ASHFORD HOSPITALITY TRUST INC
Form 10-K
February 28, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number: 001-31775

ASHFORD HOSPITALITY TRUST, INC.

(Exact name of registrant as specified in its charter)

Maryland	**86-1062192**
(State or other jurisdiction of incorporation or organization)	*(IRS employer identification number)*
14185 Dallas Parkway, Suite 1100 **Dallas, Texas**	**75254**
(Address of principal executive offices)	*(Zip code)*

(972) 490-9600

(Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock	**New York Stock Exchange**
Preferred Stock, Series A	**New York Stock Exchange**
Preferred Stock, Series D	**New York Stock Exchange**

Preferred Stock, Series E	**New York Stock Exchange**

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

None

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

þ Yes ¨ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

¨ Yes þ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. þ Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) þ Yes ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

As of June 30, 2011, the aggregate market value of 56,401,846 shares of the registrant s common stock held by non-affiliates was approximately $702,203,000.

As of February 21, 2012, the registrant had 68,032,289 shares of common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement pertaining to the 2012 Annual Meeting of Shareholders are incorporated herein by reference into Part III of this Form 10-K.

ASHFORD HOSPITALITY TRUST, INC.

YEAR ENDED DECEMBER 31, 2011

INDEX TO FORM 10-K

Table of Contents

This Annual Report is filed by Ashford Hospitality Trust, Inc., a Maryland corporation (the Company). Unless the context otherwise requires, all references to the Company include those entities owned or controlled by the Company. In this report, the terms the Company, we, us or our mean Ashford Hospitality Trust, Inc. and all entities included in its consolidated financial statements.

FORWARD-LOOKING STATEMENTS

Throughout this Form 10-K and documents incorporated herein by reference, we make forward-looking statements that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition and 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 words or phrases such as will likely result, may, anticipate, estimate, should, expect, believe, intend, or similar ex 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.

PART I

Item 1. *Business*

GENERAL

Ashford Hospitality Trust, Inc., together with its subsidiaries, is a self-administered real estate investment trust (REIT) focused on investing in the hospitality industry across all segments and in all methods including direct real estate, securities, equity and debt. Additional information can be found on our website at www.ahtreit.com. We commenced operations in August 2003 with the acquisition of six hotel properties (the Initial Properties) in connection with our initial public offering. 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 the Company, serves as the sole general partner of our operating partnership.

Since the initial public offering and through 2006, we acquired a total of 67 hotel properties through purchase transactions. In April 2007, we acquired a 51-property hotel portfolio from CNL Hotels and Resorts, Inc. (CNL). Pursuant to the CNL purchase agreement, we acquired 100% of 33 properties and interests ranging from 70% to 89% in 18 properties through existing joint ventures. In connection with the CNL transaction, we acquired the 15% remaining joint venture interest in one hotel property not owned by CNL at the acquisition, and in May 2007, we acquired two other hotel properties previously owned by CNL (collectively, the CNL Acquisition). In December 2007, we completed an asset swap with Hilton Hotels Corporation (Hilton), whereby we surrendered our majority ownership interest in two hotel properties in exchange for Hilton s minority ownership interest in nine hotel properties. Effective December 2, 2011, one of our joint venture partners assigned to us its 11% ownership interest in the joint venture, in which we previously had an 89% ownership interest. The joint venture held a single hotel property under a triple-net lease arrangement. As of December 31, 2011, our consolidated financial statements included 92 directly owned hotel properties and four hotel properties that we owned through majority-owned investments in joint ventures. These hotels represent 20,656 total rooms, or 20,395 net rooms, excluding those attributable to joint venture partners. Our hotels are primarily operated under the widely recognized upscale and upper upscale brands of Crowne Plaza, Hilton, Hyatt, Marriott and Sheraton. Currently, all of our hotels are located in the United States.

In March 2011, in connection with the foreclosure on a mezzanine loan held in a joint venture with Prudential Real Estate Investors (PREI), we and PREI each invested additional funds and each contributed an existing mezzanine loan to form a new joint venture, the PIM Highland JV, which acquired the 28-hotel property portfolio (the Highland Portfolio) securing the two mezzanine loans. We have an ownership interest of 71.74% in PIM Highland JV s common equity and a $25.0 million preferred equity interest. Our investment in the PIM Highland JV is accounted for using the equity method. The Highland Portfolio consists of high quality full and select service hotel properties with 8,084 total rooms, or 5,800 net rooms excluding those attributable to our joint venture partner.

Additionally, in March 2011, we acquired 96 hotel condominiums units at WorldQuest Resort in Orlando, Florida for $12.0 million and subsequently during the period sold two units. At December 31, 2011, we also wholly owned one mezzanine loan of $3.1 million and one note receivable of $8.1 million in connection with a joint venture restructuring.

Beginning in March 2008, we entered into various derivative transactions with financial institutions to hedge our debt, to improve cash flows, and to capitalize on the historical correlation between changes in LIBOR and RevPAR (Revenue Per Available Room). Through December 31, 2011, we recorded cash and accrued income of $196.1 million from the derivative transactions.

For federal income tax purposes, we elected to be treated as a REIT, which imposes limitations related to operating hotels. As of December 31, 2011, all of our 96 hotel properties were leased or owned by our wholly-owned subsidiaries that are treated as taxable REIT subsidiaries for federal income tax purposes (collectively, these 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. Hotel operating results related to these properties are included in the consolidated statements of operations. Through December 1, 2011, the hotel property held by a joint venture in which we previously had an ownership of 89% was leased on a triple-net lease basis to a third-party tenant who operated the hotel property. Rental income from this operating lease is included in the consolidated results of operations for the period from January 1, 2011 through December 1, 2011. Effective December 2, 2011, we acquired the remaining 11% ownership interest from our joint venture partner at no cost to us. The triple-net lease agreement was canceled and the operating results of this hotel property have been included in our consolidated statements of operations since December 2, 2011. With respect to our unconsolidated joint venture, PIM Highland JV, the 28 hotels are leased to PIM Highland JV s wholly-owned subsidiary, which is treated as a taxable REIT subsidiary for federal income tax purposes.

We do not operate any of our hotels directly; instead we employ hotel management companies to operate them for us under management contracts. Remington Lodging & Hospitality, LLC, together with its affiliates, (Remington Lodging), is our primary property manager, and is beneficially wholly owned by Mr. Archie Bennett, Jr., our Chairman, and Mr. Monty J. Bennett, our Chief Executive Officer. As of December 31, 2011, Remington Lodging managed 45 of our 96 legacy hotel properties, while third-party management companies managed the remaining 51 hotel properties. In addition, Remington Lodging also managed 19 of the 28 PIM Highland JV hotel properties and the WorldQuest condominium properties.

SIGNIFICANT TRANSACTIONS IN 2011 AND RECENT DEVELOPMENTS

Restructuring and Extension of a Mortgage Loan In December 2011, we successfully restructured a $203.4 million mortgage loan and extended the maturity date from December 2011 to March 2014. There is also a one-year extension option subject to the satisfaction of certain conditions. The restructuring provides for a new interest rate of LIBOR plus 4.5% with no LIBOR floor. At the closing of the restructuring, we paid down the loan by $25.0 million to $178.4 million. In connection with the restructuring and extension of the mortgage loan, we entered into an interest rate cap agreement through the new maturity date with a strike rate of 6.25% on $178.4 million notional amount for $68,000.

In addition, we are engaged in negotiations with the existing lenders to restructure and extend the $167.2 million non-recourse portfolio mortgage loan that matures in May 2012. On a parallel path, we are also in discussions with third party lenders to refinance this loan.

Reinstatement of Share Repurchase Program and Increased Authorization In September 2011, our Board of Directors authorized the reinstatement of our 2007 share repurchase program and authorized an increase in our repurchase plan authority from $58.4 million to $200 million (excluding fees, commissions and all other ancillary expenses). Under this plan, the board has authorized: (i) the repurchase of shares of our common stock, Series A preferred stock, Series D preferred stock and Series E preferred stock, and/or (ii) discounted purchases of our outstanding debt obligations, including debt secured by our hotel assets. We intend to fund any repurchases or discounted debt purchases with the net proceeds from asset sales, cash flow from operations, existing cash on the balance sheet, and other sources. As of December 31, 2011, no shares of our common or preferred stock have been repurchased under the share repurchase program since its reinstatement.

New Credit Facility In September 2011, we obtained a new $105.0 million senior credit facility which matures in September 2014 with a one-year extension option and replaces our previous credit line that was scheduled to mature in April 2012. The new credit facility provides for a three-year revolving line of credit priced at 275 to 350 basis points over LIBOR or Base Rate, as defined in the agreement, which is the same as our previous credit line. The new credit facility includes the opportunity to expand the borrowing capacity by up to $45.0 million to an aggregate size of $150.0 million upon a request by us and the consent of each lender, provided there is no default or event of default and each representation and warranty made or deemed made by us

Table of Contents

remains true and correct in all material respects on the effective date of such increase. The previous credit line was repaid in full in July 2011. The financial covenant tests with respect to the fixed charge coverage ratio and the leverage tests are similar to our previous credit line. On February 21, 2012, we closed on expanding the borrowing capacity to an aggregate $145.0 million.

Credit Default Swap Transactions In August 2011, we entered into credit default swap transactions for a notional amount of $100.0 million to hedge financial and capital market risk for an upfront cost of $8.2 million that was subsequently returned to us by our counterparty. A credit default swap is a derivative contract that works like an insurance policy against the credit risk of an entity or obligation. The credit risk underlying the credit default swaps are referenced to the CMBX index. The CMBX is a group of indices that references underlying bonds from 25 Commercial Mortgage-Backed Securities (CMBS), tranched by rating class. The CMBX is traded via pay-as-you-go credit default swaps, which involve ongoing, two-way payments over the life of the contract between the buyer and the seller of protection. The reference obligations are CMBS bonds. The seller of protection assumes the credit risk of the reference obligation from the buyer of protection in exchange for payments of an annual premium. If there is a default or a loss, as defined in the credit default swap agreements, on the underlying bonds, then the buyer of protection is protected against those losses. The only liability for Ashford, the buyer of protection, is the annual premium and any change in value of the underlying CMBX index (if the trade is terminated prior to maturity). For the CMBX trades that we have completed, we were the buyer of protection in all trades. Assuming the underlying bonds pay off at par over their remaining average life, our total exposure for these trades is approximately $8.5 million. The fair value of the credit default swaps is obtained from a third party who publishes various information including the index composition and price data. The change in the market value of the credit default swaps is settled net through posting cash collateral or reclaiming cash collateral between us and our counterparty when the change in the market value is over $250,000. As of December 31, 2011, the credit default swap had a net carrying value of a liability of $2,000, and since inception we have recognized an unrealized loss of $1.3 million. See Notes 10 and 11 of Notes to Consolidated Financial Statements in Item 8.

Sale of Additional Shares of Our Common Stock In July 2011, we reissued 7.0 million of our treasury shares at $12.50 per share and received net proceeds of $83.2 million. The net proceeds were used to repay the $50.0 million outstanding balance on our senior credit facility and for general corporate purposes, including investments, capital expenditures and working capital.

In January 2011, an underwriter purchased 300,000 shares of our common stock through the partial exercise of the underwriter s 1.125 million share over-allotment option in connection with the issuance of 7.5 million shares of common stock completed in December 2010, and we received net proceeds of $2.8 million, which were used for general corporate purposes.

Investments in Securities and Other We continually seek new and alternative strategies to leverage our industry and capital markets knowledge in ways that we believe will be accretive to our company. We believe that we can utilize the same real-time information we use to manage our portfolio and capital structure to invest capital in the public markets. To implement this investment strategy, during the second quarter of 2011, our Board of Directors authorized the formation of an investment subsidiary to invest in public securities and other investments. These investments are carried at fair market value. Our maximum aggregate net investment amount is limited to $20 million. As of December 31, 2011, based on the closing price of the securities, we recorded total investments in securities and other of $21.4 million and liabilities associated with investments in securities of $2.2 million. Through December 31, 2011, we recognized unrealized losses of $391,000. We also recognized realized losses of $981,000 and investment income of $2,000, or a net investment loss of $979,000. See Notes 10 and 11 of Notes to Consolidated Financial Statements in Item 8.

Preferred Stock Offering and Redemption of Series B-1 Convertible Preferred Stock In April 2011, we completed the offering of 3.35 million shares (including 350,000 shares pursuant to the underwriters exercise of an over-allotment option) of our 9.00% Series E Cumulative Preferred Stock at a net price of $24.2125 per share, and we received net proceeds of $80.8 million after underwriting fees. Of the net proceeds from the offering, $73.0 million was used to redeem 5.9 million shares of the total 7.3 million shares of our Series B-1 convertible preferred stock outstanding on May 3, 2011. The remaining proceeds were used for other general corporate purposes. The remaining 1.4 million outstanding Series B-1 convertible preferred shares were converted into 1.4 million shares of our common stock, which was treated as a stock dividend of $17.4 million to the Series B-1 preferred shareholder in accordance with the applicable accounting guidance.

In October 2011, we issued and sold an additional 1.3 million shares of our 9.00% Series E Cumulative Preferred Stock at a price of $23.47 per share, in an underwritten public offering pursuant to an effective registration statement. We received net proceeds of $28.9 million after underwriting fees. The proceeds from the offering may be used for general corporate purposes, including, without limitation, repayment of debt or other maturing obligations, financing future hotel related investments, capital expenditures and working capital. A portion of the proceeds may also be used for repurchasing shares of our common stock under our existing repurchase program.

At-the-Market Preferred Stock Offering On September 30, 2011, we entered into an at-the-market (ATM) program with an investment banking firm, pursuant to which we may issue up to 700,000 shares of 8.55% Series A Cumulative Preferred Stock and up to 700,000 shares of 8.45% Series D Cumulative Preferred Stock at market prices up to $30.0 million. No shares of our preferred stock have been sold under this program as of the date of this report.

Repayment of a Mezzanine Loan In April 2011, we entered into a settlement agreement with the borrower of the mezzanine loan which was secured by a 105-hotel property portfolio and scheduled to mature in April 2011. The borrower paid off the loan for $22.1 million. The difference between the settlement amount and the carrying value of $17.9 million was recorded as a credit to impairment charges in accordance with applicable accounting guidance.

Acquisition of Hotel Properties Securing Mezzanine Loans Held in Unconsolidated Joint Ventures In July 2010, as a strategic complement to our existing joint venture with Prudential Real Estate Investors (PREI) formed in 2008, we contributed $15.0 million for an ownership interest in a new joint venture with PREI. The new joint venture acquired a portion of the tranche 4 mezzanine loan associated with JER Partners 2007 privatization of the JER/Highland Hospitality portfolio (the Highland Portfolio). The mezzanine loan was secured by the same 28 hotel properties as our then existing joint venture investment in the tranche 6 mezzanine loan. Both of these mezzanine loans had been in default since August 2010. After negotiating with the borrowers, senior secured lenders and senior mezzanine lenders for a restructuring, we, through a new joint venture, the PIM Highland JV, with PRISA III Investments, LLC (PRISA III) (an affiliate of PREI), invested $150.0 million and PRISA III invested $50.0 million of new capital to acquire the 28 high quality full and select service hotel properties comprising the Highland Portfolio on March 10, 2011. We and PRISA III have ownership interests of 71.74% and 28.26%, respectively, in the new joint venture. In addition to the common equity splits, we and PRISA III each have a $25.0 million preferred equity interest earning an accrued but unpaid 15% annual return with priority over common equity distributions. Our investment in the PIM Highland JV is accounted for using the equity method and the carrying value was $179.5 million at December 31, 2011. The PIM Highland JV recognized a gain of $82.1 million related to a bargain purchase and settlement of a pre-existing relationship, of which our share was $46.3 million. The purchase price allocation has been finalized as of December 31, 2011. See Note 5 of Notes to Consolidated Financial Statements in Item 8.

Litigation Settlement In March 2011, we entered into a Consent and Settlement Agreement (the Settlement Agreement) with Wells Fargo Bank, N.A. (Wells) to resolve potential disputes and claims between us and Wells relating to our purchase of a participation interest in certain mezzanine loans. Wells denied the allegations in our complaint and further denies any liability for the claims asserted by us; however, the Settlement Agreement was entered into to resolve our claims against Wells and to secure Wells consent to our participation in the Highland Hospitality Portfolio restructuring. Pursuant to the Settlement Agreement, Wells agreed to pay us $30.0 million over the next five years, or earlier, if certain conditions are satisfied. As part of the Settlement Agreement, we and Wells have agreed to a mutual release of claims. We received the settlement payment of $30.0 million and paid legal costs of $6.9 million in June 2011. The settlement amount was recorded as Other income and the legal costs of $6.9 million were recorded as Corporate general and administrative expenses in the consolidated statements of operations.

Acquisition of Condominium Properties In March 2011, we acquired real estate and certain other rights in connection with the acquisition of the WorldQuest Resort, a condominium hotel project. More specifically, we acquired 96 condominium units, hotel amenities, land and improvements, developable raw land, developer rights and Rental Management Agreements (RMAs) with third party owners of condominium units in the project. Units owned by third parties with RMAs and all of the 96 units we acquired participate in a rental pool program whereby the units are rented to guests similar to a hotel operation. Under the terms of the RMA, we share in a percentage of the guest room revenues and are reimbursed for certain costs. In the third quarter 2011, we sold two of the completed units at a price of $175,000 each and realized a gain of $96,000. All of the units owned at December 31, 2011, are included in Investment in hotel properties, net in the consolidated balance sheets.

Resumption of Common Dividends In February 2011, the Board of Directors accepted management s recommendation to resume paying cash dividends on our outstanding shares of common stock with an annualized target of $0.40 per share for 2011. For the year ended December 31, 2011, we have declared dividends of $0.40 per share. In December 2011, the Board of Directors approved our dividend policy for 2012 and we expect to pay a quarterly dividend of $0.11 per share for 2012. The adoption of a dividend policy does not commit our Board of Directors to declare future dividends or the amount thereof. The Board of Directors will continue to review its dividend policy on a quarterly basis.

Completion of Sales of Hotel Properties In 2011, we completed the sale of four hotel properties, the Hampton Inn hotel in Jacksonville, Florida, the JW Marriott hotel in San Francisco, California, the Hilton hotel in Rye Town, New York and the Hampton Inn hotel in Houston, Texas. We received total proceeds of $153.7 million and repaid the related mortgage debt of $50.2 million. We used the net proceeds to reduce $70.0 million of the borrowings on our senior credit facility. We recorded an impairment charge of $6.2 million on the Jacksonville Hampton Inn hotel property in June 2011, based on the selling price. The operating results of these hotel properties, including the impairment charge, for all periods presented have been reported as discontinued operations in the consolidated statements of operations.

BUSINESS STRATEGIES

Following a recession that lasted over two years, beginning in 2010 the lodging industry started experiencing improvement in fundamentals, specifically occupancy and this improvement continued into 2011. Room rates, measured by the average daily rate, or ADR, which typically lags occupancy growth in the early stage of a recovery, have continued showing upward growth. We believe the improvements in the economy will continue to positively impact the lodging industry and hotel operating results for 2012, and we intend to continue to seek ways to benefit from the cyclical nature of the hotel industry. We believe that in the current cycle, hotel values and cash flows, for the most part, peaked in 2007, and we believe we will not achieve similar cash flows and values in the immediate future. Industry experts have suggested that cash flows within our industry may achieve these previous highs again in 2014 through 2016.

Based on our primary business objectives and forecasted operating conditions, our current key priorities and financial strategies include, among other things:

- acquisition of hotel properties;

- disposition of hotel properties;

- investing in securities;
- pursuing capital market activities to enhance long-term shareholder value;
- repurchasing capital stock subject to regulatory limitations and our Board of Directors authorization;
- preserving capital, enhancing liquidity, and continuing current cost saving measures;
- implementing selective capital improvements designed to increase profitability;
- implementing effective asset management strategies to minimize operating costs and increase revenues;
- financing or refinancing hotels on competitive terms;
- utilizing hedges and derivatives to mitigate risks; and
- making other investments or divestitures that our Board of Directors deems appropriate.

Our investment strategies continue to focus on the upscale and upper-upscale segments within the lodging industry. We believe that as supply, demand, and capital market cycles change, we will be able to shift our investment strategies to take advantage of new lodging-related investment opportunities as they may develop. Our Board of Directors may change our investment strategies at any time without shareholder approval or notice.

As the business cycle changes and the hotel markets continue to improve, we intend to continue to invest in a variety of lodging-related assets based upon our evaluation of diverse market conditions including our cost of capital and the expected returns from those investments. Our investments may include: (i) direct hotel investments; (ii) mezzanine financing through origination or acquisition; (iii) first-lien mortgage financing through origination or acquisition; and (iv) sale-leaseback transactions.

Our strategy is designed to take advantage of lodging industry conditions and adjust to changes in market circumstances 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 strategy of combining lodging-related equity and debt investments seeks, among other things, to:

- capitalize on both current yield and price appreciation, while simultaneously offering diversification of types of assets within the hospitality industry; and
- vary investments across an array of hospitality assets to take advantage of market cycles for each asset class.

Our long-term investment strategy primarily targets select service and full-service hotels in primary, secondary, and resort markets, typically throughout the United States. To take full advantage of future investment opportunities in the lodging industry, we intend to invest according to the asset allocation strategies described below. However, 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 without notice.

Direct Hotel Investments In selecting hotels to acquire, we target hotels that offer one or more of the following attributes: a high current return or have the opportunity to increase in value through repositioning, capital investments, market-based recovery, or improved management practices. Our direct hotel acquisition strategy will continue to follow similar investment criteria and will seek to achieve both current income and appreciation. In addition, we will continue to assess our existing hotel portfolio and make strategic decisions to sell certain under-performing or non-strategic hotels that do not fit our investment strategy or criteria due to micro or macro market changes or other reasons.

Mezzanine Financing Subordinated loans, or mezzanine loans, that we acquire or originate may relate to a diverse segment of hotels that are located across the U.S. These mezzanine loans are secured by junior mortgages on hotels or pledges of equity interests in entities owning hotels. As the global economic environment improves and the hotel industry stabilizes, we may refocus our efforts on the acquisition or origination of mezzanine loans. Given the greater repayment risks of these types of loans, to the extent we acquire or originate them in the future, we will have a more conservative approach in underwriting these assets. Mezzanine loans that we acquire in the future may be secured by individual assets as well as cross-collateralized portfolios of assets.

First Mortgage Financing From time to time, we may acquire or originate first mortgages. As the dynamics in the capital markets and the hotel industry make first-mortgage investments more attractive, we may 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 a bank or a federally chartered lending institution, we are not subject to state and federal regulatory constraints imposed on such entities.

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.

BUSINESS SEGMENTS

We currently operate in two business segments within the hotel lodging industry: direct hotel investments and hotel financing. A discussion of each operating segment is incorporated by reference to Note 22 of Notes to Consolidated Financial Statements set forth in Part II, Item 8. Financial Statements and Supplementary Data.

FINANCING STRATEGY

We utilize debt to increase equity returns. 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:

- our leverage levels across the portfolio;
- the purchase price of our investments to be acquired with debt financing;
- impact on financial covenants;
- cost of debt;
- loan maturity schedule;
- 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

Table of Contents

indebtedness may be secured or unsecured by mortgages or other interests in our properties or mortgage loans. This indebtedness may be recourse, non-recourse, or cross-collateralized. If recourse, such 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 debt investments; or
- finance acquisitions, expand, redevelop or improve existing properties, or develop new properties or other uses.

In addition, if we do not have sufficient cash available, we may need to borrow to meet taxable income distribution requirements under the Internal Revenue Code. 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 debt financing on our individual properties and debt investments.

DISTRIBUTION POLICY

In February 2011, the Board of Directors accepted management s recommendation to resume paying cash dividends on our outstanding shares of common stock with an annualized target of $0.40 per share for 2011. For the year ended December 31, 2011, we have declared dividends of $0.40 per share. We may incur indebtedness to meet distribution requirements imposed on REITs under the Internal Revenue Code to the extent that working capital and cash flow from our investments are insufficient to fund required distributions. Or, we may elect to pay dividends on our common stock in cash or a combination of cash and shares of securities as permitted under federal income tax laws governing REIT distribution requirements. We may pay dividends in excess of our cash flow.

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. In December 2011, the Board of Directors approved our dividend policy for 2012 and we expect to pay a quarterly dividend of $0.11 per share for 2012. The adoption of a dividend policy does not commit our Board of Directors to declare future dividends or the amount thereof. The Board of Directors will continue to review its dividend policy on a quarterly basis. Our ability to pay distributions to our shareholders 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 properties by our property managers. Distributions to our shareholders are generally taxable to our shareholders 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 non-taxable return of capital, to the extent of a shareholder s tax basis in the stock. To the extent that it is consistent 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, such as our Series A, Series D and Series E preferred stock. The partnership agreement of our operating partnership also allows the operating partnership to issue units with a preference on distributions, such as our class B common units. The issuance of

Table of Contents

these series of preferred stock and units together with any similar issuance in the future, given the dividend preference on such stock or units, could limit our ability to make a dividend distribution to our common shareholders.

COMPETITION

The hotel industry is highly competitive and the hotels in which we invest are subject to competition from other hotels for guests. Competition is based on a number of factors, most notably convenience of location, brand affiliation, price, range of services, guest amenities or accommodations offered and quality of customer service. Competition is often specific to the individual markets in which our properties are located and includes competition from existing and new hotels. Increased competition could have a material adverse effect on the occupancy rate, average daily room rate and room revenue per available room of our hotels or may require us to make capital improvements that we otherwise would not have to make, which may result in decreases in our profitability.

Our principal competitors include other hotel operating companies, ownership companies (including hotel REITs) and national and international hotel brands. We face increased competition from providers of less expensive accommodations, such as select service hotels or independent owner-managed hotels, during periods of economic downturn when leisure and business travelers become more sensitive to room rates.

EMPLOYEES

At December 31, 2011, we had 75 full-time employees. These employees directly or indirectly perform various acquisition, development, asset management, capital markets, accounting, tax, risk management, legal, redevelopment, and corporate management functions. None of our corporate employees are unionized. All persons employed in day-to-day hotel operations are employees of the management companies and not the Company, and some of the management company employees are unionized. Occasionally, we hire temporary employees to assist in tasks. We also hire numerous third parties to provide various professional services. In addition, certain employees of a related party provide services to us or split their time between us and the related party. Costs for these services are included in the corporate general and administrative expense reimbursements to the related party.

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 substantially all 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.

INSURANCE

We maintain comprehensive insurance, including liability, property, workers compensation, rental loss, environmental, terrorism, and, when available on commercially reasonable 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.

FRANCHISE LICENSES

We believe that the public s perception of quality associated with a franchisor can be 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, 2011, we owned interests in 124 hotels, 120 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.

Table of Contents

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.

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.

Renaissance is a registered trademark of Marriott International, Inc.

Ritz Carlton 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.

One Ocean is a registered trademark of Remington Hotels LP.

Our management companies, including our affiliate 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 pursuant to such terms. In the event of termination of a particular franchise or brand management agreement, our management companies must operate any affected hotels under another franchise or brand management agreement, if any, that we enter into. We anticipate that many of the additional hotels we acquire could be operated under franchise licenses or brand management agreements as well.

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;

Table of Contents

display of signage; and

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

SEASONALITY

Our properties operations historically have been seasonal as certain properties maintain higher occupancy rates during the summer months and some during the winter months. This seasonality pattern can cause fluctuations in our quarterly lease revenue under our percentage leases. We anticipate that our cash flows 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 flows from operations are insufficient during any quarter due to temporary or seasonal fluctuations in lease revenue, we expect to utilize other cash on