ —

The items accounting for the difference between income taxes computed at the Federal statutory rate and our effective rate were as follows:

	For the year ended December 31, 2017 2016			
Federal statutory rate	34	%	34	%
Effect of:				
Noncontrolling interest	(31)	%	26	%
State income tax benefit, net of Federal tax effect	4	%	—	%
Change in deferred valuations	—	%	(63)	%
Change in deferred rate from 34% to 21% for 2017 and 40% to 34% for 2016	12	%	(59)	%
Change in valuation allowance	(15)	%	62	%
Effective rate	4	%	—	%

Deferred tax assets and liabilities consist of the following (in thousands):

	At December 31, 2017 2016	
Deferred tax assets and liabilities:		
Net operating loss carry-forwards	\$ 164	\$ 250
Depreciation and amortization	209	449
Acquisition and organizational costs	72	125
Accruals and others	45	43
Total deferred tax assets and liabilities	490	867

Valuation allowance	(490 )	(867 )
Deferred tax assets and liabilities net of valuation allowance	\$—	\$—

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Realization of deferred tax assets is dependent upon generation of sufficient future taxable income and the effects of other loss utilization provisions. Management has determined that sufficient uncertainty exists regarding the realizability of the net deferred tax assets and has provided a full valuation allowance of \$490,000 and \$867,000, against the net deferred tax assets of the Company as of December 31, 2017 and 2016, respectively. A valuation allowance is considered to be a significant estimate that may change in the near term.

As of December 31, 2017, the Company had net operating loss carry-forwards of \$777,000 available to be carried to future periods.

The loss carry-forwards expire as follows (in thousands):

Year Expiring	Net Operating Loss
2026	\$ 41
2027	114
2028	60
2029	81
2030	52
2031	39
2032	61
2033	54
2034	57
2035	67
2036	108
2037	43
Total loss carry-forwards	\$ 777

## 17. RELATED PARTY TRANSACTIONS

On December 8, 2016, the Company entered into the Contribution Agreement with Pillarstone OP and Whitestone OP, both of which are related parties, resulting in the contribution of an equity ownership interest in Pillarstone OP to the Company valued at \$4,121,312 and representing approximately 18.6% of the outstanding equity in Pillarstone OP. The terms of the Contribution Agreement were determined through arm's-length negotiations and were recommended to the board of trustees by a special committee of the board of trustees consisting solely of disinterested trustees of the Company and approved by the full board.

Pursuant to the Contribution Agreement, the Company has agreed to file with the SEC on or prior to June 8, 2018, a shelf registration statement to register for sale under the Securities Act, the issuance of the Common Shares of beneficial interest in the Company (the "Common Shares") that may be issued upon redemption of the OP Units issued pursuant to each of the Contribution Agreement and the OP Unit Purchase Agreement (as defined below) and the offer and resale of such Common Shares by the holders thereof. In addition, pursuant to the Contribution Agreement, in the event of a Change of Control (as defined therein) of Whitestone, Pillarstone OP shall have the right, but not the obligation, to repurchase the OP Units issued thereunder from Whitestone OP at their initial issue price of \$1.331 per OP Unit.

In connection with the Contribution Agreement, on December 8, 2016, the Company and Pillarstone OP entered into an OP Unit Purchase Agreement (the “OP Unit Purchase Agreement”) with Whitestone OP pursuant to which Pillarstone OP may require Whitestone OP to purchase up to an aggregate of \$3.0 million of OP Units at a price of \$1.331 per OP Unit over the two-year term of the OP Unit Purchase Agreement on the terms set forth therein. In addition, pursuant to the OP Unit Purchase Agreement, in the event of a Change of Control (as defined therein) of Whitestone, Pillarstone OP shall have the right, but not the obligation, to repurchase the OP Units issued thereunder from Whitestone OP at their initial issue price of \$1.331 per OP Unit. Pillarstone and Whitestone agreed to extend the filing of the shelf registration statement to a date not later than June 8, 2019, or the date that the Company closes a public equity offering.

In connection with the Contribution Agreement, on December 8, 2016, the Company and Pillarstone OP entered into a Tax Protection Agreement (the “Tax Protection Agreement”) with Whitestone OP pursuant to which Pillarstone OP agreed to indemnify Whitestone OP for certain tax liabilities resulting from its recognition of income or gain prior to December 8, 2021 if such liabilities result from a transaction involving a direct or indirect taxable disposition of all or a portion of the Property or if Pillarstone OP fails to maintain and allocate to Whitestone OP for taxation purposes minimum levels of liabilities as specified in the Tax Protection Agreement, the result of which causes such recognition of income or gain and Whitestone incurs taxes that must be paid to maintain its REIT status for federal tax purposes.

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During the ordinary course of business, we have transactions with Whitestone that include, but are not limited to, rental income, interest expense, general and administrative costs, commissions, management and asset management fees, and property expenses.

In connection with the Contribution Agreement, on December 8, 2016, the Company and Pillarstone OP entered into a Management Agreement (collectively, the “Management Agreements”) with Whitestone TRS, Inc., a subsidiary of Whitestone (“Whitestone TRS”). Pursuant to the Management Agreements with respect to each property, other than Uptown Tower, Whitestone TRS agreed to provide certain property management, leasing and day-to-day advisory and administrative services to such properties in exchange for (1) a monthly property management fee equal to 5.0% of the monthly revenues of each property and (2) a monthly asset management fee equal to 0.125% of GAV (as defined in each Management Agreement as, generally, the purchase price of the respective property based upon the purchase price allocations determined pursuant to the Contribution Agreement, excluding all indebtedness, liabilities or claims of any nature) of such property. Pursuant to the Management Agreement with respect to Uptown Tower, Whitestone TRS agreed to provide certain property management, leasing and day-to-day advisory and administrative services in exchange for (1) a monthly property management fee equal to 3.0% of the monthly revenues of Uptown Tower and (y) a monthly asset management fee equal to 0.125% of GAV of Uptown Tower.

The following table presents the revenue and expenses with Whitestone included in our consolidated statements of operations for the years ended December 31, 2017 and 2016 (in thousands):

		Year Ended December 31,	
	Location of Revenue (Expense)	2017	2016
Rent	Rental revenues	\$782	\$58
Property management fees	Property operation and maintenance	\$(732)	\$(57)
Asset management fees	Property operation and maintenance	\$(264)	\$(17)
Interest expense	Interest expense	\$(528)	\$(26)

Receivables due from related parties consisted of the following as of December 31, 2017 and 2016 (in thousands):

	Year Ended December 31,	
	2017	2016
Construction in process <sup>(1)</sup>	\$45	\$1,439
Tenant receivables and other receivables	1,259	1,379
Total	\$1,304	\$2,818

Amount relates to future tenant and building improvement expenditures implicit within the Contribution Agreement to be paid by Whitestone and capitalized by the Company in subsequent periods when placed in service.

Payables due to related parties consisted of the following as of December 31, 2017 and 2016 (in thousands):

	Year Ended December 31,	
	2017	2016
Payables due to related party	\$1,005	\$265

Total \$1,005 \$265

## 18. COMMITMENTS AND CONTINGENCIES

### Employment Agreements

On April 3, 2006, the board of trustees authorized modifications to Mr. Mastandrea's employment agreement. The modification agreement allows Mr. Mastandrea to devote time to other business and personal investments while performing his

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PILLARSTONE CAPITAL REIT  
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duties for Pillarstone. The original employment agreement with Mr. Mastandrea provides for an annual salary of \$60,000 effective as of March 4, 2003. The initial term of Mr. Mastandrea's employment is for two years and may be extended for terms of one year. Mr. Mastandrea's base annual salary may be adjusted from time to time, except that the adjustment may not be lower than the preceding year's base salary. The employment agreement provides that Mr. Mastandrea will be entitled to base salary and bonus at the rate in effect before any termination for a period of three years in the event that his employment is terminated without cause by us or for good reason by Mr. Mastandrea. Effective September 29, 2006, in lieu of an annual salary of \$100,000 and to conserve cash, Mr. Mastandrea agreed to receive 44,444 Class C Preferred Shares for his services as an officer of Pillarstone through September 29, 2008. The shares were fully amortized by the original date in 2008.

Mr. Dee's employment agreement was also modified on April 3, 2006 in a similar way to Mr. Mastandrea's employment agreement as explained above, except Mr. Dee does not receive any Class C Preferred Shares for his services as an officer of Pillarstone. Mr. Dee's base annual salary may be adjusted from time to time, except that the adjustment may not be lower than the preceding year's base salary. The employment agreement provides that Mr. Dee will be entitled to base salary and bonus at the rate in effect before any termination for a period of three years in the event that his employment is terminated without cause by us or for good reason by Mr. Dee. On September 29, 2006, the board of trustees approved compensation to Mr. Dee of \$125 per hour, up to a maximum of \$5,000 per month. However, Mr. Dee has forgone receiving any cash compensation under this arrangement in order to preserve the Company's cash.

#### 19. SEGMENT INFORMATION

Our management historically has not differentiated by property types and therefore does not present segment information.

PILLARSTONE CAPITAL REIT

Schedule II - Valuation and Qualifying Accounts

December 31, 2017

Description	(in thousands)			
	Balance at Beginning of Year	Charged to Costs and Expense	Deductions from Reserves	Balance at End of Year
Deferred tax asset allowance:				
Year ended December 31, 2017	\$867	\$ (377 )	\$ —	\$ 490
Year ended December 31, 2016	1,031	(164 )	—	867
Year ended December 31, 2015	1,004	27	—	1,031
Allowance for doubtful accounts:				
Year ended December 31, 2017	\$125	412	2	\$ 539
Year ended December 31, 2016	—	127	(2 )	125
Year ended December 31, 2015	—	—	—	—

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## PILLARSTONE CAPITAL REIT

## Schedule III - Real Estate and Accumulated Depreciation

December 31, 2017

(Restated)

Property Name	Initial Cost (in thousands)		Costs Capitalized Subsequent to Acquisition (in thousands)		Gross Amount at which Carried at End of Period (in thousands) <sup>(1) (2)</sup>		
	Land	Building and Improvements	Improvements (net)	Carrying Costs	Land	Building and Improvements	Total
Pillarstone OP Properties:							
9101 LBJ Freeway	\$3,590	\$ 2,811	\$ 82	\$ —	—\$3,590	\$ 2,893	\$6,483
Corporate Park Northwest	1,326	5,009	189	—	1,326	5,198	6,524
Corporate Park West	2,772	10,144	501	—	2,772	10,645	13,417
Corporate Park Woodland	1,144	4,764	65	—	1,144	4,829	5,973
Corporate Park Woodland II	2,730	24	—	—	2,730	24	2,754
Dairy Ashford	325	920	2	—	325	922	1,247
Holly Hall Industrial Park	2,730	1,768	1	—	2,730	1,769	4,499
Holly Knight	807	1,231	110	—	807	1,341	2,148
Interstate 10 Warehouse	2,915	765	110	—	2,915	875	3,790
Main Park	1,176	1,626	432	—	1,176	2,058	3,234
Plaza Park	1,527	1,660	50	—	1,527	1,710	3,237
Uptown Tower	7,304	15,493	690	—	7,304	16,183	23,487
Westbelt Plaza	1,171	1,393	81	—	1,171	1,474	2,645
Westgate Service Center	937	2,502	267	—	937	2,769	3,706
Total - Pillarstone OP Properties	\$30,454	\$ 50,110	\$ 2,580	\$ —	—\$30,454	\$ 52,690	\$83,144

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## PILLARSTONE CAPITAL REIT

## Schedule III - Real Estate and Accumulated Depreciation

December 31, 2017

(Restated)

Property Name	Encumbrances	Accumulated Depreciation (in thousands)	Date Acquired	Depreciation Life
Pillarstone OP Properties:				
9101 LBJ Freeway		\$ 213	12/8/2016	5-39 years
Corporate Park Northwest		416	12/8/2016	5-39 years
Corporate Park West	(3)	333	12/8/2016	5-39 years
Corporate Park Woodland	(3)	194	12/8/2016	5-39 years
Corporate Park Woodland II		3	12/8/2016	5-39 years
Dairy Ashford	(3)	26	12/8/2016	5-39 years
Holly Hall Industrial Park	(3)	95	12/8/2016	5-39 years
Holly Knight		48	12/8/2016	5-39 years
Interstate 10 Warehouse	(3)	48	12/8/2016	5-39 years
Main Park	(3)	155	12/8/2016	5-39 years
Plaza Park	(3)	152	12/8/2016	5-39 years
Uptown Tower	(4)	913	12/8/2016	5-39 years
Westbelt Plaza	(3)	163	12/8/2016	5-39 years
Westgate Service Center	(3)	175	12/8/2016	5-39 years
Total - Pillarstone OP Properties		\$ 2,934		

(1) Reconciliations of total real estate carrying value for the years ended December 31, 2017 and 2016 follows:

	(in thousands)	
	2017	2016
Balance at beginning of period	\$80,564	\$—
Additions during the period:		
Acquisitions	—	80,564
Improvements	2,641	—
	2,641	80,564
Deductions - cost of real estate sold or retired	(61)	—
Balance at close of period	\$83,144	\$80,564

(2) The aggregate cost of real estate (in thousands) for federal income tax purposes is \$84,646.

(3) These properties secure a \$37.0 million mortgage note.

(4) This property secures a \$16.5 million mortgage note.