STRATUS PROPERTIES INC
Form 10-K
June 24, 2009

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

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

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: 0-19989

Stratus Properties Inc.
(Exact name of registrant as specified in its charter)

Delaware	72-1211572
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

98 San Jacinto Blvd., Suite 220 Austin, Texas	78701
(Address of principal executive offices)	(Zip Code)

(512) 478-5788
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	NASDAQ
Preferred Stock Purchase Rights	NASDAQ

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act 0 Yes R 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. 0 Yes R 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. 0 Yes R No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the 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. 0

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). 0 Yes 0 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one): 0 Large accelerated filer R Accelerated filer 0 Non-accelerated filer 0 Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). 0 Yes R No

The aggregate market value of common stock held by non-affiliates of the registrant was approximately $31.3 million on May 31, 2009, and approximately $85.1 million on June 30, 2008.

Common stock issued and outstanding was 7,435,133 shares on May 31, 2009, and 7,636,341 shares on June 30, 2008.

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PART I

Item 1. Business

Except as otherwise described herein or the context otherwise requires, all references to “Stratus,” “we,” “us,” and “our” in this Form 10-K refer to Stratus Properties Inc. and all entities owned or controlled by Stratus Properties Inc. All of our periodic report filings with the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available, free of charge, through our web site, www.stratusproperties.com, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports. These reports and amendments are available through our web site as soon as reasonably practicable after we electronically file or furnish such material to the SEC. All subsequent references to “Notes” in this report refer to the Notes to Consolidated Financial Statements located in Item 8. of this Form 10-K.

Overview

We are engaged in the acquisition, development, management, operations and sale of commercial, multi-family and residential real estate properties located primarily in the Austin, Texas area.

Our principal real estate holdings are in southwest Austin, Texas. We also own undeveloped commercial property in San Antonio, Texas. The number of developed lots, developed or under development acreage and undeveloped acreage as of December 31, 2008, that comprise our principal properties are presented in the following table.

		Acreage							
		Developed or Under Development				Undeveloped			
	Developed Lots	Single Family	Multi-family	Commercial	Total	Single Family	Commercial	Total	Total Acreage
Austin									
Barton Creek	125	358	249	376	983	510	20	530	1,513
Lantana	-	-	-	-	-	-	223	223	223
Circle C	98a	148a	-	265	413	-	122	122	535
W Austin Hotel & Residences	-	-	-	2b	2	-	-	-	2
San Antonio									
Camino Real	-	-	-	-	-	-	2	2	2
Total	223	506	249	643	1,398	510	367	877	2,275

a. Relates to Meridian, an 800-lot residential development.
b. Represents a city block in downtown Austin planned for a mixture of hotel, residential, retail, office and entertainment uses.

Our other Austin holdings at December 31, 2008, consisted of two 75,000-square-foot office buildings at 7500 Rialto Boulevard (7500 Rialto) located in our Lantana development, a 22,000-square-foot retail complex representing phase one of Barton Creek Village and two retail buildings totaling 21,000 square feet at the 5700 Slaughter project in Circle C.

For information about our operating segments see “Results of Operations” within Items 7. and 7A. and Note 14.

Company Strategies and Development Activities

Our overall strategy is to enhance the value of our properties by securing and maintaining development entitlements and developing and building real estate projects on these properties for sale or investment. We also continue to investigate and pursue opportunities for new projects that offer the possibility of acceptable returns and risk. As a result of the settlement of certain development-related lawsuits and an increasing level of cooperation with the City of Austin (the City) regarding the development of our properties, we substantially increased our development activities and expenditures during the last five years (see discussion below), which has resulted in our debt increasing to $63.4 million at December 31, 2008. We also had cash, cash equivalents and investments in U.S. treasury securities of $32.5 million at December 31, 2008. We have funded our development activities primarily through sales proceeds, $40.0 million of unsecured term loans and our

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expanded credit facility (see "Credit Facility and Other Financing Arrangements" below and Note 9), which was established as a result of the financing relationship we have built with Comerica Bank (Comerica) over the past several years. In August 2002, the City granted final approval of a development agreement (Circle C settlement) and permanent zoning for our real estate located within the Circle C community, thereby establishing all essential municipal development regulations applicable to our Circle C properties for 30 years (see "Development and Other Activities" within Items 7. and 7A. and Note 13). The credit facility and other sources of financing have increased our financial flexibility and, together with the Circle C settlement, have allowed us to focus our efforts on developing our properties, acquiring other properties and increasing shareholder value. In addition, we continue to pursue additional development opportunities, and currently believe we can obtain bank financing necessary for developing our properties, although our ability to obtain bank financing in the future may be impacted by the current United States (U.S.) economic conditions.

Our progress towards accomplishing these goals includes the following:

- Over the past several years we have successfully permitted and developed significant projects in our Barton Creek and Lantana project areas.

Barton Creek

Calera. In 2002, we secured subdivision plat approval for a new residential subdivision called Calera, which consists of 155 lots. During 2004, we began construction of 16 courtyard homes at Calera Court, the 16-acre initial phase of the Calera subdivision. The second phase of Calera, Calera Drive, consisting of 53 single-family lots, many of which adjoin Fazio Canyons Golf Course, received final plat and construction permit approval in 2005. In the third quarter of 2005, development of these lots was completed and the initial lots were sold. As of December 31, 2008, four courtyard homes at Calera Court and eight lots at Calera Drive remained unsold. Construction of the final phase, known as Verano Drive, began in the first quarter of 2007 and was completed in July 2008. Verano Drive includes 71 single-family lots, three of which were sold in July 2008.

Amarra Drive. During 2007, we completed development of Amarra Drive Phase I, the initial phase of the Amarra Drive subdivision. Amarra Drive Phase I includes eight lots, one of which was sold in September 2007, with sizes ranging from approximately one to four acres, some of which are course-side lots on the Fazio Canyons Golf Course and others are secluded lots adjacent to the Nature Conservancy of Texas. In January 2008, we commenced development of Amarra Drive Phase II, which consists of 35 lots on 51 acres and two townhome tracts on 31 acres. Development was substantially completed in October 2008.

Mirador and Escala Drive. We completed construction of Mirador, a subdivision within the Barton Creek community adjoining the Escala Drive subdivision. We developed 34 estate lots in the Mirador subdivision, with each lot averaging approximately 3.5 acres in size, and have sold 32 of these lots. As of December 31, 2008, we owned two Mirador estate lots. By the end of 2006, we had sold all of the 54 lots at Escala Drive in the Barton Creek community.

Wimberly Lane. During 1999, we completed the development of 75 residential lots at the Wimberly Lane subdivision at Barton Creek, all of which were sold by the end of 2003. During 2004, we completed the development of 47 lots in the second phase of Wimberly Lane (Wimberly Lane Phase II), and we also entered into a contract with a national homebuilder to sell 41 of these Wimberly Lane Phase II lots. We sold the last homebuilder lot in January 2008 and have one Wimberly Lane lot remaining for sale.

Barton Creek Village. In the second quarter of 2007, we completed the first phase of Barton Creek Village, which includes a 22,000-square-foot retail complex. In July 2007, we began construction of a 3,300-square-foot bank building within this retail complex, and it was completed in early 2008. As of December 31, 2008, the first retail complex was 71 percent leased and the bank building is leased through 2022. Construction of the second retail complex is expected to begin during 2010.

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Lantana

Lantana is a partially developed, mixed-use real-estate development project. As of December 31, 2008, we had remaining entitlements for approximately 1.0 million square feet of office and retail use on 223 acres. Regional utility and road infrastructure is in place with capacity to serve Lantana at full build-out permitted under our existing entitlements.

In 2006, we sold 7000 West for $22.3 million (see "Discontinued Operations" below and Note 12) and a 58-acre tract at Lantana to Advanced Micro Devices, Inc. (NYSE: AMD) for $21.2 million. As demand for office space within Lantana increased, we constructed a second 75,000-square-foot office building at 7500 Rialto Boulevard, which was completed in September 2006. As of December 31, 2008, occupancy was 97 percent for the first Rialto Boulevard office building and 100 percent for the second office building.

- In December 2006, we purchased a city block in downtown Austin, Texas to develop as a multi-use property.

The W Austin Hotel & Residences

In December 2006, we acquired a city block in downtown Austin for $15.1 million. The project, known as the W Austin Hotel & Residences project, is planned for a mixture of hotel, residential, retail, office and entertainment uses on approximately two acres. We have executed agreements with Starwood Hotels & Resorts Worldwide, Inc. for the development of a W Hotel & Residences on the site. Effective May 1, 2008, we entered into a joint venture with Canyon-Johnson Urban Fund II, L.P., (Canyon-Johnson) for the development of the W Austin Hotel & Residences project (see Note 6). At December 31, 2008, we had $2.1 million of borrowings outstanding under the W Austin Hotel & Residences project construction loan and total remaining commitments available of approximately $163 million (see Note 9). Construction of the $300 million project commenced in the second quarter of 2008 and is proceeding as scheduled. See Note 15 for additional discussion of Corus Bank, N.A. (Corus), the bank providing the construction loan.

- We have made significant progress in obtaining the permitting necessary to pursue development of additional Austin-area properties.

Circle C Community

We obtained permits and approvals necessary to develop 1.16 million square feet of commercial space, 504 multi-family units and 830 single-family residential lots. The Circle C settlement, effective August 2002, firmly established all essential municipal development regulations applicable to our Circle C properties for 30 years. The City also provided us $15 million of cash incentives in connection with our future development of our Circle C and other Austin-area properties. These incentives, which are in the form of Credit Bank capacity, can be used for City fees and for reimbursement of certain infrastructure costs. Annually, we may elect to sell up to $1.5 million of the incentives to other developers for their use in paying City fees related to their projects. As of December 31, 2008, we have permanently used $8.2 million of our City-based incentives including cumulative sales of $4.1 million to other developers, and we also have $2.8 million in Credit Bank capacity in use as temporary fiscal deposits. At December 31, 2008, unencumbered Credit Bank capacity was $4.0 million.

We are developing the Circle C community based on the entitlements secured in our Circle C settlement with the City, as amended in 2004. In 2005, we commenced the first phase of construction and contracted to sell a total of 494 of a total 800 lots in our Meridian project to three national homebuilders in four phases. Sales for each of the four phases commence upon substantial completion of development for that phase, and continue every quarter until all of the lots have been sold. The first and second phases each consisted of 134 lots. The first phase was substantially completed at the end of 2005. Development of the second phase was substantially completed in March 2006. Development of the 108-lot third phase of Meridian was completed in September 2007. The 118-lot fourth phase commenced in early 2008 and was completed in June 2008.

In 2006, we signed another contract with a national homebuilder for 42 additional lots. Development of those lots commenced in April 2007 and substantial completion occurred in April 2008. Construction of the final phase of Meridian, which consists of 57 one-acre lots, is expected to commence in 2010.

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In addition, several retail sites at the Circle C community received final City approvals and are being developed. In the third quarter of 2008, we completed the construction of two retail buildings totaling 21,000 square feet at the 5700 Slaughter project. This retail project also includes a 4,000-square-foot building on an existing ground lease. Leasing for the two buildings is under way with 22 percent of the 21,000-square-foot retail complex leased as of December 31, 2008, and the initial tenants have opened for business. We expect the 21,000-square-foot retail complex to be fully leased by the end of 2009.

The Circle C community also includes Parkside Village, an 80,000-square-foot planned retail project. The project will be developed in two phases. The first phase will consist of a 34,000-square-foot building to accommodate a full-service restaurant and theater. The second phase will consist of three tilt-wall retail buildings at 14,775 square feet, 8,075 square feet and 7,600 square feet, and two pads available for ground leases. We are pursuing final permits and entitlements to position the project for commencement of construction when appropriate.

Escarpment Village, a 168,000-square-foot retail project anchored by a grocery store, opened in May 2006. On October 12, 2007, we sold Escarpment Village for $46.5 million, before closing costs and other adjustments (see "Discontinued Operations" below and Note 12).

- We believe that we have the potential right to receive approximately $13.8 million of future reimbursements associated with previously incurred Barton Creek utility infrastructure development costs.

At December 31, 2008, we had approximately $4.1 million of expected future reimbursements of previously incurred costs recorded as a component of "Real estate, commercial leasing assets and facilities, net" on our balance sheet. The remaining potential future reimbursements are not recorded on our balance sheet because they relate to costs incurred prior to the 1995 formation of the Barton Creek Municipal Utility District (MUD). Since these costs pre-date the formation of the MUDs, there is less certainty in their potential reimbursement. Costs incurred after the 1995 formation of the MUDs were capitalized into property costs and subsequently expensed through cost of sales as properties sold. A significant portion of the substantial additional costs which we will incur in the future as our development activities at Barton Creek continue, is expected to be eligible for reimbursement. We received total infrastructure reimbursements, comprised of Barton Creek MUD reimbursements, of $7.2 million during 2008, $4.8 million during 2007 and $1.6 million during 2006.

- We completed the development and related sale of lots for a project in Plano, Texas.

Deerfield

In January 2004, we acquired the Deerfield property in Plano, Texas, for $7.0 million. The property was zoned and subject to a preliminary subdivision plan for 234 residential lots. We executed agreements with a national homebuilder, whereby the homebuilder paid us $1.4 million for an option to purchase all 234 lots over 36 monthly take-downs. The net purchase price for each of the 234 lots was $61,500, subject to certain terms and conditions. The $1.4 million non-refundable option payment was applied against subsequent purchases of lots by the homebuilder after certain thresholds were achieved and was recognized by us as income as lots were sold. In October 2005, we executed a revised agreement with the homebuilder, increasing the lot sizes and average purchase price to $67,150 based on a new total of 224 lots. In January 2008, we sold the remaining lots.

- We formed a joint venture in November 2005 to purchase and develop a multi-use property in Austin, Texas.

Crestview Station

In November 2005, we formed a joint venture partnership with Trammell Crow to acquire an approximate 74-acre tract at the intersection of Airport Boulevard and Lamar Boulevard in Austin, Texas for $7.7 million. The property, known as Crestview Station, is a single-family, multi-family, retail and office development, which is located on the future commuter rail line approved by City voters. With Trammel Crow, we have completed environmental remediation, which the State of Texas certified as complete in September 2007, and permitting the property. Infrastructure development of Crestview Station is progressing. The initial phase of utility and roadway infrastructure is under construction and expected to be completed by the end of 2009. Crestview Station sold substantially all of its multi-family and commercial properties in 2007. The joint

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venture retained the single family component of Crestview Station and two commercial sites, one of which was sold in the first quarter of 2008. The joint venture is currently processing permits to develop the residential portion of Crestview Station as a 450-unit transit-oriented neighborhood. At December 31, 2008, our investment in the Crestview Station project totaled $2.3 million and the joint venture partnership had $9.1 million of outstanding debt, of which we guarantee $1.9 million (see Notes 8 and 15).

Credit Facility and Other Financing Arrangements

Acquiring and maintaining adequate financing is an important element of our business. For information about our credit facility and other financing arrangements, see “Credit Facility and Other Financing Arrangements” within Items 7. and 7A. and Note 9.

Discontinued Operations

On March 27, 2006, we sold Stratus 7000 West Joint Venture (7000 West) and on October 12, 2007, we sold the Escarpment Village shopping center. As a result, 7000 West and Escarpment Village are reported as discontinued operations and the consolidated financial statements for all periods have been adjusted to reflect this presentation. For information about our discontinued operations, see “Discontinued Operations” within Items 7. and 7A. and Note 12.

Regulation and Environmental Matters

Our real estate investments are subject to extensive local, city, county and state rules and regulations regarding permitting, zoning, subdivision, utilities and water quality as well as federal rules and regulations regarding air and water quality and protection of endangered species and their habitats. Such regulation has delayed and may continue to delay development of our properties and result in higher developmental and administrative costs. See “Risk Factors.”

We have made, and will continue to make, expenditures for the protection of the environment with respect to our real estate development activities. Emphasis on environmental matters will result in additional costs in the future. Based on an analysis of our operations in relation to current and presently anticipated environmental requirements, we currently do not anticipate that these costs will have a material adverse effect on our future operations or financial condition.

Employees

At December 31, 2008, we had a total of 23 employees located at our Austin, Texas headquarters. We do not have any union employees. We believe we have a good relationship with our employees. Since January 1, 1996, numerous services necessary for our business and operations, including certain executive, administrative, accounting, financial, tax and other services, have been performed by FM Services Company (FM Services) pursuant to a services agreement. FM Services is a wholly owned subsidiary of Freeport-McMoRan Copper & Gold Inc. Either party may terminate the services agreement at any time upon 60 days notice or earlier upon mutual written agreement.

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Item 1A. Risk Factors

This report includes "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements about our plans, strategies, expectations, assumptions and prospects. "Forward-looking statements" are all statements other than statements of historical fact, or current facts, that address activities, events, outcomes and other matters that we plan, expect, intend, assume, believe, budget, predict, forecast, project, estimate or anticipate (or other similar expressions) will, should or may occur in the future, such as: statements regarding our financial plans; our indebtedness; share repurchases; strategic plans; future financing plans; development and capital expenditures; obtaining necessary permits for new developments; and other plans and objectives.

Forward-looking statements are based on our assumptions and analysis made in light of our experience and perception of historical trends, current conditions, expected future developments and other factors that we believe are appropriate under the circumstances. These statements are subject to a number of assumptions, risks and uncertainties, including the risk factors discussed below and in our other filings with the SEC, general economic and business conditions, the business opportunities that may be presented to and pursued by us, changes in laws or regulations and other factors, many of which are beyond our control. Readers are cautioned that forward-looking statements are not guarantees of future performance, and the actual results or developments may differ materially from those projected, predicted or assumed in the forward-looking statements. Important factors that could cause actual results to differ materially from our expectations include, among others, the following:

Economic conditions could negatively impact our business.

Our business is affected by local, national and worldwide economic conditions and the condition and levels of activity in the real estate industry. During 2008, worldwide economic conditions significantly deteriorated, and the U.S. economy and most other major economies entered a recessionary period. We are unable to predict how long these global recessionary conditions will continue, but it is reasonable to expect that our financial performance will continue to be adversely affected as long as current conditions continue.

The continuation of the current recessionary environment could also pose a threat to the ability of our insurers, suppliers, customers and financial institutions to perform their obligations. Although we monitor the creditworthiness of the third parties with whom we do business, if any such party fails to perform, our financial results could be adversely affected and we could incur losses and our liquidity could be negatively impacted.

A prolonged recession could result in a lower level of economic activity, decreased real estate development and increased uncertainty regarding real estate prices and the capital and credit markets. A lower level of real estate development could have a material adverse effect on our business, which may also adversely affect our revenues. If the capital and credit markets continue to experience volatility and the availability of funds remains limited, we may incur increased costs associated with any additional financing we may require for future operations.

We are vulnerable to concentration risks because our operations are almost exclusive to the Austin, Texas, market.

Our real estate activities are almost entirely located in Austin, Texas. Because of our geographic concentration and limited number of projects, our operations are more vulnerable to local economic downturns and adverse project-specific risks than those of larger, more diversified companies. The performance of the Austin economy greatly affects our sales and consequently the underlying values of our properties. Our geographic concentration may create increased vulnerability during regional economic downturns, which can significantly affect our financial condition and results of operations.

To continue development of the W Austin Hotel & Residences project, we may need to obtain additional financing, which could be difficult in the current credit market.

We currently have agreements with third parties to support the funding and development of our W Austin Hotel & Residences project. In May 2008, the joint venture entered into a construction loan agreement with Corus under which the joint venture has the ability to borrow up to an aggregate of $165 million to fund the construction, development and marketing costs of the W Austin Hotel & Residences project. On February 18, 2009, Corus

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entered into a written agreement with the Federal Reserve Bank of Chicago and a consent order with the Office of the Comptroller of the Currency (collectively, the Regulatory Agreements). We are unsure how the Regulatory Agreements will affect the construction loan agreement. As a result of the continued downturn in the real estate industry, current market and economic conditions, and Corus' entry into the Regulatory Agreements, Corus may become unable or unwilling to fund any of our joint venture's future borrowing requests. We are pursuing other options for financing the W Austin Hotel & Residences project, including additional equity contributions by Stratus and our joint venture partner, obtaining financing from other financial institutions, admitting new equity partners, or a combination of these alternatives, if Corus fails to fulfill its obligations. Alternate financing may not be available on favorable terms, if at all. If Corus is unable or unwilling to fulfill its funding obligations, and if alternate financing cannot be obtained, we may be required to delay further construction of the project until additional sources of financing are available or we may be required to write down our investment at amounts that could be significant.

We currently participate in two joint ventures and may participate in other joint ventures in the future. We could be adversely impacted if any of our joint venture partners would fail to fulfill their obligations or if we had disagreements with any of our joint venture partners.

We currently have investments in and commitments to two joint ventures with unrelated parties to develop land and we may participate in other joint ventures in the future. Under existing joint venture agreements, we and our joint venture partners could be required to, among other things, provide guarantees of obligations or contribute additional capital until specified capital contribution requirements are met and we may have little or no control over the amount or timing of these obligations. In some circumstances, decisions of the joint venture are made by unanimous vote of the partners. As a result of the continued downturn in the real estate industry and current market and economic conditions, our existing joint ventures or the joint venture partners may become unable or unwilling to fulfill their economic or other obligations. If our joint venture partners are unable or unwilling to fulfill their obligations or if we have any disagreements with our joint venture partners, we may be required to fulfill those obligations alone, expend additional resources to continue development of projects or delay further construction of projects, or we may be required to write down our investments at amounts that could be significant.

We may participate in other joint ventures in the future, which could subject us to certain risks, which may not otherwise be present, including:

- the potential that our joint venture partner may not perform;
- the joint venture partner may have economic, business or legal interests or goals that are inconsistent with or adverse to our interests or goals or the goals of the joint venture;
- the joint venture partner may take actions contrary to our requests or instructions or contrary to our objectives or policies;
- the joint venture partner might become bankrupt or fail to fund its share of required capital contributions;
- we and the joint venture partner may not be able to agree on matters relating to the property; and
- we may become liable for the actions of our third-party joint venture partners.

Any disputes that may arise between joint venture partners and us may result in litigation or arbitration that would increase our expenses and prevent us from focusing our time and effort on the business of the joint ventures.

If we are unable to generate sufficient cash from operations, we may find it necessary to curtail our development activities.

Significant capital resources will be required to fund our development expenditures. Our performance continues to depend on future cash flows from real estate sales and rental income, and there can be no assurance that we will generate sufficient cash flow or otherwise obtain sufficient funds to meet the expected development plans for our properties.

If we are not able to obtain suitable financing or our credit ratings are lowered, our business and results of operations may decline.

Our business and results of operations depend substantially on our ability to obtain financing for our real estate developments. The availability of financing from banks and the public debt markets has declined significantly.

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Because of the deterioration of the credit markets and the uncertainties that exist in the economy and for real estate developers in general, we cannot be certain that we will be able to replace existing financing or find additional sources of financing on reasonable terms or at all. In such an event, we could be precluded from sustaining our operations at current levels.

The conditions of the capital markets may adversely affect our ability to draw on our revolving credit facility as well as have an adverse effect on other financial transactions.

Global financial markets continue to be under considerable stress, and traditional sources of equity and debt for capital or financing continue to be difficult to find. In particular, the cost of raising funds from the debt and equity capital markets has increased substantially while the availability of funds has diminished significantly. Many lenders and institutional investors have increased interest rates, enacted tighter lending or investment standards, refused to refinance existing debt at maturity at all or on terms similar to our current debt.

Because of these factors, we cannot be certain that funding will be available if needed and to the extent required, on acceptable terms. If funding is not available when needed, or is available only on unfavorable terms, we may be unable to meet our obligations as they come due or be required to post collateral to support our obligations, or we may be unable to implement our development plan, enhance our existing projects, complete projects or otherwise take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our revenues and results of operations.

If other financial institutions that have extended credit commitments to us are adversely affected by the conditions of the capital markets, they may become unable to fund borrowings under our credit commitments with them, which could have a material and adverse impact on our financial condition and our ability to borrow additional funds, if needed, for working capital, capital expenditures, acquisitions, investments, development and other corporate purposes.

Our indebtedness could adversely affect our operating results and financial condition.

As of December 31, 2008, the outstanding principal amount of our indebtedness was $63.4 million. Our level of indebtedness could have important consequences. For example, it could:

- increase our vulnerability to adverse changes in economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations and proceeds from asset sales to pay or provide for our indebtedness, thus reducing the availability of cash flows to fund working capital, capital expenditures, acquisitions, investments and other general corporate purposes;
- limit our flexibility to plan for, or react to, changes in our business and the market in which we operate;
- place us at a competitive disadvantage to our competitors that have less debt; and
- limit our ability to borrow money to fund our working capital, capital expenditures, debt service requirements and other financing needs.

In addition, the terms of the agreements governing our indebtedness include restrictive covenants and require that certain financial ratios be maintained. We may also need to incur additional indebtedness in the future in the ordinary course of business to fund our development projects and our operations. If new debt is added to current debt levels, the risks described above could intensify. Further, if future debt financing is not available to us when required or is not available on acceptable terms, as mentioned above, we may be unable to grow our business, take advantage of business opportunities, respond to competitive pressures or refinance maturing debt, any of which could have a material adverse effect on our operating results and financial condition.

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Our results of operations, cash flows and financial condition are greatly affected by the performance of the real estate industry.

The real estate industry is highly cyclical and is affected by changes in national, global and local economic conditions, which, as mentioned above, have significantly deteriorated in the last year, and events, such as employment and income levels, availability of financing, interest rates, consumer confidence and overbuilding or decrease in demand. Our real estate activities are subject to numerous factors beyond our control, including local real estate market conditions (both where our properties are located and in areas where our potential customers reside), substantial existing and potential competition, general national, regional and local economic conditions, fluctuations in interest rates and mortgage availability, changes in demographic conditions and changes in government regulations or requirements. The occurrence of any of the foregoing could result in a reduction or cancellation of sales and/or lower gross margins for sales. Lower than expected sales as a result of these occurrences could have a material adverse effect on the level of our profits and the timing and amounts of our cash flows.

Real estate investments often cannot easily be converted into cash and market values may be adversely affected by these economic circumstances, market fundamentals, competition and demographic conditions. Because of the effect these factors have on real estate values, it is difficult to predict the level of future sales or sales prices that will be realized for individual assets.

Mortgage financing issues, including lack of supply of mortgage loans and tightened lending requirements, could reduce demand for our products.

Our real estate operations are dependent upon the availability and cost of mortgage financing for potential customers, to the extent they finance their purchases, and for buyers of the potential customers' existing residences. Many mortgage lenders and investors in mortgage loans are currently experiencing severe financial difficulties arising from losses incurred on sub-prime and other loans originated before the downturn in the real estate market. These factors have led to a decrease in the availability of financing and an increase in the cost of financing. These issues in the mortgage lending industry could adversely affect potential purchasers of our products, negatively affecting demand for our products.

If the market value of our land and developments declines, our results of operations will likely decrease.

The market value of our land and our developments depend on market conditions. We acquire land for expansion into new markets and for replacement of land inventory and expansion within our current markets. If real estate demand decreases below what we anticipated when we acquired our properties, we may not be able to recover our investment in such property through sales or leasing, and our profitability may be adversely affected. If the current recession is prolonged, we may have additional write-downs to the carrying values of our properties and/or be required to sell property at a loss.

Unfavorable changes in market and economic conditions could negatively impact occupancy or rental rates, which could negatively affect our profitability.

The current market and economic conditions may significantly affect rental rates. Occupancy and rental rates in our market, in turn, may significantly affect our profitability and our ability to satisfy our financial obligations. The risks that may affect conditions in our market include the following:

- a further deterioration in economic conditions;
-

local conditions, such as oversupply of office space, a decline in the demand for office space or increased competition from other available office buildings;

- the inability or unwillingness of tenants to pay their current rent or rent increases; and
- declines in market rental rates.

We cannot predict with certainty whether any of these factors will occur or whether, and to what extent, they will have an adverse effect on our operations.

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Our operations are subject to an intensive regulatory approval process and opposition from environmental groups that could cause delays and increase the costs of our development efforts or preclude such developments entirely.

Before we can develop a property, we must obtain a variety of approvals from local and state governments with respect to such matters as zoning, and other land use issues, subdivision, site planning and environmental issues under applicable regulations. Some of these approvals are discretionary. Because government agencies and special interest groups have in the past expressed concerns about our development plans in or near Austin, our ability to develop these properties and realize future income from our properties could be delayed, reduced, prevented or made more expensive.

Several special interest groups have long opposed our plans in the Austin area and have taken various actions to partially or completely restrict development in some areas, including areas where some of our most valuable properties are located. We have actively opposed these actions and do not believe unfavorable rulings would have a significant long-term adverse effect on the overall value of our property holdings. However, because of the regulatory environment that has existed in the Austin area and the opposition of several special interest groups, there can be no assurance that our expectations will prove correct.

Our operations are subject to governmental environmental regulation, which can change at any time and generally would result in an increase to our costs.

Real estate development is subject to state and federal regulations and to possible interruption or termination because of environmental considerations, including, without limitation, air and water quality and protection of endangered species and their habitats. Certain of the Barton Creek properties include nesting territories for the Golden-cheeked Warbler, a federally listed endangered species. In 1995, we received a permit from the U.S. Wildlife Service pursuant to the Endangered Species Act, which to date has allowed the development of the Barton Creek and Lantana properties free of restrictions under the Endangered Species Act related to the maintenance of habitat for the Golden-cheeked Warbler.

Additionally, in April 1997, the U.S. Department of Interior listed the Barton Springs Salamander as an endangered species after a federal court overturned a March 1997 decision by the Department of Interior not to list the Barton Springs Salamander based on a conservation agreement between the State of Texas and federal agencies. The listing of the Barton Springs Salamander has not affected, nor do we anticipate it will affect, our Barton Creek and Lantana properties for several reasons, including the results of technical studies and our U.S. Fish and Wildlife Service 10(a) permit obtained in 1995. The development permitted by our 2002 Circle C settlement with the City has been reviewed and approved by the U.S. Fish and Wildlife Service and, as a result, we do not anticipate that the 1997 listing of the Barton Springs Salamander will impact our Circle C properties.

We are making, and will continue to make, expenditures with respect to our real estate development for the protection of the environment. Emphasis on environmental matters will result in additional costs in the future. New environmental regulations or changes in existing regulations or their enforcement may be enacted and such new regulations or changes may require significant expenditures by us. The recent trend toward stricter standards in environmental legislation and regulations is likely to continue and could have an additional impact on our operating costs.

The real estate business is very competitive and many of our competitors are larger and financially stronger than we are.

The real estate business is highly competitive. We compete with a large number of companies and individuals that have significantly greater financial, sales, marketing and other resources than we have. Our competitors include local developers who are committed primarily to particular markets and also national developers who acquire properties throughout the U.S. The current downturn in the real estate industry could significantly increase competition among developers. Increased competition could cause us to increase our selling incentives and/or reduce our prices. An oversupply of real estate properties available for sale or lease, as well as the potential significant discounting of prices by some of our competitors, may adversely affect the results of our operations.

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Our operations are subject to natural risks.

Our performance may be adversely affected by weather conditions that delay development or damage property.

Our common stock is thinly traded; therefore, our stock price may fluctuate more than the stock market as a whole.

As a result of the thin trading market for our stock, its market price may fluctuate significantly more than the stock market as a whole or the stock prices of similar companies. Without a larger float, our common stock will be less liquid than the stock of companies with broader public ownership, and as a result, the trading prices for our common stock may be more volatile. Among other things, trading of a relatively small volume of common stock may have a greater impact on the trading price than would be the case if public float were larger.

Failure to satisfy the listing requirements of the National Association of Securities Dealers Automated Quotations (NASDAQ) stock market could result in our common stock being delisted.

On May 15, 2009, we received a staff determination letter from NASDAQ stating that in accordance with NASDAQ Marketplace Rule 5250(c)(1) our common stock is subject to delisting for failure to file our annual report on Form 10-K for the year ended December 31, 2008, by the May 14, 2009 extended filing deadline and failure to timely file our quarterly report on Form 10-Q for the quarter ended March 31, 2009, by the May 11, 2009 filing deadline. On May 22, 2009, we requested a hearing to appeal NASDAQ's determination, and also requested a further stay on the delisting of our securities. We have been notified by NASDAQ that the delisting action has been stayed pending our hearing scheduled for June 25, 2009. Accordingly, Stratus' common stock will continue to be listed on NASDAQ pending NASDAQ's decision on the appeal. There can be no assurance, however, that NASDAQ will grant our request to waive this requirement or that our common stock will not be delisted.

If our common stock is delisted from NASDAQ, our common stock would be traded over-the-counter, more commonly known as OTC. OTC transactions involve risks in addition to those associated with transactions in securities traded on NASDAQ. Many OTC stocks trade less frequently and in smaller volumes than securities traded on NASDAQ. Accordingly, our common stock would be less liquid, and the value of our common stock could decline.

Item 1B. Unresolved Staff Comments
None.

Item 2. Properties
Our developed lots, developed or under development acreage and undeveloped acreage as of December 31, 2008, are presented in the following table. The undeveloped acreage shown in the table is presented according to anticipated uses for single-family lots, multi-family units and commercial development based upon our understanding of the properties' existing entitlements. However, there is no assurance that the undeveloped acreage will be developed because of the nature and cost of the approval and development process and market demand for a particular use. Undeveloped acreage includes real estate that can be sold "as is" (i.e., no infrastructure or development work has begun on such property). A developed lot is an individual tract of land that has been developed and permitted for residential use. A developed lot may be sold with a home already built on it. As of December 31, 2008, we own only four lots with homes that have already been built on them (the Calera Court homes). Developed acreage or acreage under development includes real estate for which infrastructure work over the entire property has been completed, is currently being completed or is able to be completed and necessary permits have been obtained.

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	Acreage								
	Developed or Under Development					Undeveloped			
	Developed Lots	Single Family	Multi-family	Commercial	Total	Single Family	Commercial	Total	Total Acreage
Austin									
Barton Creek	125	358	249	376	983	510	20	530	1,513
Lantana	-	-	-	-	-	-	223	223	223
Circle C	98a	148a	-	265	413	-	122	122	535
W Austin Hotel & Residences	-	-	-	2b	2	-	-	-	2
San Antonio									
Camino Real	-	-	-	-	-	-	2	2	2
Total	223	506	249	643	1,398	510	367	877	2,275

a. Relates to Meridian, an 800-lot residential development.

b. Represents a city block in downtown Austin planned for a mixture of hotel, residential, retail, office and entertainment uses.

Our other Austin holdings at December 31, 2008, consisted of two 75,000-square-foot office buildings at 7500 Rialto Boulevard located in our Lantana development, a 22,000-square-foot retail complex representing phase one of Barton Creek Village and two retail buildings totaling 21,000 square feet at the 5700 Slaughter project in Circle C.

The following table summarizes the estimated development potential of our Austin-area acreage as of December 31, 2008:

	Single Family (lots)	Multi-family (units)	Commercial Office (gross square feet)	Commercial Retail (gross square feet)
Barton Creek	464	1,860	1,590,000	23,000
Circle C	57	-	760,000	200,000
Lantana	-	-	1,365,000	400,000
Austin 290 Tract	-	-	-	20,000
Total	521	1,860	3,715,000	643,000

Item 3. Legal Proceedings

We are from time to time involved in various legal proceedings of a character normally incident to the ordinary course of our business. We believe that potential liability from any of these pending or threatened proceedings will not have a material adverse effect on our financial condition or results of operations. We maintain liability insurance to cover some, but not all, potential liabilities normally incident to the ordinary course of our business as well as other insurance coverage customary in our business, with such coverage limits as management deems prudent.

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

None.

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PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Performance Graph

The following graph compares the change in the cumulative total stockholder return on our common stock with the cumulative total return of the Hemscott Real Estate Development Group and the S&P 500 Stock Index from 2004 through 2008. This comparison assumes $100 invested on December 31, 2003 in (a) our common stock, (b) the Hemscott Real Estate Development Group and (c) the S&P 500 Stock Index.

Comparison of Cumulative Total Return*
Stratus Properties Inc., Hemscott Real Estate
Development Group and S&P 500 Stock Index

	December 31,					
	2003	2004	2005	2006	2007	2008
Stratus Properties Inc.	$ 100.00	$ 159.50	$ 232.14	$ 318.41	$ 337.71	$ 123.98
Hemscott Real Estate Development Group	100.00	132.82	140.10	186.07	309.74	141.27
S&P 500 Stock Index	100.00	110.88	116.33	134.70	142.10	89.53

* Total return assumes reinvestment of dividends.

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Our common stock trades on the National Association of Securities Dealers Automated Quotation (NASDAQ) stock market under the symbol STRS. The following table sets forth, for the periods indicated, the range of high and low sales prices of Stratus' common stock, as reported by NASDAQ.

	2008		2007	
	High	Low	High	Low
First Quarter	$33.95	$23.98	$35.00	$28.50
Second Quarter	30.49	16.86	40.73	29.96
Third Quarter	30.75	15.72	35.92	25.91
Fourth Quarter	27.91	10.10	36.33	27.37

As of May 15, 2009, there were 600 holders of record of our common stock. We have not in the past paid, and do not anticipate in the future paying, cash dividends on our common stock. The decision whether or not to pay dividends and in what amounts is within the discretion of our Board of Directors. However, our current ability to pay dividends is also restricted by terms of our credit agreement, as discussed in management's discussion and analysis and Note 9.

The following table sets forth shares of our common stock that we repurchased during the three-month period ended December 31, 2008.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programsa	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programsa
October 1 to 31, 2008	3,400	$ 24.04	3,400	402,053
November 1 to 30, 2008	1,908	15.43	1,908	400,145
December 1 to 31, 2008	190,000b	10.00	190,000	210,145
Total	195,308	10.30	195,308	

a. In February 2001, our Board of Directors approved an open market share purchase program for up to 0.7 million shares of our common stock. The program does not have an expiration date. Our loan agreement with Comerica provides a limit of $6.5 million for our common stock repurchases after September 30, 2005. At December 31, 2008, $1.3 million remains available under the Comerica agreement for purchases of our common stock.

b. Represents shares purchased in a private transaction on December 24, 2008.

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Item 6. Selected Financial Data

The following table sets forth our selected historical financial data as of and for each of the five years in the period ended December 31, 2008. The historical financial information is derived from our audited financial statements reflecting all adjustments (consisting only of normal and recurring items, except as otherwise noted below) and is not necessarily indicative of our future results. In addition, the historical results have been adjusted to reflect the operations of Escarpment Village and Stratus 7000 West Joint Venture (7000 West) as discontinued operations (see Note 12). You should read the information in the table below together with Items 7. and 7A. “Management’s Discussion and Analysis of Financial Condition and Results of Operation and Quantitative and Qualitative Disclosures About Market Risk” and Item 8. “Financial Statements and Supplementary Data.” Refer to Note 2 regarding revisions to previously issued financial statements for the years ended December 31, 2007 and 2006, and at December 31, 2007, relating to capitalization of interest and property taxes and equity in unconsolidated affiliate’s income. Refer to footnote “c” below for information regarding revisions to previously issued financial statements for the years ended December 31, 2005 and 2004, and at December 31, 2006, 2005 and 2004, relating to capitalization of interest and property taxes.

	2008	2007	2006	2005 c	2004 c
	(In Thousands, Except Per Share Amounts)				
Years Ended December 31:					
Revenues	$ 18,783	$ 27,164	$ 61,875	$ 35,194	$ 17,725
Operating (loss) income	(7,258)	(543)	22,638	7,954	33
Interest income	1,448	849	370	226	71
Equity in unconsolidated affiliate’s income	562	982	-	-	-
(Loss) income from continuing operations	(3,732)	2,609	30,318	8,107	104
(Loss) income from discontinued operations, net of taxes	(105)a	11,180a	9,142a, b	1,232b	1,222b
Net (loss) income applicable to common stock	(3,837)	13,789	39,460	9,339	1,326
Basic net (loss) income per share:					
Continuing operations	$ (0.49)	$ 0.35	$ 4.15	$ 1.12	$ 0.01
Discontinued operations	(0.01)a	1.48a	1.25a, b	0.17b	0.17b
Basic net (loss) income per share	$ (0.50)	$ 1.83	$ 5.40	$ 1.29	$ 0.18
Diluted net (loss) income per share:					
Continuing operations	$ (0.49)	$ 0.34	$ 3.96	$ 1.06	$ 0.01
Discontinued operations	(0.01)a	1.46a	1.19a, b	0.16b	0.16b
Diluted net (loss) income per share	$ (0.50)	$ 1.80	$ 5.15	$ 1.22	$ 0.17
Average shares outstanding:					

Basic	7,621	7,554	7,306	7,209	7,196
Diluted	7,621	7,677	7,658	7,636	7,570
At December 31:					
Property held for sale	$ 143,480	$ 136,531	$ 136,911c	$ 125,285	$ 121,564
Property held for use, net	56,919	38,215	18,600	9,277	9,660
Assets from discontinued operations	-	-	35,303a, c	34,359a, b	19,903a, b
Total assets	252,546	232,634	206,558c	177,320	155,430
Debt from continuing operations	63,352	61,500	28,000	40,368	43,646
Debt from discontinued operations	-	-	22,675a	21,731a, b	12,001a, b
Stockholders' equity	149,236	155,442	136,554c	97,601	90,765

a. Relates to the operations, assets and liabilities of Escarpment Village, which we sold in October 2007 (see Note 12).

b. Relates to the operations, assets and liabilities of 7000 West, which we sold in March 2006 (see Note 12).

c. Reflects revisions of previously issued financial statements as presented below (in thousands, except per share amounts):

		2006 Adjustments			
	As Reported	Capitalized Interest	Property Tax	Net Adjustments	As Revised
At December 31:					
Property held for sale	$133,210	$ 5,425	$ (1,724)	$ 3,701	$136,911
Property held for use, net	18,874	-	(274)	(274)	18,600
Assets from discontinued operations	34,917	523	(137)	386	35,303
Total assets	203,950	3,980	(1,372)	2,608	206,558
Stockholders' equity	133,946	3,980	(1,372)	2,608	136,554

		2005 Adjustments			
	As Reported	Capitalized Interest	Property Tax	Net Adjustments	As Revised
Year Ended December 31:					
Operating income	$ 8,336	$ (110)	$ (272)	$ (382)	$ 7,954
Income from continuing operations	7,960	419	(272)	147	8,107
Income from discontinued operations	514	718	-	718	1,232
Net income applicable to common stock	8,474	1,137	(272)	865	9,339
Basic net income per share:					
Continuing operations	$ 1.11	$ 0.05	$ (0.04)	$ 0.01	$ 1.12
Discontinued operations	0.07	0.10	-	0.10	0.17
Basic net income per share	$ 1.18	$ 0.15	$ (0.04)	$ 0.11	$ 1.29
Diluted net income per share:					
Continuing operations	$ 1.04	$ 0.06	$ (0.04)	$ 0.02	$ 1.06
Discontinued operations	0.07	0.09	-	0.09	0.16
Diluted net income per share	$ 1.11	$ 0.15	$ (0.04)	$ 0.11	$ 1.22
At December 31:					
Property held for sale	$122,468	$ 4,555	$ (1,738)	$ 2,817	$125,285
Property held for use, net	9,452	(61)	(114)	(175)	9,277
Assets from discontinued operations	33,956	516	(113)	403	34,359
Total assets	173,886	5,399	(1,965)	3,434	177,320
Stockholders' equity	94,167	5,399	(1,965)	3,434	97,601

		2004 Adjustments			
	As Reported	Capitalized Interest	Property Tax	Net Adjustments	As Revised
Year Ended December 31:					
Operating income	$ 338	$ (34)	$ (271)	$ (305)	$ 33

Income from continuing operations	99	276	(271)	5	104
Income from discontinued operations	573	649	-	649	1,222
Net income applicable to common stock	672	925	(271)	654	1,326
Basic net income per share:					
Continuing operations	$ 0.01	$ 0.04	$ (0.04)	$ -	$ 0.01
Discontinued operations	0.08	0.09	-	0.09	0.17
Basic net income per share	$ 0.09	$ 0.13	$ (0.04)	$ 0.09	$ 0.18
Diluted net income per share:					
Continuing operations	$ 0.01	$ 0.04	$ (0.04)	$ -	$ 0.01
Discontinued operations	0.08	0.08	-	0.08	0.16
Diluted net income per share	$ 0.09	$ 0.12	$ (0.04)	$ 0.08	$ 0.17
At December 31:					
Property held for sale	$119,067	$ 3,963	$ (1,466)	$ 2,497	$121,564
Property held for use, net	9,926	(152)	(114)	(266)	9,660
Assets from discontinued operations	19,961	55	(113)	(58)	19,903
Total assets	152,861	4,262	(1,693)	2,569	155,430
Stockholders' equity	88,196	4,262	(1,693)	2,569	90,765

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Items 7. and 7A. Management's Discussion and Analysis of Financial Condition and Results of Operation and Quantitative and Qualitative Disclosures About Market Risk

OVERVIEW

In management's discussion and analysis "we," "us," and "our" refer to Stratus Properties Inc. and its consolidated subsidiaries and joint venture. You should read the following discussion in conjunction with our consolidated financial statements and the related discussion of "Business," "Risk Factors" and "Properties" included elsewhere in this Form 10-K. The results of operations reported and summarized below are not necessarily indicative of our future operating results. All subsequent references to "Notes" refer to Notes to Consolidated Financial Statements located in Item 8. "Financial Statements and Supplementary Data."

We are engaged in the acquisition, development, management, operations and sale of commercial, multi-family and residential real estate properties located primarily in the Austin, Texas area.

Our principal real estate holdings are in southwest Austin, Texas. We also own undeveloped commercial property in San Antonio, Texas. The number of developed lots, developed or under development acreage and undeveloped acreage as of December 31, 2008, that comprise our principal development projects are presented in the following table.

		Acreage							
		Developed or Under Development				Undeveloped			
	Developed Lots	Single Family	Multi-family	Commercial	Total	Single Family	Commercial	Total	Total Acreage
Austin									
Barton Creek	125	358	249	376	983	510	20	530	1,513
Lantana	-	-	-	-	-	-	223	223	223
Circle C	98a	148a	-	265	413	-	122	122	535
W Austin Hotel & Residences	-	-	-	2b	2	-	-	-	2
San Antonio									
Camino Real	-	-	-	-	-	-	2	2	2
Total	223	506	249	643	1,398	510	367	877	2,275

a. Relates to Meridian, an 800-lot residential development.
b. Represents a city block in downtown Austin planned for a mixture of hotel, residential, retail, office and entertainment uses.

Our other Austin holdings at December 31, 2008, consisted of two 75,000-square-foot office buildings at 7500 Rialto Boulevard (7500 Rialto) located in our Lantana development, a 22,000-square-foot retail complex representing phase one of Barton Creek Village and two retail buildings totaling 21,000 square feet at the 5700 Slaughter project in Circle C.

The sharp decline in the real estate market, among other factors, significantly impacted our consolidated financial results for 2008. In 2008, we recognized $18.8 million of revenues and recorded a net loss of $3.8 million, compared to $27.2 million of revenues and $13.8 million of net income in 2007, which included a gain on the sale of Escarpment Village of $10.8 million, net of taxes of $5.0 million. During the fourth quarter of 2008, we evaluated the carrying values of our long-lived assets for impairment and recognized charges of $0.3 million ($0.2 million to net loss or $0.02 per share). Refer to Notes 1 and 4 for further discussion of these impairment charges.

Real Estate Market Conditions

Factors that significantly affect United States (U.S.) real estate market conditions include interest rate levels and the availability of financing, the supply of product (i.e. developed and/or undeveloped land, depending on buyers' needs) and current and anticipated future economic conditions. These market conditions historically move in periodic cycles, and can be volatile in specific regions. Because of the concentration of our assets primarily in the Austin, Texas area, market conditions in this region significantly affect our business.

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In addition to the traditional influence of state and federal government employment levels on the local economy, in recent years the Austin area has experienced significant growth in the technology sector. The Austin-area population increased approximately 25 percent between 1999 and 2008, largely due to an influx of technology companies and related businesses. Median family income levels in Austin also increased during the period from 1999 through 2007, rising by 15 percent. The expanding economy resulted in rising demands for residential housing, commercial office space and retail services. Between 1999 and 2007, sales tax receipts in Austin rose by 43 percent, an indication of the dramatic increase in business activity during the period. The increases in population, income levels and sales tax revenues have been less dramatic over the last few years.

The following chart compares Austin's five-county metro area population and median family income for 1989, 1999 and the most current information available for 2007 and 2008, based on U.S. Census Bureau data and City of Austin data.

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Based on the City of Austin's fiscal year of October 1st through September 30th, the chart below compares Austin's sales tax revenues for 1989, 1999 and 2007.

Real estate development in southwest Austin historically has been constrained as a result of various restrictions imposed by the City of Austin (the City). Several special interest groups have also traditionally opposed development in that area, where most of our property is located. From 2001 through 2004, a downturn in the technology sector negatively affected the Austin real estate market, especially the high-end residential and commercial leasing markets; however, beginning in 2005 through mid-2007, market conditions improved. Beginning in the third quarter of 2007, market conditions began to weaken. The December 31, 2008 and 2007 vacancy percentages for various types of developed properties in Austin are noted below.

	December 31,	
	2008	2007
Building Type	Vacancy Factor	
Industrial Buildings	16%a	6% b
Office Buildings (Class A)	19% a	14% b
Multi-Family Buildings	9% b	6% b
Retail Buildings	7% b	7% b

a. CB Richard Ellis: Austin MarketView
b. Texas A&M University Real Estate Center: Texas Market News

Our operating cash flows and, ultimately, our ability to develop our properties and expand our business are largely dependent on the level of our real estate sales. In turn, these sales will be significantly affected by future real estate market conditions in Austin, Texas, including development costs, interest rate levels, the availability of credit to finance real estate transactions, and regulatory issues including our land use and development entitlements.

Since the third quarter of 2007, U.S. economic activity has progressively weakened due initially to stresses in the residential housing and financial sectors, aggravated by the impact of rising food and energy prices on consumer spending. Weaker economic growth resulted in a general decline in real estate activity across the U.S. in 2008, and has caused vacancy rates to increase in most markets, including Austin, Texas. U.S. investment sales activity also declined sharply during 2008 because of, among other factors, limited availability and increased cost of financing, especially the absence of securitized debt, which was the source of recent heightened investment activity, and the resulting gap between buyer and seller expectations of value.

We continue to focus on our near-term goal of developing our properties and projects in a difficult economic climate and our long-term goal of maximizing the value of our development communities. We believe that Austin, Texas continues to be a very desirable market and many of our developments are in locations that are unique and where approvals that we have obtained have been increasingly difficult for others to achieve. Real estate development in southwest Austin historically has been constrained as a result of various restrictions imposed by the City and several special interest groups have also traditionally opposed development in the area where most of our property is located. We believe that many of our developments have inherent value given their unique nature and location and that this value should be sustainable in the future. Our long-term success will depend on our ability to maximize the value of our real estate through obtaining additional required approvals that permit us to develop and sell our properties in a timely manner at a reasonable cost. In addition, we continue to pursue additional development opportunities and believe we can obtain bank financing for developing our properties at a reasonable cost. See “Risk Factors” located in Item 1A.

The recovery of U.S. credit markets has yet to materialize, and given the current business climate in which we are operating and the numerous uncertainties related to our business, including the rate of sales, sales prices, and mortgage constraints, it is difficult to provide specific guidance for fiscal 2009. We believe that our performance in 2009 will be significantly affected by real estate market conditions in Austin, Texas, including development costs, interest rate levels, the availability of credit to finance real estate transactions, and regulatory issues including our land use and development entitlements.

REVISIONS OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS AND RECLASSIFICATIONS

As discussed in Note 2, certain accounting matters were identified during 2008 and subsequently that required revisions of our financial statements for the years ended December 31, 2007 and December 31, 2006. Management’s discussion and analysis has been updated to discuss changes in comparative results of operations and cash flows after considering the impacts of the items discussed in detail in Notes 2 and 3.

DEVELOPMENT AND OTHER ACTIVITIES

W Austin Hotel & Residences. In 2005, the City selected our proposal to develop a mixed-use project in downtown Austin immediately north of the new City Hall complex. The W Austin Hotel & Residences project includes an entire city block and is planned for a mixture of hotel, residential, retail, office and entertainment uses. In December 2006, we acquired the property for $15.1 million. We have executed agreements with Starwood Hotels & Resorts Worldwide, Inc. for the development of a W Hotel & Residences on the site. In May 2007, we announced our proposed partnership with Canyon-Johnson Urban Fund II, L.P. (Canyon-Johnson) for the development of the W Austin Hotel & Residences project. The grand opening for the onsite sales center was held in conjunction with the groundbreaking ceremony in October 2007. Effective May 1, 2008, we entered into a joint venture with Canyon-Johnson for the development of the project (see Note 6). At December 31, 2008, we had $2.1 million of borrowings outstanding under the W Austin Hotel & Residences project construction loan and total remaining commitments available of approximately $163 million (see Notes 9 and 15). Construction of the $300 million project commenced in the second quarter of 2008 and is proceeding as scheduled. We currently consolidate the joint venture with Canyon-Johnson because under the provisions of Financial Accounting Standards Board Interpretation No. 46R, “Consolidation of Variable Interest Entities (revised December 2003) –an Interpretation of ARB No. 51” (FIN 46R), the project is considered a variable interest entity (VIE) and we are considered the primary beneficiary. If it is determined that the W Austin Hotel & Residences project is no longer a VIE under the guidance of FIN 46R or that we are no longer the primary beneficiary of the entity, the project will be deconsolidated from our financial statements (see Note 6).

Crestview Station. In 2005, we formed a joint venture with Trammell Crow to acquire an approximate 74-acre tract at the intersection of Airport Boulevard and Lamar Boulevard in Austin, Texas, for $7.7 million. The property, known as Crestview Station, is a single-family, multi-family, retail and office development, which is located on the site of a future commuter rail line approved by City voters. With Trammell Crow, we have completed environmental remediation, which the State of Texas certified as complete in September 2007, and permitting of the property. Infrastructure development of Crestview Station is progressing. The initial phase of

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utility and roadway infrastructure is under construction and expected to be completed by year-end 2009. Crestview Station sold substantially all of its multi-family and commercial properties in 2007. The joint venture retained the single family component of Crestview Station and two commercial sites, one of which was sold in the first quarter of 2008. The joint venture is currently processing permits to develop the residential portion of Crestview Station as a 450-unit transit-oriented neighborhood. At December 31, 2008, our investment in the Crestview Station project totaled $2.3 million and the joint venture partnership had $9.1 million of outstanding debt, of which we guarantee $1.9 million (see Notes 8 and 15). We account for our 50 percent interest in the Crestview Station joint venture under the equity method.

Residential. As of December 31, 2008, the number of our residential developed lots, lots under development and development potential by area are shown below (excluding lots and units associated with our Canyon-Johnson and Crestview joint ventures):

	Residential Lots			
	Developed	Under Development	Potential Development a	Total
Barton Creek:				
Calera:				
Calera Court Courtyard Homes	4	-	-	4
Calera Drive	8	-	-	8
Verano Drive	68	-	-	68
Amarra Drive:				
Phase I Lots	7	-	-	7
Phase II Lots	35	-	-	35
Townhomes	-	-	221	221
Phase III	-	-	89	89
Mirador Estate	2	-	-	2
Wimberly Lane Phase II	1	-	-	1
Section N Multi-family	-	-	1,860	1,860
Other Barton Creek Sections	-	-	154	154
Circle C:				
Meridian	98	57	-	155
Total Residential Lots	223	57	2,324	2,604

a. Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City. Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future.

Calera. In 2002, we secured subdivision plat approval for a new residential subdivision called Calera, which consists of 155 lots. During 2004, we began construction of 16 courtyard homes at Calera Court, the 16-acre initial phase of the Calera subdivision. The second phase of Calera, Calera Drive, consisting of 53 single-family lots, many of which adjoin the Fazio Canyons Golf Course, received final plat and construction permit approval in 2005. In the third quarter of 2005, development of these lots was completed and the initial lots were sold. As of December 31, 2008, four courtyard homes at Calera Court and eight lots at Calera Drive remained unsold. Construction of the final phase, known as Verano Drive, began in the first quarter of 2007 and was completed in July 2008. Verano Drive includes 71 single-family lots, three of which were sold in July 2008.

Amarra Drive. During 2007, we completed development of Amarra Drive Phase I, the initial phase of the Amarra Drive subdivision. Amarra Drive Phase I includes eight lots, one of which was sold in September 2007, with sizes ranging from approximately one to four acres, some of which are course-side lots on the Fazio Canyons Golf Course and others are secluded lots adjacent to the Nature Conservancy of Texas. In January 2008, we commenced development of Amarra Drive Phase II, which consists of 35 lots on 51 acres and two townhome tracts on 31 acres. Development was substantially completed in October 2008.

Mirador Estate. In 2001, we completed construction of the Mirador subdivision, which included the development of 34 estate lots with each lot averaging approximately 3.5 acres in size, and have sold 32 of these lots. As of December 31, 2008, we owned two Mirador estate lots.

Wimberly Lane Phase II. In 2004, we entered into a contract with a national homebuilder to sell 41 lots within the Wimberly Lane Phase II subdivision. The average purchase price for each of the 41 lots was $150,400, subject

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to a six percent annual escalator. We sold the last homebuilder lot in January 2008 and have one Wimberly Lane lot remaining for sale.

Circle C. We are developing the Circle C community based on the entitlements secured in our Circle C settlement with the City, as amended in 2004. In 2005, we commenced the first phase of construction and contracted to sell 494 of a total of 800 lots in our Meridian project to three national homebuilders in four phases. Sales for each of the four phases commence upon substantial completion of development for that phase, and continue every quarter until all of the lots have been sold. The first and second phases each consisted of 134 lots. The first phase was substantially completed at the end of 2005. Development of the second phase was substantially completed in March 2006. Development of the 108-lot third phase of Meridian was completed in September 2007. The 118-lot fourth phase commenced in early 2008 and was completed in June 2008.

In 2006, we signed another contract with a national homebuilder for 42 additional lots. Development of those lots commenced in April 2007 and substantial completion occurred in April 2008. Construction of the final phase of Meridian, which consists of 57 one-acre lots, is expected to commence in 2010.

Deerfield. In January 2004, we acquired the Deerfield property in Plano, Texas, for $7.0 million. The property was zoned and subject to a preliminary subdivision plan for 234 residential lots. We executed agreements with a national homebuilder, whereby the homebuilder paid us $1.4 million for an option to purchase all 234 lots over 36 monthly take-downs. The net purchase price for each of the 234 lots was $61,500, subject to certain terms and conditions. The $1.4 million non-refundable option payment was applied against subsequent purchases of lots by the homebuilder after certain thresholds were achieved and was recognized by us as income as lots were sold. In October 2005, we executed a revised agreement with the homebuilder, increasing the lot sizes and average purchase price to $67,150 based on a new total of 224 lots. In January 2008, we sold the final 21 lots for $1.4 million.

Commercial. As of December 31, 2008, the number of square feet of our commercial property developed, under development and our remaining entitlements are shown below (excluding property associated with our Canyon-Johnson and Crestview joint ventures):

	Commercial Property			
	Developed	Under Development	Potential Development a	Total
Barton Creek:				
Barton Creek Village Phase I	22,000	-	-	22,000
Barton Creek Village Phase II	-	18,000	-	18,000
Entry Corner	-	-	5,000	5,000
Amarra Retail/Office	-	-	90,000	90,000
Section N	-	-	1,500,000	1,500,000
Circle C:				
Chase Ground Lease	4,000	-	-	4,000
Tract 106	21,000	-	-	21,000
Tract 110	-	760,000	-	760,000
Tract 107	-	80,000	-	80,000
Tract 101	-	-	90,000	90,000
Tract 102	-	-	25,000	25,000
Tract 114	-	-	5,000	5,000

Lantana:				
7500 Rialto	150,000	-	-	150,000
Advanced Micro Devices Option				
Tracts	-	-	760,000	760,000
Tract GR1	-	-	325,000	325,000
Tract G07	-	-	210,000	210,000
Tract CS5	-	-	175,000	175,000
Tract CS1-CS3	-	-	150,000	150,000
Tract LR1	-	-	75,000	75,000
Tract L04	-	-	70,000	70,000
Austin 290 Tract	-	-	20,000	20,000
Total Square Feet	197,000	858,000	3,500,000	4,555,000

a. Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City. Those governmental agencies may either not approve one or more development plans and permit applications related to such properties

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or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future.

Barton Creek. In the second quarter of 2007, we completed the first phase of the Barton Creek Village. The first phase includes a 22,000-square-foot retail complex. In July 2007, we began construction of a 3,300-square-foot bank building within this retail complex, and it was completed in early 2008. As of December 31, 2008, the first retail complex was 71 percent leased and the bank building is leased through 2022. Construction of the second retail complex is expected to begin during 2010.

Circle C. During the third quarter of 2008, Stratus completed the construction of two retail buildings totaling 21,000 square feet at the 5700 Slaughter project. This retail project also includes a 4,000-square-foot building on an existing ground lease. Leasing for the two retail buildings is under way with 22 percent of the 21,000-square-foot retail complex leased as of December 31, 2008, and the initial tenants have opened for business. We expect the 21,000-square-foot retail complex to be fully leased by the end of 2009.

The Circle C community also includes Parkside Village, an 80,000-square-foot planned retail project. The project will be developed in two phases. The first phase will consist of a 34,000-square-foot building to accommodate a full-service restaurant and theater. The second phase will consist of three tilt-wall retail buildings at 14,775 square feet, 8,075 square feet and 7,600 square feet, and two pads available for ground leases. We are pursuing final permits and entitlements to position the project for commencement of construction when appropriate.

Lantana. Lantana is a partially developed, mixed-use real-estate development project with remaining entitlements for approximately 1.0 million square feet of office and retail use on 223 acres as of December 31, 2008. Regional utility and road infrastructure is in place with capacity to serve Lantana at full build-out permitted under our existing entitlements. Lantana also includes 760,000 square feet of potential development for commercial property under an option contract with Advanced Micro Devices, Inc. (NYSE:AMD).

In Lantana, we also own two 75,000-square-foot office buildings at 7500 Rialto. As of December 31, 2008, occupancy was 97 percent for the original office building and 100 percent for the second office building.

RESULTS OF OPERATIONS

We are continually evaluating the development potential of our properties and will continue to consider opportunities to enter into transactions involving our properties. As a result, and because of numerous other factors affecting our business activities as described herein, our past operating results are not necessarily indicative of our future results.

Summary operating results follow (in thousands):

	2008	2007	2006
Revenues:			
Real estate operations	$ 14,310	$ 24,083	$ 60,213
Commercial leasing	4,473	3,081	1,662
Total revenues	$ 18,783	$ 27,164	$ 61,875
Operating (loss) income	$ (7,258)	$ (543)	$ 22,638
Benefit from (provision for) income taxes	$ 1,734	$ (1,679)	$ 7,310
(Loss) income from continuing operations	$ (3,732)	$ 2,609	$ 30,318

(Loss) income from discontinued operations		(105)a		11,180b	9,142c
Net (loss) income	$	(3,837)	$	13,789 $	39,460

a. Relates to the revised amount of Texas margin tax accrued on Escarpment Village income earned during 2007 (see Note 12).

b. Includes a gain on sale of Escarpment Village of $10.8 million, net of taxes of $5.0 million.

c. Includes a gain on sale of Stratus 7000 West Joint Venture (7000 West) of $8.3 million, net of taxes of $1.5 million.

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Our deferred tax assets at December 31, 2005, totaled $18.3 million and we had provided a 100 percent valuation allowance because realization of the deferred tax assets was not considered likely. Realization of our deferred tax assets is dependent on generating sufficient taxable income within the carryforward period available under tax law. In 2006, we sold 7000 West (see Note 12) and 58 acres at our Lantana property. These transactions generated pre-tax income of approximately $26 million and, along with our then-current homebuilder contract arrangements and projected levels of future sales, provided sufficient evidence that we would more likely than not be able to realize certain of our deferred tax assets. As a result, income from continuing operations for 2006 included a $15.3 million tax benefit, $2.09 per basic share and $2.00 per diluted share, resulting from the reversal of a portion of our deferred tax asset valuation allowance. Based on the expectation of future taxable income and that deductible temporary differences will offset existing taxable temporary differences, management believes it is more likely than not that the benefits of these deductible differences, net of the existing valuation allowances, are realizable at December 31, 2008 and 2007. The valuation allowance at December 31, 2008 relates to certain net operating loss carryforwards which are not expected to be realized due to limitations imposed under the Internal Revenue Code.

We have two operating segments, "Real Estate Operations" and "Commercial Leasing" (see Note 14). The following is a discussion of our operating results by segment.

Real Estate Operations

Summary real estate operating results follow (in thousands):

	2008	2007	2006
Revenues:			
Developed property sales	$ 13,231	$ 21,388	$ 33,459
Undeveloped property sales	40	1,082	24,929
Commissions, management fees and other	1,039	1,613	1,825
Total revenues	14,310	24,083	60,213
Cost of sales, including depreciation and long-lived asset impairments	(13,482)a	(16,299)	(29,940)
General and administrative expenses	(6,496)	(6,119)	(6,281)
Operating (loss) income	$ (5,668)	$ 1,665	$ 23,992

a. Includes long-lived asset impairments of $0.3 million (see Note 4).

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Developed Property Sales. Property sales for the last three years follow (revenues in thousands):

	2008		2007		2006	
	Lots	Revenues	Lots	Revenues	Lots	Revenues
Residential Properties:						
Barton Creek						
Calera Court Courtyard Homes	2	$ 1,278	2	$ 1,307	5	$ 2,922
Calera Drive	-	-	2	809	24	10,363
Mirador Estate	-	-	3	2,334	7	3,791
Wimberly Lane Phase II Standard Homebuilder	1	265a	12	2,114	11	1,804
Escala Drive Estate	-	-	-	-	1	695
Amarra Drive Phase I	-	-	1	1,250	-	-
Verano Drive	3	1,875	-	-	-	-
Circle C						
Meridian	120	8,403	138	8,898	166	9,881
Deerfield	21	1,410	70	4,676	60	4,003
Total Residential	147	$ 13,231	228	$ 21,388	274	$ 33,459

a. Includes $0.1 million for homebuilder contract termination fee.

Undeveloped Property Sales. During 2007, we sold a five-acre tract at Circle C for $1.1 million. During 2006, we sold a 7.5-acre tract in the Barton Creek community for $1.5 million, a 58-acre tract at Lantana to AMD for $21.2 million of which $0.5 million represented a reimbursement of certain costs which we recorded as a reduction of cost of sales and an approximate 29-acre tract in Circle C for $2.7 million.

Commissions, Management Fees and Other. Commissions, management fees and other revenues totaled $1.0 million in 2008, compared to $1.6 million in 2007, and included sales of our development fee credits to third parties totaling $0.6 million in 2008 and $0.8 million in 2007. We received these development fee credits as part of the Circle C settlement (see Note 13). Commissions, management fees and other revenues decreased from 2007 to 2008 as a result of lower sales activity in 2008.

Commissions, management fees and other revenues totaled $1.6 million in 2007, compared to $1.8 million in 2006, and included sales of our development fee credits to third parties totaling $0.8 million in 2007 and $1.3 million in 2006. Commissions, management fees and other revenues decreased from 2006 to 2007 as a result of a decrease in sales of our development fee credits, partially offset by an increase in commission income.

Cost of Sales. Cost of sales includes cost of property sold, project expenses, allocated overhead costs, asset impairments, and reductions for certain municipal utility district reimbursements (see Note 1). Cost of sales totaled $13.5 million in 2008 and $16.3 million in 2007. Cost of sales for 2008 included long-lived asset impairments related to properties in the Barton Creek community of $0.3 million (see Note 4), $0.4 million of costs incurred for our proposal for the right to develop a new project in downtown Austin, which was awarded to another developer, and reductions totaling $0.1 million for Barton Creek Municipal Utility District (MUD) reimbursements. Cost of sales for 2008 decreased compared to 2007 primarily because of a decrease in developed property sales in 2008.

Cost of sales decreased to $16.3 million in 2007 from $29.9 million in 2006, primarily because of a decrease in developed and undeveloped property sales in 2007. Cost of sales included reductions for Barton Creek MUD reimbursements of $1.7 million in 2007 and $0.1 million in 2006.

We are projecting fewer lot sales in the next several quarters because of the recent weakness in the U.S. and Austin real estate markets.

General and Administrative Expenses. General and administrative expenses increased to $6.5 million in 2008 from $6.1 million in 2007, primarily because of higher third-party fees related to the capitalized interest revisions (see Note 2). General and administrative expenses decreased to $6.1 million in 2007 from $6.3 million in 2006, primarily as a result of a higher allocation of general and administrative expenses to the commercial leasing segment in 2007 because of increased commercial leasing activity.

Commercial Leasing

Summary commercial leasing operating results follow (in thousands):

	2008	2007	2006
Rental income	$ 4,473	$ 3,081	$ 1,662
Rental property costs	(3,554)	(3,264)	(1,712)
Depreciation	(1,451)	(1,115)	(725)
General and administrative expenses	(1,058)	(910)	(579)
Operating loss	$ (1,590)	$ (2,208)	$ (1,354)

Our commercial leasing operating results primarily reflect the activities at 7500 Rialto. As of December 31, 2008, occupancy was 97 percent for the original office building and 100 percent for the second building, which was completed in September 2006.

Rental Income. Rental income increased in 2008 compared to 2007, primarily because of a $0.8 million increase in rental income at 7500 Rialto related to an increase in the occupancy rate of the second office building from 2007. In addition, rental income for 2008 reflects an increase of $0.5 million related to Barton Creek Village, which includes a retail building completed in the second quarter of 2007 and a bank building completed in early 2008. Rental income for 2008 also reflects an increase of $0.2 million related to 5700 Slaughter, which includes two retail buildings completed in the third quarter of 2008.

Rental income increased in 2007 compared to 2006 primarily because of the increase in occupancy of the second office building at 7500 Rialto during 2007. The second building was only 50 percent leased as of December 31, 2006.

Rental Property Costs. Rental property costs increased to $3.6 million in 2008 compared to $3.3 million in 2007 primarily as a result of increased occupancy at Barton Creek Village and 5700 Slaughter. Rental property costs increased from $1.7 million in 2006 to $3.3 million in 2007 primarily as a result of the increase in occupancy at the second office building at 7500 Rialto.

Depreciation. Depreciation increased to $1.5 million in 2008 compared to $1.1 million in 2007 primarily as a result of an increase in depreciation expense for Barton Creek Village. The increase from $0.7 million in 2006 to $1.1 million in 2007 primarily is the result of an increase in depreciation expense for the second office building at 7500 Rialto.

General and Administrative Expenses. General and administrative expenses increased to $1.1 million in 2008 from $0.9 million in 2007, primarily because of higher third-party fees related to the capitalized interest revisions (see Note 2). General and administrative expenses also increased in 2008 because of increases in compensation costs related to personnel severance packages paid in 2008 in conjunction with the closure of our Southwest Property Services subsidiary. There are no additional costs expected to be incurred as a result of our decision to outsource property management operations.

General and administrative expenses totaled $0.9 million in 2007 and $0.6 million in 2006. The increase in 2007 compared to 2006 primarily relates to higher compensation costs, including stock-based compensation costs.

Non-Operating Results

In connection with the sale of an oil and gas property in 1993, we indemnified the purchaser for any abandonment costs in excess of cumulative net revenues received. The property was subsequently sold to other parties, most recently in 2007. After assessing available information concerning the terms of the 2007 sale and the new purchaser's future plans for the property, we concluded that our obligation to the seller still exists and did not transfer to the new purchaser. Additionally, we concluded that the new purchaser's assumption of all abandonment obligations, along with its significant financial investment and expanded development plans for the property, make the likelihood of our being required to satisfy this contingent abandonment obligation remote. As a result, we reversed our $3.0 million reserve and recorded the same amount as other income in 2007.

Interest Income. Interest income totaled $1.4 million in 2008, $0.8 million in 2007 and $0.4 million in 2006. The increase in interest income primarily reflects interest on our higher average cash balance during 2008. Interest income included interest on Barton Creek MUD reimbursements totaling $0.9 million in 2008, $0.5 million in 2007 and $0.1 million in 2006.

Loss on Interest Rate Cap Agreement. Losses recognized on the interest rate cap agreement totaled $0.6 million in 2008, reflecting falling interest rates reducing the fair value of this derivative instrument. The interest rate cap agreement relates to the W Austin Hotel & Residences construction loan (see Note 7).

Minority Interest in Net Loss of Consolidated Subsidiary. Minority interest in net loss of consolidated subsidiary totaled $0.4 million in 2008 related to the W Austin Hotel & Residences project (see Note 6).

Equity in Unconsolidated Affiliate’s Income. We account for our 50 percent interest in our unconsolidated affiliate, Crestview Station, using the equity method. Crestview Station sold substantially all of its multi-family and commercial properties in 2007 and one commercial site in the first quarter of 2008, which resulted in our equity in Crestview Station’s earnings totaling $0.6 million in 2008 and $1.0 million in 2007.

Benefit from (Provision for) Income Taxes. We recorded an income tax benefit of $1.7 million in 2008, a provision of $1.7 million in 2007 and a benefit of $7.3 million for the year ended December 31, 2006. The difference between our consolidated effective income tax rates for 2008 and 2007 and the U.S. federal statutory rate of 35 percent primarily was attributable to state income tax expense. The difference between our consolidated effective income tax rate for 2006 and the U.S. federal statutory rate of 35 percent primarily was attributable to a $15.3 million tax benefit resulting from the reversal of a portion of our deferred tax asset valuation allowance (see Note 10).

DISCONTINUED OPERATIONS

On October 12, 2007, we sold the Escarpment Village shopping center, located in Austin, Texas, to Lake Villa, L.L.C. (the Purchaser) for $46.5 million, before closing costs and other adjustments. The Purchaser paid $23.0 million in cash at closing and assumed the $22.4 million principal balance remaining under our loan from Teachers Insurance and Annuity Association of America (TIAA). We used a portion of the net proceeds from the sale to pay the outstanding balance on the $45.0 million Comerica revolving credit facility and used the remainder of the net proceeds for general corporate purposes. We recorded a gain of $15.8 million ($10.8 million net of taxes or $1.43 per basic share and $1.41 per diluted share) on the sale.

Upon completion of the sale of Escarpment Village, we ceased all involvement with the Escarpment Village shopping center. The results of operations, assets and liabilities of Escarpment Village, which have been classified as discontinued operations in our consolidated financial statements, previously represented a component of our commercial leasing segment. We earned rental income from Escarpment Village totaling $2.8 million in 2007 and $2.1 million in 2006.

In June 2008, we revised the amount of Texas margin tax accrued on Escarpment Village income earned during 2007. The revised accrual resulted in $0.1 million of additional income tax charges related to 2007, which were recognized in June 2008. As the results of operations of Escarpment Village have been appropriately classified as discontinued operations, the additional Texas margin tax has also been classified as discontinued operations in the consolidated statements of operations.

On March 27, 2006, we sold our two 70,000-square-foot office buildings at 7000 West, known as the Lantana Corporate Center, to CarrAmerica Lantana, LP (CarrAmerica) for $22.3 million, resulting in a gain of $9.1 million ($8.3 million net of taxes or $1.13 per basic share and $1.08 per diluted share). CarrAmerica paid us $10.6 million cash at closing and assumed the $11.7 million principal balance remaining under our 7000 West project loan.

Upon completion of the sale of 7000 West, we ceased all involvement with the 7000 West office buildings. The operations, assets and liabilities of 7000 West represented a component of our commercial leasing segment. We earned rental income of $1.1 million in 2006 from the two fully leased office buildings at 7000 West.

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Income from discontinued operations totaled $11.2 million, including a $10.8 million gain net of taxes on the Escarpment Village sale, in 2007, and $9.8 million, including an $8.3 million gain net of taxes on the 7000 West sale in 2006.

CAPITAL RESOURCES AND LIQUIDITY

As a result of weak economic conditions and the sharp decline in the real estate market, including the markets in which we operate, there is significant uncertainty about the near-term outlook for sales of our properties. However, we believe that the unique nature and location of our assets will provide positive cash flows when market conditions improve.

At December 31, 2008, we had $32.5 million in cash, cash equivalents and investments in U.S. treasury securities (see Note 1), and $45 million in availability under our revolving credit facility, which matures in May 2010. At March 31, 2009, we had $31.4 million in cash, cash equivalents and investments in U.S. treasury securities and $43 million available under our revolving credit facility. Additionally, we have no significant debt maturities in the near-term. We do not expect to make additional capital contributions to the joint venture with Canyon-Johnson until mid-2009, at which time we are committed to begin our additional contributions that will total approximately $20 million. Canyon-Johnson has funded $22.6 million through December 31, 2008, and is committed to fund 100 percent of project costs until their contributions total approximately $44 million. As of December 31, 2008, Canyon-Johnson has an additional $21.4 million to contribute before reaching approximately $44 million, at which point we will be committed to begin our additional contributions that will total approximately $20 million (as discussed above) and Canyon-Johnson will be committed to begin its additional contributions that will total approximately $30 million. Once we and Canyon-Johnson have funded the required capital commitments (approximately $49 million for us and $74 million for Canyon-Johnson) the joint-venture will be able to utilize the balance of its $165 million construction loan, subject to limitations placed on Corus Bank N.A. (Corus) to fund the balance of the loan (see Notes 9 and 15, and "Credit Facility and Other Financing Arrangements").

Comparison of Year-to-Year Cash Flows

Cash (used in) provided by operating activities totaled $(16.8) million in 2008, $(0.6) million in 2007 and $9.2 million in 2006, including cash provided by (used in) discontinued operations totaling $11.4 million in 2007 and $(4.9) million in 2006. Operating cash flows for 2008 decreased compared to 2007 primarily because of a net loss, partially offset by a $3.7 million increase in MUD reimbursements and a $1.3 million distribution of income from our unconsolidated affiliate, Crestview Station. Operating cash flows for 2007 decreased compared to 2006 primarily because of lower sales and net income. Expenditures for purchases and development of real estate properties for 2008, 2007 and 2006 included development costs for properties held for sale, including the residential portion of the W Austin Hotel & Residences project ($15.7 million in 2008, $5.9 million in 2007 and $17.4 million in 2006), and the Barton Creek, Lantana and Circle C communities. We received Barton Creek MUD reimbursements totaling $6.2 million in 2008, $2.6 million in 2007 and $1.3 million in 2006.

Cash (used in) provided by investing activities totaled $(29.2) million in 2008, $3.4 million in 2007 and $(6.5) million in 2006. Cash provided by discontinued operations totaled $10.7 million in 2007, including a $10.8 million gain on sale partly offset by $0.1 of million capital expenditures related to Escarpment Village, and $2.5 million in 2006, including an $8.3 million gain on sale of 7000 West partly offset by $5.3 million of capital expenditures related to Escarpment Village (see "Discontinued Operations" and Note 12). Commercial leasing development expenditures for 2008 and 2007 included development costs for the commercial portion of the W Austin Hotel & Residences project totaling $14.7 million in 2008 and $5.5 million in 2007. There were no commercial leasing development expenditures for the W Austin Hotel & Residences project in 2006. Other expenditures for commercial leasing properties primarily related to Barton Creek Village in 2008 and 7500 Rialto in 2007 and 2006. In 2008, we also invested $15.4 million in U.S. treasury securities, received distributions representing a partial return of our investment in Crestview Station totaling $2.4 million and purchased an interest rate cap agreement totaling $0.7 million.

Cash provided by financing activities totaled $22.2 million in 2008, which included $25.7 million of contributions from Canyon-Johnson for the W Austin Hotel & Residences project and $2.1 million in borrowings from the W Austin Hotel & Residences project construction loan, partly offset by $2.8 million of financing costs for the W Austin Hotel & Residences project construction loan. In 2008, we used $2.5 million to repurchase shares of our common stock on the open market (see below). Financing activities provided cash of $36.5 million in 2007, which included $15.0 million of borrowings under three unsecured term loans and $21.5 million of borrowings

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under the Lantana promissory note, which were primarily used to fund our development activities, partly offset by $3.0 million of net repayments on our revolving line of credit. In 2007, we used $1.5 million to repurchase shares of our common stock on the open market. Excess tax benefits from exercised stock options totaled $4.8 million in 2007 and $1.1 million in 2006. Financing activities used cash of $2.3 million in 2006, which included net repayments of $12.7 million on our revolving line of credit and net repayments of $14.7 million on our project construction loans, partly offset by $15.0 million in borrowings under two separate First American Asset Management (FAAM) term loan agreements. In 2006, we used $0.6 million to repurchase shares of our common stock on the open market. See "Credit Facility and Other Financing Arrangements" below for a discussion of our outstanding debt at December 31, 2008.

In 2001, our Board of Directors approved an open market share purchase program for up to 0.7 million shares of our common stock. During 2008, we purchased 214,216 shares for $2.5 million, an $11.80 per share average, including 190,000 shares purchased for $10.00 per share in a private transaction on December 24, 2008. During 2007, we purchased 45,449 shares for $1.5 million, a $31.97 per share average, and in 2006 we purchased 22,806 shares for $0.6 million, a $24.77 per share average. We also purchased in a private transaction in January 2009, 49,000 shares for $0.4 million or $8.25 per share. As of May 31, 2009, a total of 161,145 shares remain available under this program. Our loan agreement with Comerica provides a limit of $6.5 million for common stock purchases after September 30, 2005, of which $0.9 million was available at May 31, 2009. The timing of future purchases of our common stock is dependent on many factors including the price of our common shares, our cash flows and financial position, and general economic and market conditions.