

ASHFORD HOSPITALITY TRUST INC

Form 10-K

March 09, 2007

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

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number: 001-31775

ASHFORD HOSPITALITY TRUST, INC.
(Exact name of registrant as specified in its charter)

MARYLAND
*(State or other jurisdiction of
incorporation or organization)*

86-1062192
*(I.R.S. Employer
Identification No.)*

**14185 Dallas Parkway, Suite 1100,
Dallas, Texas**
(Address of principal executive offices)

75254
(Zip Code)

(972) 490-9600
(Registrant's telephone number, including area code)

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

**Common Stock, \$0.01 Par
Preferred Stock, Series A, \$0.01 Par**

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 by Rule 405 of the Securities Exchange Act). Yes No

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

Indicate by check mark whether the registrant (i) 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 (ii) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act).

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant, computed by reference to the price at which the registrant's common stock was last sold on the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$690.7 million. As of March 8, 2007, the registrant had issued and outstanding 72,936,841 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's definitive Proxy Statement pertaining to the 2007 Annual Meeting of Stockholders (the Proxy Statement), filed or to be filed not later than 120 days after the end of the fiscal year pursuant to Regulation 14A, is incorporated herein by reference into Part III.

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Forward-Looking Statements

We make forward-looking statements throughout this Form 10-K and documents incorporated herein by reference that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans, and objectives. Statements regarding the following subjects are forward-looking by their nature:

- our business and investment strategy;
- our projected operating results;
- completion of any pending transactions;
- our ability to obtain future financing arrangements;
- our understanding of our competition;
- market trends;
- projected capital expenditures; and
- the impact of technology on our operations and business.

Such forward-looking statements are based on our beliefs, assumptions, and expectations of our future performance taking into account all information currently known to us. These beliefs, assumptions, and expectations can change as a result of many potential events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity, results of operations, plans, and other objectives may vary materially from those expressed in our forward-looking statements. Additionally, the following factors could cause actual results to vary from our forward-looking statements:

- factors discussed in this Form 10-K, including those set forth under the sections titled Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations, Business, and Properties;
- general volatility of the capital markets and the market price of our common stock;
- changes in our business or investment strategy;
- availability, terms, and deployment of capital;
- availability of qualified personnel;
- changes in our industry and the market in which we operate, interest rates, or the general economy; and
- the degree and nature of our competition.

When we use the words will likely result, may, anticipate, estimate, should, expect, believe, intend, or similar expressions, we intend to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. We are not obligated to publicly update or revise any forward-looking statements,

whether as a result of new information, future events, or otherwise.

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PART I

Item 1. *Business*

OUR COMPANY

Ashford Hospitality Trust, Inc. and subsidiaries (the *Company* or *we* or *our*) is a self-advised real estate investment trust (*REIT*), which commenced operations on August 29, 2003 (*inception*) when it completed its initial public offering (*IPO*). We own our lodging investments and conduct our business through Ashford Hospitality Limited Partnership, our operating partnership. Ashford OP General Partner LLC, a wholly-owned subsidiary of ours, serves as the sole general partner of our operating partnership.

The *Company* elected to be treated as a *REIT* for federal income tax purposes. As a result of limitations imposed on *REITs* related to operating hotel properties, each of the *Company's* hotel properties is leased or owned by wholly-owned subsidiaries of the *Company* that are treated as taxable *REIT* subsidiaries for federal income tax purposes (collectively, such subsidiaries are referred to as *Ashford TRS*). *Ashford TRS* then engages third-party or affiliated hotel management companies to operate the hotels under management contracts. Remington Lodging & Hospitality, L.P. and Remington Management, L.P. (collectively, *Remington Lodging*), both primary property managers for the *Company*, are beneficially wholly owned by Mr. Archie Bennett, Jr., the *Company's* Chairman, and Mr. Montgomery J. Bennett, the *Company's* President and Chief Executive Officer. As of December 31, 2006, *Remington Lodging* managed 37 of the *Company's* 81 hotel properties while unaffiliated management companies managed the remaining 44 hotel properties.

As of December 31, 2006, 72,942,841 shares of common stock, 2,300,000 shares of Series A preferred stock, 7,447,865 shares of Series B preferred stock, and 13,512,425 units of limited partnership interest held by entities other than the *Company* were outstanding. During the year ended December 31, 2006, the *Company* completed the following transactions:

On January 25, 2006, the *Company* issued 12,107,623 shares of common stock in a follow-on public offering.

On March 28, 2006, the *Company* issued 642,557 shares of restricted common stock to its executive officers and certain employees of the *Company* and its affiliates.

On May 2, 2006, the *Company* issued 16,000 shares of common stock to its directors as compensation for serving on the Board of Directors through May 2007.

On July 13, 2006, the *Company* issued 3,814,842 units of limited partnership interest in connection with the acquisition of a hotel property.

On July 25, 2006, the *Company* issued 14,950,000 shares of common stock in a follow-on public offering.

On August 1, 2006, the *Company* issued 3,000 shares of restricted common stock to certain employees of the *Company*.

During the year ended December 31, 2006, the *Company* issued 1,394,492 shares of common stock in exchange for 1,394,492 units of limited partnership interest.

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As of December 31, 2006, we owned 81 hotel properties in 26 states with 15,492 rooms, an office building with nominal operations, and approximately \$103.0 million of mezzanine or first-mortgage loans receivable. Our hotel investments are currently focused on the upscale and upper-upscale lodging segments and primarily concentrated among Marriott, Hilton, Hyatt, and Starwood brands.

We maintain a website at www.ahtreit.com. On our website, we make available free-of-charge all our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission. In addition, our Code of Business Conduct and Ethics, Code of Ethics for the Chief Executive Officer, Chief Financial

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Officer, and Chief Accounting Officer, Corporate Governance Guidelines, and Board Committee Charters are also available free-of-charge on our website or can be made available in print upon request.

All reports filed with the Securities and Exchange Commission may also be read and copied at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. Further information regarding the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. In addition, all of our filed reports can be obtained at the SEC's website at www.sec.gov.

OUR BUSINESS STRATEGIES

We currently focus our investment strategies on the upscale and upper-upscale segments within the lodging industry. However, we also believe that as supply, demand, and capital market cycles change, we will be able to shift our investment strategies to take advantage of newly created lodging-related investment opportunities as they develop. Currently, we do not limit our acquisitions to any specific geographical market. While our current investment strategies are well defined, our Board of Directors may change our investment policies at any time without stockholder approval.

We intend to continue to invest in a variety of lodging-related assets based upon our evaluation of diverse market conditions. These investments may include: (i) direct hotel investments; (ii) mezzanine financing through origination or acquisition in secondary markets; (iii) first-lien mortgage financing through origination or acquisition in secondary markets; and (iv) sale-leaseback transactions.

Our strategy is designed to take advantage of current lodging industry conditions and adjust to changes in market conditions over time. In the current market, we believe we can continue to purchase assets at discounts and acquire or originate debt positions with attractive relative yields. Over time, our assessment of market conditions will determine asset reallocation strategies. While we seek to capitalize on favorable market fundamentals, conditions beyond our control may have an impact on overall profitability and our investment returns.

Our current investment strategy primarily targets limited and full-service hotels in primary, secondary, and resort markets throughout the United States. To take full advantage of current and future investment opportunities in the lodging industry, we will invest according to the asset allocation strategies described below. Due to ongoing changes in market conditions, we will continually evaluate the appropriateness of our investment strategies. Our Board of Directors may change any or all of these strategies at any time.

Direct Hotel Investments In selecting hotels to acquire, we target hotels that either offer a high current return or have the opportunity to increase in value through repositioning, capital investments, market-based recovery, or improved management practices. We intend to continue to acquire existing hotels and, under appropriate market conditions, may develop new hotels. Our direct hotel acquisition strategy will continue to follow similar investment criteria and will seek to achieve both current income and income from appreciation. In addition, we will continue to assess our existing hotel portfolio and make strategic decisions to sell certain under-performing or smaller hotels that do not fit our investment strategy or criteria.

Mezzanine Financing Subordinated loans, or mezzanine loans, that we acquire or originate relate to upscale or full-service hotels with reputable managers that are located in established or emerging sub-markets. These mezzanine loans are secured by junior mortgages on hotels or pledges of equity interests in entities owning hotels. We intend to continue to acquire or originate mezzanine loans. Mezzanine loans that we acquire in the future may be secured by individual assets as well as cross-collateralized portfolios of assets. Although these types of loans generally have greater repayment risks than first mortgages due to the subordinated nature of the loans, we have a disciplined approach in underwriting the value of the asset. We expect this asset class to provide us with attractive returns. In

addition, subject to restrictions applicable to REITs, we may acquire or originate corporate-level mezzanine loans on an unsecured basis.

First Mortgage Financing From time to time, we acquire or originate junior participations in first mortgages, which we often refer to as mezzanine loans. As interest rates increase and the dynamics in the hotel industry make first-mortgage investments more attractive, we intend to acquire, potentially at a discount to par, or originate loans secured by first priority mortgages on hotels. We may be subject to certain state-imposed licensing regulations related to commercial mortgage lenders, with which we intend to comply. However, because we are not

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a bank or a federally chartered lending institution, we are not subject to the state and federal regulatory constraints imposed on such entities. Also, we expect we will be able to offer more flexible terms than commercial lenders who contribute loans to securitized mortgage pools. We anticipate that this asset class will provide us with stable, attractive current yields.

Sale-Leaseback Transactions To date, we have not participated in any sale-leaseback transactions. However, if the lodging industry fundamentals shift such that sale-leaseback transactions become more attractive investments, we intend to purchase hotels and lease them back to their existing hotel owners.

OUR OPERATING SEGMENTS

As addressed in Item 15, Financial Statements Schedules, we currently operate in two business segments within the hotel lodging industry: direct hotel investments and hotel financing. These operating segments are described above along with additional operating segments where we anticipate future participation.

OUR FINANCING STRATEGY

We utilize our borrowing power to leverage future investments. When evaluating our future level of indebtedness and making decisions regarding the incurrence of indebtedness, our Board of Directors considers a number of factors, including:

- the purchase price of our investments to be acquired with debt financing;

- the estimated market value of our investments upon refinancing; and

- the ability of particular investments, and our Company as a whole, to generate cash flow to cover expected debt service.

We may incur debt in the form of purchase money obligations to the sellers of properties, publicly or privately placed debt instruments, or financing from banks, institutional investors, or other lenders. Any such indebtedness may be unsecured or secured by mortgages or other interests in our properties or mortgage loans. This indebtedness may be recourse, non-recourse, or cross-collateralized. If recourse, that recourse may include our general assets or be limited to the particular investment to which the indebtedness relates. In addition, we may invest in properties or loans subject to existing loans secured by mortgages or similar liens on the properties, or we may refinance properties acquired on a leveraged basis. We may use the proceeds from any borrowings for working capital to:

- purchase interests in partnerships or joint ventures;

- refinance existing indebtedness;

- finance the origination or purchase of mortgage investments; or

- finance acquisitions, expand or redevelop existing properties, or develop new properties.

In addition, we may need to borrow to meet the taxable income distribution requirements under the Internal Revenue Code if we do not have sufficient cash available to meet those distribution requirements. No assurances can be given that we will obtain additional financings or, if we do, what the amount and terms will be. Our failure to obtain future financing under favorable terms could adversely impact our ability to execute our business strategy. In addition, we may selectively pursue mortgage financing on our individual properties and mortgage investments.

OUR DISTRIBUTION POLICY

To maintain our qualification as a REIT, we make annual distributions to our stockholders of at least 90% of our REIT taxable income (which does not necessarily equal net income as calculated in accordance with generally accepted accounting principles). Distributions are authorized by our Board of Directors and declared by us based upon a variety of factors deemed relevant by our directors. No assurance can be given that our dividend policy will not change in the future. Our ability to pay distributions to our stockholders will depend, in part, upon our receipt of distributions from our operating partnership. This, in turn, may depend upon receipt of lease payments with respect to our properties from indirect, wholly-owned subsidiaries of our operating partnership and the management of our

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properties by our property managers. Distributions to our stockholders are generally taxable to our stockholders as ordinary income. However, since a portion of our investments are equity ownership interests in hotels, which result in depreciation and non-cash charges against our income, a portion of our distributions may constitute a tax-free return of capital. To the extent that it is not inconsistent with maintaining our REIT status, we may maintain accumulated earnings of Ashford TRS in that entity.

Our charter allows us to issue preferred stock with a preference on distributions. The partnership agreement of our operating partnership also allows the operating partnership to issue units with a preference on distribution. Such issuance of preferred stock or preferred units, given the dividend preference on this stock or units, could limit our ability to make a dividend distribution to our common stockholders.

OUR RECENT DEVELOPMENTS

During the year ended December 31, 2006, we completed the following significant transactions:

Business Combinations:

On February 24, 2006, the Company acquired the Marriott at Research Triangle Park hotel property in Durham, North Carolina, from Host Marriott Corporation for approximately \$28.0 million in cash. The Company used proceeds from its follow-on public offering on January 25, 2006 to fund this acquisition.

On April 19, 2006, the Company acquired the Pan Pacific San Francisco Hotel in San Francisco, California, from W2001 Pac Realty, L.L.C. for approximately \$95.0 million in cash. The hotel was immediately re-branded as a JW Marriott. The Company used proceeds from two credit facility draws of approximately \$88.9 million and \$15.0 million to fund this acquisition.

On July 13, 2006, the Company acquired the Marriott Crystal Gateway hotel in Arlington, Virginia, from EADS Associates Limited Partnership for approximately \$107.2 million. The purchase price consisted of the assumption of approximately \$53.3 million of mortgage debt, the issuance of approximately \$42.7 million worth of limited partnership units, which equates to 3,814,842 units valued at \$11.20 per unit, approximately \$2.5 million in cash paid in lieu of units, the reimbursement of capital expenditures costs of approximately \$7.2 million, and other net closing costs and adjustments of approximately \$1.5 million.

On November 9, 2006, the Company acquired the Westin O Hare hotel property in Rosemont, Illinois, from JER Partners for approximately \$125.0 million in cash. To fund this acquisition, the Company used cash available on its balance sheet and a draw on a line of credit, which was paid down with proceeds from a \$101.0 million mortgage loan executed on November 16, 2006.

On December 7, 2006, the Company acquired a seven-property hotel portfolio (MIP Portfolio) from a partnership of affiliates of Oak Hill Capital Partners, The Blackstone Group, and Interstate Hotels and Resorts for approximately \$267.2 million in cash. Of the seven acquired hotels, five are considered core hotels while two are considered non-core hotels, which the Company intends to sell. To fund this acquisition, the Company used cash available on its balance sheet, proceeds from a \$25.0 million draw on a credit facility, and proceeds from a \$212.0 million mortgage loan executed on December 7, 2006.

Capital Stock:

On January 25, 2006, in a follow-on public offering, the Company issued 12,107,623 shares of its common stock at \$11.15 per share, which generated gross proceeds of approximately \$135.0 million. However, the aggregate proceeds

to the Company, net of underwriters' discount and offering costs, was approximately \$128.1 million. The 12,107,623 shares issued include 1,507,623 shares sold pursuant to an over-allotment option granted to the underwriters. The net proceeds were used for a \$60.0 million pay-down on the Company's \$100.0 million credit facility, due August 17, 2008, on January 31, 2006, a \$45.0 million pay-down on the Company's \$45.0 million mortgage loan, due October 10, 2007, on February 9, 2006, and the acquisition of the Marriott at Research Triangle Park hotel property on February 24, 2006 for \$28.0 million.

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On July 25, 2006, in a follow-on public offering, the Company issued 14,950,000 shares of its common stock at \$11.40 per share, which generated gross proceeds of approximately \$170.4 million. However, the aggregate proceeds to the Company, net of underwriters' discount and offering costs, was approximately \$162.0 million. The 14,950,000 shares issued include 1,950,000 shares sold pursuant to an over-allotment option granted to the underwriters. On July 25, 2006, the net proceeds were used to pay down the Company's \$30.0 million balance on its \$47.5 million credit facility, due October 10, 2007, and pay down its \$98.9 million balance on its \$100.0 million credit facility, due August 17, 2008.

Discontinued Operations:

On January 17, 2006, the Company sold two hotel properties for approximately \$10.7 million, net of closing costs.

On March 24, 2006, the Company sold eight hotel properties for approximately \$100.4 million, net of closing costs.

Notes Receivable:

On May 3, 2006, the Company received approximately \$7.3 million in full payment of all principal and interest due under its \$6.6 million mezzanine loan receivable, due May 2006 under a forbearance agreement.

On June 9, 2006, the Company originated a \$26.3 million mezzanine loan receivable, due April 2008.

On June 15, 2006, the Company received approximately \$15.2 million in full payment of all principal and interest due under its \$15.0 million loan receivable, due January 2007.

On July 21, 2006, the Company received approximately \$15.2 million in full payment of all principal and interest due under its \$15.0 million loan receivable, due April 2007.

On September 24, 2006, the Company extended the maturity date on its \$5.0 million note receivable, originally due October 2006, to October 2007. On December 5, 2006, the Company received approximately \$5.1 million related to all principal and interest due under this loan.

On November 17, 2006, the Company received a principal payment of approximately \$614,000 related to a portion of its \$26.3 million note receivable, due April 2008. As a result of this prepayment, the \$26.3 million note receivable, originally secured by 107 hotel properties, became a \$25.7 million note receivable, secured by 105 hotel properties.

On December 27, 2006, the Company originated a \$7.0 million mezzanine loan receivable, due December 2009.

On December 27, 2006, the Company originated a \$4.0 million mezzanine loan receivable, due December 2009.

Indebtedness:

On February 9, 2006, the Company paid down its \$45.0 million mortgage loan, due October 10, 2007, at an interest rate of LIBOR plus 2%, to \$100. On April 3, 2006, the Company modified this mortgage note payable to a \$47.5 million revolving credit facility, with a revolving period through October 11, 2006 and interest rates during the revolving period ranging from LIBOR plus 1% to LIBOR plus 1.5% depending on the outstanding balance. After the revolving period expires, the interest rate resumes its original rate of LIBOR plus 2%. Consistent with the original mortgage, the modified credit facility requires monthly interest-only payments and has three one-year extension options. On April 18, 2006 and June 6, 2006, the Company completed draws of approximately \$15.0 million each on

this credit facility. On July 25, 2006, the Company repaid the \$30.0 million outstanding balance on this credit facility. On July 26, 2006, the Company modified this credit facility to extend both the revolving period and maturity date by one year to October 11, 2007 and October 10, 2008, respectively. As of December 31, 2006, approximately \$100 was outstanding on this credit facility.

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On March 24, 2006, in connection with the sale of eight hotel properties for approximately \$100.4 million, net of closing costs, the buyer assumed approximately \$93.7 million of mortgage debt, which had an interest rate of 5.32% and matured July 1, 2015. This reduced the Company's \$580.8 million mortgage note payable outstanding at December 31, 2005, secured by 40 hotels, with an average interest rate of 5.4%, to \$487.1 million outstanding at December 31, 2006, secured by 32 hotels, with an average interest rate of 5.41%. In connection with the buyer's assumption of this debt, the Company wrote-off unamortized loan costs of approximately \$687,000.

On May 30, 2006, the Company repaid its then outstanding \$11.1 million balance on its mortgage note payable, due April 1, 2011, which resulted in the write-off of unamortized loan costs of approximately \$102,000.

On July 13, 2006, in connection with the acquisition of the Marriott Crystal Gateway hotel in Arlington, Virginia, the Company assumed a mortgage note payable of approximately \$53.3 million, due December 1, 2017, at an interest rate of 7.24% through December 31, 2007 and 7.39% thereafter.

On September 8, 2006, the Company modified its \$100.0 million credit facility, due August 16, 2008, to increase the capacity to \$150.0 million with the ability to be increased to \$200.0 million subject to certain conditions and reduced the interest rate from LIBOR plus a range of 1.6% to 1.95% to LIBOR plus a range of 1.6% to 1.85% depending on the loan-to-value ratio. On February 27, 2006, April 18, 2006, July 14, 2006, November 8, 2006, and December 6, 2006, the Company completed draws on this credit facility of \$10.0 million, \$88.9 million, \$25.0 million, \$80.0 million, and \$25.0 million, respectively. On January 31, 2006, June 28, 2006, July 25, 2006, and November 16, 2006, the Company paid down this credit facility by \$60.0 million, \$25.0 million, \$98.9 million, and \$80.0 million, respectively. At December 31, 2006, the Company had an outstanding balance of \$25.0 million on this credit facility.

On November 16, 2006, the Company executed a \$101.0 million mortgage note payable, due December 8, 2016, at an interest rate of 5.81%, with interest-only payments due monthly for five years plus principal payments thereafter based on a thirty-year amortization schedule.

On December 7, 2006, the Company executed a \$247.0 million mortgage note payable, of which \$212.0 million was funded immediately with the remaining balance to be funded over the next two years as capital expenditures are incurred by the Company. The loan matures December 11, 2009, with two one-year extension options, bears interest at a rate of LIBOR plus 1.72%, and requires interest-only payments due monthly.

Dividends:

During the year ended December 31, 2006, the Company declared cash dividends of approximately \$60.1 million, or \$0.20 per diluted share per quarter, related to both common stockholders and common unit holders, of which approximately \$51.9 million and \$8.3 million related to each, respectively.

During the year ended December 31, 2006, the Company declared cash dividends of approximately \$1.4 million, or \$0.19 per diluted share per quarter prorated for days outstanding, related to Class B unit holders.

During the year ended December 31, 2006, the Company declared cash dividends of approximately \$4.9 million, or \$0.5344 per diluted share per quarter, related to Series A preferred stockholders.

During the year ended December 31, 2006, the Company declared cash dividends of approximately \$6.0 million, or \$0.20 per diluted share per quarter, related to Series B preferred stockholders.

OUR COMPETITION

The hotel industry is highly competitive. All of our hotels are located in developed areas that include other hotel properties. Accordingly, our hotels compete for guests with other full-service or limited-service hotels in their immediate vicinities and, secondarily, with hotels in their geographic markets. The future occupancy, ADR, and RevPAR of any hotel could be materially and adversely affected by an increase in the number or quality of competitive hotel properties in its market area. We believe that brand recognition, location, quality of the hotel and the services provided, and price are the principal competitive factors affecting our hotels.

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OUR EMPLOYEES

At December 31, 2006, we had 43 full-time employees. Such employees perform directly or through our operating partnership various acquisition, development, redevelopment, and corporate management functions. All persons employed in the day-to-day operations of our hotels are employees of the management companies rather than employees of ours.

OUR ENVIRONMENTAL MATTERS

Under various federal, state, and local laws and regulations, an owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on such property. These laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence of hazardous or toxic substances. Furthermore, a person who arranges for the disposal of a hazardous substance or transports a hazardous substance for disposal or treatment from property owned by another may be liable for the costs of removal or remediation of hazardous substances released into the environment at that property. The costs of remediation or removal of such substances may be substantial, and the presence of such substances, or the failure to promptly remediate such substances, may adversely affect the owner's ability to sell the affected property or to borrow using the affected property as collateral. In connection with the ownership and operation of our properties, we, our operating partnership, or Ashford TRS may be potentially liable for any such costs. In addition, the value of any lodging property loan we originate or acquire would be adversely affected if the underlying property contained hazardous or toxic substances.

Phase I environmental assessments, which are intended to identify potential environmental contamination for which our properties may be responsible, have been obtained on each of our properties. Phase I environmental assessments included:

historical reviews of the properties,

reviews of certain public records,

preliminary investigations of the sites and surrounding properties,

screening for the presence of hazardous substances, toxic substances, and underground storage tanks, and

the preparation and issuance of a written report.

Phase I environmental assessments did not include invasive procedures, such as soil sampling or ground water analysis.

Phase I environmental assessments have not revealed any environmental liability that we believe would have a material adverse effect on our business, assets, results of operations, or liquidity, and we are not aware of any such liability. To the extent Phase I environmental assessments reveal facts that require further investigation, we would perform a Phase II environmental assessment. However, it is possible that these environmental assessments will not reveal all environmental liabilities. There may be material environmental liabilities of which we are unaware, including environmental liabilities that may have arisen since the environmental assessments were completed or updated. No assurances can be given that (i) future laws, ordinances, or regulations will not impose any material environmental liability, or (ii) the current environmental condition of our properties will not be affected by the condition of properties in the vicinity (such as the presence of leaking underground storage tanks) or by third parties

unrelated to us.

We believe our properties are in compliance in all material respects with all federal, state, and local ordinances and regulations regarding hazardous or toxic substances and other environmental matters. Neither we nor, to our knowledge, any of the former owners of our properties have been notified by any governmental authority of any material noncompliance, liability, or claim relating to hazardous or toxic substances or other environmental matters in connection with any of our properties.

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OUR INSURANCE

We maintain comprehensive insurance, including liability, property, workers' compensation, rental loss, environmental, terrorism, and, when available on reasonable commercial terms, flood and earthquake insurance, with policy specifications, limits, and deductibles customarily carried for similar properties. Certain types of losses (for example, matters of a catastrophic nature such as acts of war or substantial known environmental liabilities) are either uninsurable or require substantial premiums that are not economically feasible to maintain. Certain types of losses, such as those arising from subsidence activity, are insurable only to the extent that certain standard policy exceptions to insurability are waived by agreement with the insurer. We believe, however, that our properties are adequately insured, consistent with industry standards.

OUR FRANCHISE LICENSES

We believe that the public's perception of quality associated with a franchisor is an important feature in the operation of a hotel. Franchisors provide a variety of benefits for franchisees, which include national advertising, publicity, and other marketing programs designed to increase brand awareness, training of personnel, continuous review of quality standards, and centralized reservation systems. As of December 31, 2006, the Company owned 81 hotels, 79 of which operated under the following franchise licenses or brand management agreements:

Embassy Suites is a registered trademark of Hilton Hospitality, Inc.

Doubletree is a registered trademark of Hilton Hospitality, Inc.

Hilton is a registered trademark of Hilton Hospitality, Inc.

Hilton Garden Inn is a registered trademark of Hilton Hospitality, Inc.

Homewood Suites by Hilton is a registered trademark of Hilton Hospitality, Inc.

Hampton Inn is a registered trademark of Hilton Hospitality, Inc.

Radisson is a registered trademark of Radisson Hotels International, Inc.

Marriott is a registered trademark of Marriott International, Inc.

JW Marriott is a registered trademark of Marriott International, Inc.

SpringHill Suites is a registered trademark of Marriott International, Inc.

Residence Inn by Marriott is a registered trademark of Marriott International, Inc.

Courtyard by Marriott is a registered trademark of Marriott International, Inc.

Fairfield Inn by Marriott is a registered trademark of Marriott International, Inc.

TownePlace Suites is a registered trademark of Marriott International, Inc.

Hyatt Regency is a registered trademark of Hyatt Corporation.

Sheraton is a registered trademark of Sheraton Hotels and Resorts, a division of Starwood Hotels and Resorts Worldwide, Inc.

Westin is a registered trademark of Westin Hotels and Resorts, a division of Starwood Hotels and Resorts Worldwide, Inc.

Crowne Plaza is a registered trademark of InterContinental Hotels Group.

Our management companies, including Remington Lodging, must operate each hotel pursuant to the terms of the related franchise or brand management agreement, and must use their best efforts to maintain the right to operate each hotel as such. In the event of termination of a particular franchise or brand management agreement, our management companies must operate the affected hotels under another franchise or brand management agreement, if any, that we enter into. We anticipate that most of the additional hotels we acquire will be operated under franchise licenses or brand management agreements as well.

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Our franchise licenses and brand management agreements generally specify certain management, operational, recordkeeping, accounting, reporting, and marketing standards and procedures with which the franchisee or brand operator must comply, including requirements related to:

training of operational personnel;

safety;

maintaining specified insurance;

types of services and products ancillary to guestroom services that may be provided;

display of signage; and

type, quality, and age of furniture, fixtures, and equipment included in guestrooms, lobbies, and other common areas.

OUR SEASONALITY MATTERS

Our properties' operations historically have been seasonal as certain properties maintain higher occupancy rates during the summer months. This seasonality pattern can cause fluctuations in our quarterly lease revenue under our percentage leases. We anticipate that the cash flow from the operations of our properties will be sufficient to enable us to make quarterly distributions to maintain our REIT status. To the extent that cash flow from operations is insufficient during any quarter due to temporary or seasonal fluctuations in lease revenue, we expect to utilize other cash on hand or borrowings to make required distributions. However, we cannot make any assurances that we will make distributions in the future.

Item 1A. Risk Factors

Risks Related to Our Business

Our business strategy depends on our continued growth. We may fail to integrate recent and additional investments into our operations or otherwise manage our planned growth, which may adversely affect our operating results.

Our business plan contemplates a period of continued growth in the next several years. We cannot assure you that we will be able to adapt our management, administrative, accounting, and operational systems, or hire and retain sufficient operational staff to successfully integrate our recent investments into our portfolio and manage any future acquisitions of additional assets without operating disruptions or unanticipated costs. Acquisitions of any additional portfolios of properties or mortgages would generate additional operating expenses that we will be required to pay. As we acquire additional assets, we will be subject to the operational risks associated with owning new lodging properties. Our failure to successfully integrate our recent acquisitions as well as any future acquisitions into our portfolio could have a material adverse effect on our results of operations and financial condition and our ability to pay dividends to stockholders.

We may be unable to identify additional real estate investments that meet our investment criteria or to acquire the properties we have under contract.

We cannot assure you that we will be able to identify real estate investments that meet our investment criteria, that we will be successful in completing any investment we identify, or that any investment we complete will produce a return on our investment. Moreover, we will have broad authority to invest in any real estate investments that we may identify in the future. We also cannot assure you that we will acquire properties we currently have under firm purchase contracts, if any, or that the acquisition terms we have negotiated will not change.

Conflicts of interest could result in our management acting other than in our stockholders' best interest.

Conflicts of interest relating to Remington Lodging may lead to management decisions that are not in the stockholders' best interest. The Chairman of our Board of Directors, Mr. Archie Bennett, Jr., serves as the Chairman of the Board of Directors of Remington Lodging, and our Chief Executive Officer and President, Mr. Montgomery

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Bennett, serves as the Chief Executive Officer and President of Remington Lodging. Messrs. Archie and Montgomery Bennett own 100% of Remington Lodging, which manages 37 of our 81 properties and provides related services, including property management services and project management services.

Messrs. Archie and Montgomery Bennett's ownership interests in and management obligations to Remington Lodging present them with conflicts of interest in making management decisions related to the commercial arrangements between us and Remington Lodging and will reduce the time and effort they each spend managing us. Our Board of Directors has adopted a policy that requires all management decisions relating to the management agreements with Remington Lodging be approved by a majority or, in certain circumstances, all of our independent directors.

Holders of units in our operating partnership, including members of our management team, may suffer adverse tax consequences upon our sale of certain properties. Therefore, holders of units, either directly or indirectly, including Messrs. Archie and Montgomery Bennett, Mr. David Brooks, our Chief Legal Officer, Mr. David Kimichik, our Chief Financial Officer, Mr. Mark Nunneley, our Chief Accounting Officer, and Mr. Martin L. Edelman (or his family members), one of our directors, may have different objectives regarding the appropriate pricing and timing of a particular property's sale. These officers and directors of ours may influence us not to sell or refinance certain properties, even if such sale or refinancing might be financially advantageous to our stockholders, or to enter into tax deferred exchanges with the proceeds of such sales when such a reinvestment might not otherwise be in our best interest. In addition, we have agreed to indemnify contributors of properties contributed to us in exchange for operating partnership units, including (indirectly) Messrs. Archie and Montgomery Bennett, Brooks, Kimichik, Nunneley, and Edelman (or his family members), against the income tax they may incur if we dispose of the specified contributed properties. Because of this indemnification, our indemnified management team members may make decisions about selling any of these properties that are not in our stockholders' best interest.

We are a party to a master hotel management agreement and an exclusivity agreement with Remington Lodging, which describes the terms of Remington Lodging's management of our hotels, as well as any future hotels we may acquire that will be managed by Remington Lodging. If we terminate the management agreement as to any of the six hotels we acquired in connection with our initial public offering, which are all subject to the management agreement, because we elect to sell those hotels, we will be required to pay Remington Lodging a substantial termination fee. Remington Lodging may agree to waive the termination fee if a replacement hotel is substituted but is under no contractual obligation to do so. The exclusivity agreement requires us to engage Remington Lodging, unless our independent directors either (i) unanimously vote to hire a different manager or developer, or (ii) by a majority vote, elect not to engage Remington Lodging because they have determined that special circumstances exist or that, based on Remington Lodging's prior performance, another manager or developer could perform the duties materially better. As the sole owners of Remington Lodging, which would receive any development, management, and management termination fees payable by us under the management agreement, Messrs. Archie and Montgomery Bennett may influence our decisions to sell, acquire, or develop hotels when it is not in the best interests of our stockholders to do so.

In addition, Ashford Financial Corporation, an affiliate, contributed certain asset management and consulting agreements to us in connection with our initial public offering relating to management and consulting services that Ashford Financial Corporation agreed to perform for hotel property managers with respect to 27 identified hotel properties in which Messrs. Archie and Montgomery Bennett held a minority interest. Ashford Financial Corporation is 100% owned by Messrs. Archie and Montgomery Bennett. The agreements provided for annual payments to us, as the assignee of Ashford Financial Corporation, in consideration for our performance of certain asset management and consulting services. The exact amount of the consideration due to us under the remaining asset management and consulting agreements was initially contingent upon the revenue generated by the hotels underlying the asset management and consulting agreements. Ashford Financial Corporation guaranteed a minimum payment to us of \$1.2 million per year, subject to adjustments based on the consumer price index, through December 31, 2008. All of

the 27 hotel properties for which we previously provided the asset management and consulting services have been sold, including our acquisition of 21 of the hotel properties in March 2005. Accordingly, we anticipate collecting the balance of the guaranteed minimum payment of \$1.2 million per year from Ashford Financial Corporation under its guarantee.

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Tax indemnification obligations that apply in the event that we sell certain properties could limit our operating flexibility.

If we dispose of any of the five properties that were contributed to us in exchange for units in our operating partnership in connection with our initial public offering, we may be obligated to indemnify the contributors, including Messrs. Archie and Monty Bennett whom have substantial ownership interests, against the tax consequences of the sale. In addition, under the tax indemnification agreements, we have agreed for a period of 10 years to use commercially reasonable efforts to maintain non-recourse mortgage indebtedness in the amount of at least \$16.0 million, which will allow the contributors to defer recognition of gain in connection with the contribution of the Las Vegas hotel property as part of our formation.

Additionally, for certain periods of time, we are prohibited from selling or transferring the Sea Turtle Inn in Atlantic Beach, Florida, and the Marriott Crystal Gateway in Arlington, Virginia, if as a result, the entity from which we acquired the property would recognize gain for federal tax purposes.

Further, in connection with our acquisition of certain properties in March 2005 that were contributed to us in exchange for units in our operating partnership, we agreed to certain tax indemnities with respect to 11 additional properties. If we dispose of any of these 11 properties or reduce the debt on these properties in a transaction that results in a taxable gain to the contributors, we may be obligated to indemnify the contributors or their specified assignees against the tax consequences of the transaction.

In general, our tax indemnities will be equal to the amount of the federal, state, and local income tax liability the contributor or its specified assignee incurs with respect to the gain allocated to the contributor. The terms of the contribution agreements also generally require us to gross up tax indemnity payments for the amount of income taxes due as a result of the tax indemnity.

While the tax indemnities generally do not contractually limit our ability to conduct our business in the way we desire, we are less likely to sell any of the contributed properties for which we have agreed to the tax indemnities described above in a taxable transaction during the applicable indemnity period. Instead, we would either hold the property for the entire indemnity period or seek to transfer the property in a tax-deferred like-kind exchange. In addition, a condemnation of one of our properties could trigger our tax indemnification obligations.

Hotel franchise requirements could adversely affect distributions to our stockholders.

We must comply with operating standards, terms, and conditions imposed by the franchisors of the hotel brands under which our hotels operate. Franchisors periodically inspect their licensed hotels to confirm adherence to their operating standards. The failure of a hotel to maintain standards could result in the loss or cancellation of a franchise license. With respect to operational standards, we rely on our property managers to conform to such standards. Franchisors may also require us to make certain capital improvements to maintain the hotel in accordance with system standards, the cost of which can be substantial. It is possible that a franchisor could condition the continuation of a franchise based on the completion of capital improvements that our management or Board of Directors determines is too expensive or otherwise not economically feasible in light of general economic conditions or the operating results or prospects of the affected hotel. In that event, our management or Board of Directors may elect to allow the franchise to lapse or be terminated, which could result in a change in brand franchising or operation of the hotel as an independent hotel.

In addition, when the term of a franchise expires, the franchisor has no obligation to issue a new franchise. The loss of a franchise could have a material adverse effect on the operations or the underlying value of the affected hotel because

of the loss of associated name recognition, marketing support, and centralized reservation systems provided by the franchisor. The loss of a franchise could also have a material adverse effect on cash available for distribution to stockholders.

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Future terrorist attacks similar in nature to the events of September 11, 2001 may negatively affect the performance of our properties, the hotel industry in general, and our future results of operations and financial condition.

The terrorist attacks of September 11, 2001, their after-effects, and the resulting U.S.-led military action in Iraq substantially reduced business and leisure travel throughout the United States and hotel industry revenue per available room, or RevPAR, generally during the period following September 11, 2001. We cannot predict the extent to which additional terrorist attacks, acts of war, or similar events may occur in the future or how such events would directly or indirectly impact the hotel industry or our operating results.

Future terrorist attacks, acts of war, or similar events could have further material adverse effects on the hotel industry at large and our operations in particular.

Our investments will be concentrated in particular segments of a single industry.

Our entire business is hotel related. Our current investment strategy is to acquire or develop upscale to upper-upscale hotels, acquire first mortgages on hotel properties, invest in other mortgage-related instruments such as mezzanine loans to hotel owners and operators, and participate in hotel sale-leaseback transactions. Adverse conditions in the hotel industry will have a material adverse effect on our operating and investment revenues and cash available for distribution to our stockholders.

We rely on third party property managers, including Remington Lodging, to operate our hotels and for a significant majority of our cash flow.

For us to continue to qualify as a REIT, third parties must operate our hotels. A REIT may lease its hotels to taxable REIT subsidiaries in which the REIT can own up to a 100% interest. A taxable REIT subsidiary, or TRS, pays corporate-level income tax and may retain any after-tax income. A REIT must satisfy certain conditions to use the TRS structure. One of those conditions is that the TRS must hire, to manage the hotels, an eligible independent contractor (EIC) that is actively engaged in the trade or business of managing hotels for parties other than the REIT. An EIC cannot (i) own more than 35% of the REIT, (ii) be owned more than 35% by persons owning more than 35% of the REIT, or (iii) provide any income to the REIT (i.e., the EIC cannot pay fees to the REIT, and the REIT cannot own any debt or equity securities of the EIC).

Accordingly, while we may lease hotels to a TRS that we own, the TRS must engage a third-party operator to manage the hotels. Thus, our ability to direct and control how our hotels are operated is less than if we were able to manage our hotels directly. We have entered into a management agreement with Remington Lodging, which is owned 100% by Messrs. Archie and Montgomery Bennett, to manage 37 of our 81 lodging properties and have hired unaffiliated third party property managers to manage our remaining properties. We do not supervise any of the property managers or their respective personnel on a day-to-day basis, and we cannot assure you that the property managers will manage our properties in a manner that is consistent with their respective obligations under the applicable management agreement or our obligations under our hotel franchise agreements. We also cannot assure you that our property managers will not be negligent in their performance, will not engage in other criminal or fraudulent activity, or will not otherwise default on their respective management obligations to us. If any of the foregoing occurs, our relationships with the franchisors may be damaged, we may be in breach of the franchise agreement, and we could incur liabilities resulting from loss or injury to our property or to persons at our properties. Any of these circumstances could have a material adverse effect on our operating results and financial condition, as well as our ability to pay dividends to stockholders.

If we cannot obtain additional financing, our growth will be limited.

We are required to distribute to our stockholders at least 90% of our REIT taxable income, excluding net capital gains, each year to continue to qualify as a REIT. As a result, our retained earnings available to fund acquisitions, development, or other capital expenditures are nominal. As such, we rely upon the availability of additional debt or equity capital to fund these activities. Our long-term ability to grow through acquisitions or development of hotel-related assets will be limited if we cannot obtain additional financing. Market conditions may

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make it difficult to obtain financing, and we cannot assure you that we will be able to obtain additional debt or equity financing or that we will be able to obtain it on favorable terms.

We may be unable to generate sufficient revenue from operations to pay our operating expenses and to pay dividends to our stockholders.

As a REIT, we are required to distribute at least 90% of our REIT taxable income each year to our stockholders. We intend to distribute to our stockholders all or substantially all of our taxable income each year so as to qualify for the tax benefits accorded to REITs, but our ability to make distributions may be adversely affected by the risk factors described herein. We cannot assure you that we will be able to make distributions in the future. In the event of continued or future downturns in our operating results and financial performance, unanticipated capital improvements to our hotels, or declines in the value of our mortgage portfolio, we may be unable to declare or pay distributions to our stockholders. The timing and amount of distributions are in the sole discretion of our Board of Directors, which will consider, among other factors, our financial performance, debt service obligations applicable debt covenants, and capital expenditure requirements.

We are subject to various risks related to our use of, and dependence on, debt.

The interest we pay on variable rate debt increases as interest rates increase, which may decrease cash available for distribution to stockholders. We cannot assure you that we will be able to meet our debt service obligations. If we do not meet our debt service obligations, we risk the loss of some or all of our assets to foreclosure. Changes in economic conditions or our financial results or prospects could (i) result in higher interest rates on variable rate debt, (ii) reduce the availability of debt financing generally or debt financing at favorable rates, (iii) reduce cash available for distribution to stockholders, and (iv) increase the risk that we could be forced to liquidate assets to repay debt, any of which could have a material adverse affect on us.

If we violate covenants in any debt agreements, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. Violations of certain debt covenants may prohibit us from borrowing unused amounts under our lines of credit, even if repayment of some or all the borrowings is not required. In any event, financial covenants under our current or future debt obligations could impair our planned business strategies by limiting our ability to borrow beyond certain amounts or for certain purposes. Our governing instruments do not contain any limitation on our ability to incur indebtedness.

We compete with other hotels for guests. We also face competition for acquisitions of lodging properties and of desirable mortgage investments.

The mid, upscale, and upper-upscale segments of the hotel business are competitive. Our hotels compete on the basis of location, room rates, quality, service levels, reputation, and reservation systems, among many other factors. New hotels may be constructed and these additions to supply create new competitors, in some cases without corresponding increases in demand for hotel rooms. The result in some cases may be lower revenue, which would result in lower cash available for distribution to stockholders.

We compete for hotel acquisitions with entities that have similar investment objectives as we do. This competition could limit the number of suitable investment opportunities offered to us. It may also increase the bargaining power of property owners seeking to sell to us, making it more difficult for us to acquire new properties on attractive terms or on the terms contemplated in our business plan.

We also compete for mortgage asset investments with numerous public and private real estate investment vehicles, such as mortgage banks, pension funds, other REITs, institutional investors, and individuals. Mortgages and other investments are often obtained through a competitive bidding process. In addition, competitors may seek to establish relationships with the financial institutions and other firms from which we intend to purchase such assets. Competition may result in higher prices for mortgage assets, lower yields, and a narrower spread of yields over our borrowing costs.

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Many of our competitors are larger than us, may have access to greater capital, marketing, and other resources, may have personnel with more experience than our officers, may be able to accept higher levels of debt or otherwise may tolerate more risk than us, may have better relations with hotel franchisors, sellers, or lenders, and may have other advantages over us in conducting certain business and providing certain services.

We may engage in hedging transactions, which can limit our gains and increase exposure to losses.

We may enter into hedging transactions to protect (i) us from the effects of interest rate fluctuations on floating rate debt and (ii) our portfolio of mortgage assets from interest rate and prepayment rate fluctuations. Our hedging transactions may include entering into interest rate swap agreements or interest rate cap or floor agreements, purchasing or selling futures contracts, purchasing put and call options on securities or securities underlying futures contracts, or entering into forward rate agreements. Hedging activities may not have the desired beneficial impact on our results of operations or financial condition. No hedging activity can completely insulate us from the risks associated with changes in interest rates and prepayment rates. Moreover, interest rate hedging could fail to protect us or adversely affect us because, among other things:

Available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought.

The duration of the hedge may not match the duration of the related liability.

The party owing money in the hedging transaction may default on its obligation to pay.

The credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction.

The value of derivatives used for hedging may be adjusted from time to time in accordance with generally accepted accounting rules to reflect changes in fair value. Downward adjustments, or mark-to-market losses, would reduce our stockholders' equity.

Hedging involves both risks and costs, including transaction costs, which may reduce our overall returns on our investments. These costs increase as the period covered by the hedging relationship increases and during periods of rising and volatile interest rates. These costs will also limit the amount of cash available for distributions to stockholders. We generally intend to hedge as much of the interest rate risk as management determines is in our best interests given the cost of such hedging transactions. The REIT qualification rules may limit our ability to enter into hedging transactions by requiring us to limit our income from hedges. If we are unable to hedge effectively because of the REIT rules, we will face greater interest rate exposure than may be commercially prudent.

We may not be able to sell our investments on favorable terms.

We may decide to sell investments for a variety of reasons. We cannot assure you that we will be able to sell any of our investments on favorable terms or that our investments will not be sold for a loss.

Risks Related to Hotel Investments

We are subject to general risks associated with operating hotels.

Our hotels and hotels underlying our mortgage and mezzanine loans are subject to various operating risks common to the hotel industry, many of which are beyond our control, including the following:

our hotels compete with other hotel properties in their geographic markets and many of our competitors have substantial marketing and financial resources;

over-building in our markets, which adversely affects occupancy and revenues at our hotels;

dependence on business and commercial travelers and tourism; and

adverse effects of general, regional, and local economic conditions and increases in energy costs or labor costs and other expenses affecting travel, which may affect travel patterns and reduce the number of business and commercial travelers and tourists.

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These factors could adversely affect our hotel revenues and expenses, as well as the hotels underlying our mortgage and mezzanine loans, which in turn would adversely affect our ability to make distributions to our stockholders.

We may have to make significant capital expenditures to maintain our lodging properties.

Our hotels have an ongoing need for renovations and other capital improvements, including replacements of furniture, fixtures, and equipment. Franchisors of our hotels may also require periodic capital improvements as a condition of maintaining franchise licenses. Generally, we are responsible for the cost of these capital improvements, which gives rise to the following risks:

cost overruns and delays;

renovations can be disruptive to operations and can displace revenue at the hotels, including revenue lost while rooms under renovation are out of service;

the cost of funding renovations and the possibility that financing for these renovations may not be available on attractive terms; and

the risk that the return on our investment in these capital improvements will not be what we expect.

If we have insufficient cash flow from operations to fund needed capital expenditures, then we will need to borrow to fund future capital improvements.

The hotel business is seasonal, which affects our results of operations from quarter to quarter.

The hotel industry is seasonal in nature. Generally, occupancy rates and hotel revenues are greater in the second and third quarters than in the first and fourth quarters. This seasonality can cause quarterly fluctuations in our revenues.

Our development activities may be more costly than we have anticipated.

As part of our growth strategy, we may develop additional hotels. Hotel development involves substantial risks, including that:

actual development costs may exceed our budgeted or contracted amounts;

construction delays may prevent us from opening hotels on schedule;

we may not be able to obtain all necessary zoning, land use, building, occupancy, and construction permits;

our developed properties may not achieve our desired revenue or profit goals; and

we may incur substantial development costs and then have to abandon a development project before completion.

Risks Relating to Investments in Mortgages and Mezzanine Loans

Mortgage investments that are not United States government insured and non-investment grade mortgage assets involve risk of loss.

As part of our business strategy, we originate and acquire lodging-related uninsured and non-investment grade mortgage loans and mortgage assets, including mezzanine loans. While holding these interests, we are subject to risks of borrower defaults, bankruptcies, fraud and related losses, and special hazard losses that are not covered by standard hazard insurance. Also, costs of financing the mortgage loans could exceed returns on the mortgage loans. In the event of any default under mortgage loans held by us, we will bear the risk of loss of principal and non-payment of interest and fees to the extent of any deficiency between the value of the mortgage collateral and the principal amount of the mortgage loan. To the extent we suffer such losses with respect to our investments in mortgage loans, our value and the price of our securities may be adversely affected.

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We invest in non-recourse loans, which will limit our recovery to the value of the mortgaged property.

Our mortgage loan assets are generally non-recourse. With respect to our non-recourse mortgage loan assets, in the event of a borrower default, the specific mortgaged property and other assets, if any, pledged to secure the relevant mortgage loan, may be less than the amount owed under the mortgage loan. As to those mortgage loan assets that provide for recourse against the borrower and its assets generally, we cannot assure you that the recourse will provide a recovery in respect of a defaulted mortgage loan greater than the liquidation value of the mortgaged property securing that mortgage loan.

Investment yields affect our decision whether to originate or purchase investments and the price offered for such investments.

In making any investment, we consider the expected yield of the investment and the factors that may influence the yield actually obtained on such investment. These considerations affect our decision whether to originate or purchase an investment and the price offered for that investment. No assurances can be given that we can make an accurate assessment of the yield to be produced by an investment. Many factors beyond our control are likely to influence the yield on the investments, including, but not limited to, competitive conditions in the local real estate market, local and general economic conditions, and the quality of management of the underlying property. Our inability to accurately assess investment yields may result in our purchasing assets that do not perform as well as expected, which may adversely affect the price of our securities.

Volatility of values of mortgaged properties may adversely affect our mortgage loans.

Lodging property values and net operating income derived from lodging properties are subject to volatility and may be affected adversely by a number of factors, including the risk factors described herein relating to general economic conditions, operating lodging properties, and owning real estate investments. In the event its net operating income decreases, a borrower may have difficulty paying our mortgage loan, which could result in losses to us. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our mortgage loans, which could also cause us to suffer losses.

Mezzanine loans involve greater risks of loss than senior loans secured by income-producing properties.

We make and acquire mezzanine loans. These types of mortgage loans are considered to involve a higher degree of risk than long-term senior mortgage lending secured by income-producing real property due to a variety of factors, including the loan being entirely unsecured or, if secured, becoming unsecured as a result of foreclosure by the senior lender. We may not recover some or all of our investment in these loans. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans resulting in less equity in the property and increasing the risk of loss of principal.

Risks Related to the Real Estate Industry

Mortgage debt obligations expose us to increased risk of property losses, which could harm our financial condition, cash flow, and ability to satisfy our other debt obligations and pay dividends.

Incurring mortgage debt increases our risk of property losses because defaults on indebtedness secured by properties may result in foreclosure actions initiated by lenders and ultimately our loss of the property securing any loans for which we are in default. For tax purposes, a foreclosure of any of our properties would be treated as a sale of the property for a purchase price equal to the outstanding balance of the debt secured by the mortgage. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we would recognize taxable income

on the foreclosure but would not receive any cash proceeds. As a result, we may be required to identify and utilize other sources of cash for distributions to our stockholders of that income.

In addition, our default under any one of our mortgage debt obligations may result in a default on our other indebtedness. If this occurs, our financial condition, cash flow, and ability to satisfy our other debt obligations or ability to pay dividends may be impaired.

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Illiquidity of real estate investments could significantly impede our ability to respond to adverse changes in the performance of our properties and harm our financial condition.

Because real estate investments are relatively illiquid, our ability to promptly sell one or more properties or mortgage loans in our portfolio in response to changing economic, financial, and investment conditions is limited. The real estate market is affected by many factors that are beyond our control, including:

adverse changes in national and local economic and market conditions;

changes in interest rates and in the availability, cost, and terms of debt financing;

changes in governmental laws and regulations, fiscal policies, and zoning and other ordinances, and costs of compliance with laws and regulations;

the ongoing need for capital improvements, particularly in older structures;

changes in operating expenses; and

civil unrest, acts of war, and natural disasters, including earthquakes and floods, which may result in uninsured and underinsured losses.

We cannot predict whether we will be able to sell any property or loan for the price or on the terms set by us, or whether any price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a property or loan. Because we intend to offer more flexible terms on our mortgage loans than some providers of commercial mortgage loans, we may have more difficulty selling or participating our loans to secondary purchasers than would these more traditional lenders.

We may be required to expend funds to correct defects or to make improvements before a property can be sold. We cannot assure you that we will have funds available to correct those defects or to make those improvements. In acquiring a property, we may agree to lock-out provisions that materially restrict us from selling that property for a period of time or impose other restrictions, such as a limitation on the amount of debt that can be placed or repaid on that property. These factors and any others that would impede our ability to respond to adverse changes in the performance of our properties could have a material adverse effect on our operating results and financial condition, as well as our ability to pay dividends to stockholders.

The costs of compliance with or liabilities under environmental laws may harm our operating results.

Our properties and properties underlying our loan assets may be subject to environmental liabilities. An owner of real property, or a lender with respect to a property that exercises control over the property, can face liability for environmental contamination created by the presence or discharge of hazardous substances on the property. We may face liability regardless of:

our knowledge of the contamination;

the timing of the contamination;

the cause of the contamination; or

the party responsible for the contamination.

There may be environmental problems associated with our properties or properties underlying our loan assets of which we are unaware. Some of our properties or the properties underlying our loan assets use, or may have used in the past, underground tanks for the storage of petroleum-based or waste products that could create a potential for release of hazardous substances. If environmental contamination exists on a property, we could become subject to strict, joint and several liability for the contamination if we own the property or if we foreclose on the property or otherwise have control over the property.

The presence of hazardous substances on a property we own or have made a loan with respect to may adversely affect our ability to sell or foreclose on the property, and we may incur substantial remediation costs. The discovery

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of environmental liabilities attached to our properties or properties underlying our loan assets could have a material adverse effect on our results of operations, financial condition, and ability to pay dividends to stockholders.

We have environmental insurance policies on each of our owned properties, and we intend to obtain environmental insurance for any other properties that we may acquire. However, if environmental liabilities are discovered during the underwriting of the insurance policies for any property that we may acquire in the future, we may be unable to obtain insurance coverage for the liabilities at commercially reasonable rates or at all, and we may experience losses. In addition, we generally do not require our borrowers to obtain environmental insurance on the properties they own that secure their loans from us.

Our properties and the properties underlying our mortgage loans may contain or develop harmful mold, which could lead to liability for adverse health effects and costs of remediating the problem.

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Concern about indoor exposure to mold has been increasing as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold at any of our properties or the properties underlying our loan assets could require us or our borrowers to undertake a costly remediation program to contain or remove the mold from the affected property. In addition, the presence of significant mold could expose us or our borrowers to liability from guests, employees, and others if property damage or health concerns arise.

Compliance with the Americans with Disabilities Act and fire, safety, and other regulations may require us or our borrowers to make unintended expenditures that adversely impact our operating results.

All of our properties and properties underlying our mortgage loans are required to comply with the Americans with Disabilities Act, or the ADA. The ADA requires that public accommodations such as hotels be made accessible to people with disabilities. Compliance with the ADA requirements could require removal of access barriers and non-compliance could result in imposition of fines by the U.S. government or an award of damages to private litigants, or both. We or our borrowers may be required to expend funds to comply with the provisions of the ADA at our hotels or hotels underlying our loan assets, which could adversely affect our results of operations and financial condition and our ability to make distributions to stockholders. In addition, we and our borrowers are required to operate our properties in compliance with fire and safety regulations, building codes, and other land use regulations as they may be adopted by governmental agencies and bodies and become applicable to our properties. We and our borrowers may be required to make substantial capital expenditures to comply with those requirements, and these expenditures could have a material adverse effect on our operating results and financial condition as well as our ability to pay dividends to stockholders.

We may experience uninsured or underinsured losses.

We have property and casualty insurance with respect to our properties and other insurance, in each case, with loss limits and coverage thresholds deemed reasonable by our management (and with the intent to satisfy the requirements of lenders and franchisors). In doing so, we have made decisions with respect to what deductibles, policy limits, and terms are reasonable based on management's experience, our risk profile, the loss history of our property managers and our properties, the nature of our properties and our businesses, our loss prevention efforts, and the cost of insurance.

Various types of catastrophic losses may not be insurable or may not be economically insurable. In the event of a substantial loss, our insurance coverage may not cover the full current market value or replacement cost of our lost investment. Inflation, changes in building codes and ordinances, environmental considerations, and other factors

might cause insurance proceeds to be insufficient to fully replace or renovate a hotel after it has been damaged or destroyed. Accordingly, there can be no assurance that (i) the insurance coverage thresholds that we have obtained will fully protect us against insurable losses (i.e., losses may exceed coverage limits); (ii) we will not incur large deductibles that will adversely affect our earnings; (iii) we will not incur losses from risks that are not insurable or that are not economically insurable; or (iv) current coverage thresholds will continue to be available at reasonable

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rates. In the future, we may choose not to maintain terrorism insurance on any of our properties. As a result, one or more large uninsured or underinsured losses could have a material adverse affect on us.

Each of our current lenders requires us to maintain certain insurance coverage thresholds, and we anticipate that future lenders will have similar requirements. We believe that we have complied with the insurance maintenance requirements under the current governing loan documents and we intend to comply with any such requirements in any future loan documents. However, a lender may disagree, in which case the lender could obtain additional coverage thresholds and seek payment from us, or declare us in default under the loan documents. In the former case, we could spend more for insurance than we otherwise deem reasonable or necessary or, in the latter case, subject us to a foreclosure on hotels collateralizing one or more loans. In addition, a material casualty to one or more hotels collateralizing loans may result in (i) the insurance company applying to the outstanding loan balance insurance proceeds that otherwise would be available to repair the damage caused by the casualty, which would require us to fund the repairs through other sources, or (ii) the lender foreclosing on the hotels if there is a material loss that is not insured.

Risks Related to Our Status as a REIT

If we do not qualify as a REIT, we will be subject to tax as a regular corporation and face substantial tax liability.

We conduct operations so as to qualify as a REIT under the Internal Revenue Code. However, qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which only a limited number of judicial or administrative interpretations exist. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, new tax legislation, administrative guidance, or court decisions, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT. If we fail to qualify as a REIT in any tax year, then:

we would be taxed as a regular domestic corporation, which, among other things, means being unable to deduct distributions to stockholders in computing taxable income and being subject to federal income tax on our taxable income at regular corporate rates;

we would also be subject to federal alternative minimum tax and, possibly, increased state and local taxes;

any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders; and

unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year that we lost our qualification, and, thus, our cash available for distribution to stockholders would be reduced for each of the years during which we did not qualify as a REIT.

If we fail to qualify as a REIT, we will not be required to make distributions to stockholders to maintain our tax status. As a result of all of these factors, our failure to qualify as a REIT would impair our ability to raise capital, expand our business, and make distributions to our stockholders and would adversely affect the value of our securities.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state, and local taxes on our income and assets. For example:

We will be required to pay tax on undistributed REIT taxable income.

We may be required to pay the alternative minimum tax on our items of tax preference.

If we have net income from the disposition of foreclosure property held primarily for sale to customers in the ordinary course of business or other non-qualifying income from foreclosure property, we must pay tax on that income at the highest corporate rate.

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If we sell a property in a prohibited transaction, our gain from the sale would be subject to a 100% penalty tax.

Our taxable REIT subsidiary, Ashford TRS, is a fully taxable corporation and will be required to pay federal and state taxes on its income.

Complying with REIT requirements may cause us to forego otherwise attractive opportunities.

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders, and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Internal Revenue Code may limit our ability to hedge mortgage securities and related borrowings by requiring us to limit our income in each year from qualified hedges, together with any other income not generated from qualified real estate assets, to no more than 25% of our gross income. In addition, we must limit our aggregate income from nonqualified hedging transactions, from our provision of services, and from other non-qualifying sources to no more than 5% of our annual gross income. As a result, we may have to limit our use of advantageous hedging techniques. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur. If we were to violate the 25% or 5% limitations, we may have to pay a penalty tax equal to the amount of income in excess of those limitations multiplied by a fraction intended to reflect our profitability. If we fail to satisfy the REIT gross income tests, unless our failure was due to reasonable cause and not due to willful neglect, we could lose our REIT status for federal income tax purposes.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To qualify as a REIT, we must also ensure that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, government securities, and qualified REIT real estate assets. The remainder of our investment in securities (other than government securities and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 20% of the value of our total securities can be represented by securities of one or more taxable REIT subsidiaries. If we fail to comply with these requirements at the end of any calendar quarter, we must correct such failure within 30 days after the end of the calendar quarter to avoid losing our REIT status and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments.

Complying with REIT requirements may force us to borrow to make distributions to stockholders.

As a REIT, we must distribute at least 90% of our annual REIT taxable income (subject to certain adjustments) to our stockholders. To the extent that we satisfy the distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws.

From time to time, we may generate taxable income greater than our net income for financial reporting purposes due to, among other things, amortization of capitalized purchase premiums, or our taxable income may be greater than our cash flow available for distribution to stockholders. If we do not have other funds available in these situations, we could be required to borrow funds, sell investments at disadvantageous prices, or find another alternative source of funds to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the distribution requirement and to avoid corporate income tax and the 4% excise tax in a particular year. These alternatives could increase our costs or reduce our equity.

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We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our securities.

At any time, the federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. Any of those new laws or interpretations may take effect retroactively and could adversely affect us or our stockholders. On May 28, 2003, the President signed the Jobs and Growth Tax Relief Reconciliation Act of 2003, which we refer to as the Jobs and Growth Tax Act. Effective for taxable years beginning after December 31, 2002, the Jobs and Growth Tax Act reduced the maximum rate of tax applicable to individuals on dividend income from regular C corporations from 38.6% to 15.0%. This reduced substantially the so-called double taxation (that is, taxation at both the corporate and stockholder levels) that has generally applied to corporations that are not taxed as REITs. Generally, dividends from REITs will not qualify for the dividend tax reduction. The implementation of the Jobs and Growth Tax Act could ultimately cause individual investors to view stocks of non-REIT corporations as more attractive relative to shares of REITs because the dividends paid by non-REIT corporations would be subject to lower tax rates. We cannot predict whether in fact this will occur or whether, if it occurs, what the impact will be on the value of our securities.

Your investment in our securities has various federal, state, and local income tax risks that could affect the value of your investment.

Although the provisions of the Internal Revenue Code relevant to your investment in our securities are generally described in Federal Income Tax Consequences of Our Status as a REIT, we strongly urge you to consult your own tax advisor concerning the effects of federal, state, and local income tax law on an investment in our securities because of the complex nature of the tax rules applicable to REITs and their stockholders.

Risk Factors Related to Our Corporate Structure

There are no assurances of our ability to make distributions in the future.

We intend to continue paying quarterly dividends and to make distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Internal Revenue Code. However, our ability to pay dividends may be adversely affected by the risk factors described herein. All distributions will be made at the discretion of our Board of Directors and will depend upon our earnings, our financial condition, maintenance of our REIT status, and such other factors as our Board of Directors may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, some of our distributions may include a return of capital.

Failure to maintain an exemption from the Investment Company Act would adversely affect our results of operations.

We believe that we will conduct our business in a manner that allows us to avoid registration as an investment company under the Investment Company Act of 1940, or the 1940 Act. Under Section 3(c)(5)(C) of the 1940 Act, entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate are not treated as investment companies. The SEC staff's position generally requires us to maintain at least 55% of our assets directly in qualifying real estate interests to be able to rely on this exemption. To constitute a qualifying real estate interest under this 55% requirement, a real estate interest must meet various criteria. Mortgage securities that do not represent all of the certificates issued with respect to an underlying pool of mortgages may be treated as securities separate from the underlying mortgage loans and, thus, may not qualify for purposes of the 55% requirement. Our ownership of these mortgage securities, therefore, is limited by the provisions of the 1940

Act and SEC staff interpretive positions. There are no assurances that efforts to pursue our intended investment program will not be adversely affected by operation of these rules.

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Our charter does not permit ownership in excess of 9.8% of our capital stock, and attempts to acquire our capital stock in excess of the 9.8% limit without approval from our Board of Directors are void.

For the purpose of preserving our REIT qualification, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the lesser of the total number or value of the outstanding shares of our preferred stock unless our Board of Directors grants a waiver. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock, and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board of Directors will be void, and could result in the shares being automatically transferred to a charitable trust.

Because provisions contained in Maryland law and our charter may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares.

Provisions contained in our charter and Maryland general corporation law may have effects that delay, defer, or prevent a takeover attempt, which may prevent stockholders from receiving a control premium for their shares. For example, these provisions may defer or prevent tender offers for our common stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium for their common stock over then-prevailing market prices. These provisions include the following:

Ownership limit: The ownership limit in our charter limits related investors, including, among other things, any voting group, from acquiring over 9.8% of our common stock without our permission.

Classification of preferred stock: Our charter authorizes our Board of Directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval. Our preferred stock issuances could have the effect of delaying or preventing someone from taking control of us, even if a change in control were in our stockholders best interests.

Maryland statutory law provides that an act of a director relating to or affecting an acquisition or a potential acquisition of control of a corporation may not be subject to a higher duty or greater scrutiny than is applied to any other act of a director. Hence, directors of a Maryland corporation are not required to act in takeover situations under the same standards as apply in Delaware and other corporate jurisdictions.

Offerings of debt securities, which would be senior to our common stock and any preferred stock upon liquidation, or equity securities, which would dilute our existing stockholders' holdings be senior to our common stock for the purposes of dividend distributions, may adversely affect the market price of our common stock and any preferred stock.

We may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes, and classes of preferred stock or common stock or classes of preferred units. Upon liquidation, holders of our debt securities or preferred units and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of shares of preferred stock or common stock. Furthermore, holders of our debt securities and preferred stock or preferred units and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common

stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common or preferred stock or both. Our preferred stock or preferred units could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing, or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our securities and diluting their securities holdings in us.

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Securities eligible for future sale may have adverse effects on the market price of our securities.

We cannot predict the effect, if any, of future sales of securities, or the availability of securities for future sales, on the market price of our outstanding securities. Sales of substantial amounts of common stock, or the perception that these sales could occur, may adversely affect prevailing market prices for our securities.

We also may issue from time to time additional securities or units of our operating partnership in connection with the acquisition of properties and we may grant additional demand or piggyback registration rights in connection with these issuances. Sales of substantial amounts of our securities or the perception that such sales could occur may adversely affect the prevailing market price for our securities or may impair our ability to raise capital through a sale of additional debt or equity securities.

We depend on key personnel with long-standing business relationships. The loss of key personnel could threaten our ability to operate our business successfully.

Our future success depends, to a significant extent, upon the continued services of our management team. In particular, the lodging industry experience of Messrs. Archie and Montgomery Bennett, Kessler, Brooks, Kimichik, and Nunneley and the extent and nature of the relationships they have developed with hotel franchisors, operators, and owners and hotel lending and other financial institutions are critically important to the success of our business. We do not maintain key person life insurance on any of our officers. Although these officers currently have employment agreements with us, we cannot assure their continued employment. The loss of services of one or more members of our corporate management team could harm our business and our prospects.

An increase in market interest rates may have an adverse effect on the market price of our securities.

A factor investors may consider in deciding whether to buy or sell our securities is our dividend rate as a percentage of our share or unit price relative to market interest rates. If market interest rates increase, prospective investors may desire a higher dividend or interest rate on our securities or seek securities paying higher dividends or interest. The market price of our securities is likely based on the earnings and return that we derive from our investments, income with respect to our properties, and our related distributions to stockholders and not from the market value or underlying appraised value of the properties or investments themselves. As a result, interest rate fluctuations and capital market conditions can affect the market price of our securities. For instance, if interest rates rise without an increase in our dividend rate, the market price of our common or preferred stock could decrease because potential investors may require a higher dividend yield on our common or preferred stock as market rates on interest-bearing securities, such as bonds, rise. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby adversely affecting cash flow and our ability to service our indebtedness and pay dividends.

Our major policies, including our policies and practices with respect to investments, financing, growth, debt capitalization, and REIT qualification and distributions, are determined by our Board of Directors. Although we have no present intention to do so, our Board of Directors may amend or revise these and other policies from time to time without a vote of our stockholders. Accordingly, our stockholders will have limited control over changes in our policies and the changes could harm our business, results of operations, and share price.

Changes in our strategy or investment or leverage policy could expose us to greater credit risk and interest rate risk or could result in a more leveraged balance sheet. We cannot predict the effect any changes to our current operating policies and strategies may have on our business, operating results, and stock price. However, the effects may be adverse.

Item 1B. *Unresolved Staff Comments*

None.

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As of December 31, 2006, we owned 81 hotel properties located in 26 states with 15,492 rooms. We own our hotels in fee simple except for (a) the Radisson Hotel in Covington, Kentucky, which we own partially in fee simple and partially pursuant to a ground lease that expires in 2070 (including all extensions), (b) the Doubletree Guest Suites in Columbus, Ohio, which was built on an air rights lease above the parking garage that expires in 2045, (c) the Hilton in Ft. Worth, Texas, which we own pursuant to a ground lease which expires in 2040 (including all extensions), (d) the Radisson Hotel in Indianapolis, Indiana, which we own pursuant to a ground lease which expires in 2034 (including all extensions), (e) the Crowne Plaza in Key West, Florida, which we own pursuant to a ground lease that expires in 2084 (including all extensions), and (f) the JW Marriott in San Francisco, California, which we own pursuant to a ground lease that expires in 2083 (including all extensions). Regarding the 81 hotels, 66 are held for investment purposes while 15 are held for sale. All 81 hotels are operated by our managers. The following table sets forth certain descriptive information regarding these hotels as of December 31, 2006:

Hotel Property	Location	Rooms	
Embassy Suites	Austin, TX	150	
Embassy Suites	Dallas, TX	150	
Embassy Suites	Herndon, VA	150	
Embassy Suites	Las Vegas, NV	220	
Embassy Suites	Phoenix, AZ	229	
Embassy Suites	Syracuse, NY	215	
Embassy Suites	Flagstaff, AZ	119	
Embassy Suites	Houston, TX	150	
Embassy Suites	West Palm Beach, FL	160	
Embassy Suites	Philadelphia, PA	263	
Embassy Suites	Walnut Creek, CA	249	
Radisson Hotel	Covington, KY	236	held for sale
Radisson Hotel	Holtsville, NY	188	
Radisson Hotel (downtown)	Indianapolis, IN	371	
Radisson Hotel	Rockland, MD	127	
Radisson Hotel (airport)	Indianapolis, IN	259	held for sale
Radisson Hotel	Milford, MD	173	
Doubletree Guest Suites	Columbus, OH	194	
Doubletree Guest Suites	Dayton, OH	137	held for sale
Hilton Garden Inn	Jacksonville, FL	119	
Hilton	Ft. Worth, TX	294	
Hilton	Houston, TX	243	
Hilton	St. Petersburg, FL	333	
Hilton	Santa Fe, NM	157	
Hilton	Bloomington, MN	300	
Homewood Suites	Mobile, AL	86	
Hampton Inn	Lawrenceville, GA	86	
Hampton Inn	Evansville, IN	141	
Hampton Inn	Terre Haute, IN	112	
Hampton Inn	Horse Cave, KY	101	held for sale

Hampton Inn	Buford, GA	92
Marriott	Durham, NC	225
Marriott	Arlington, VA	697

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Hotel Property

Location