

HERSHA HOSPITALITY TRUST  
Form 10-K  
March 16, 2007

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

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**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

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: **001-14765**

**HERSHA HOSPITALITY TRUST**  
(Exact Name of Registrant as Specified in Its Charter)

**Maryland**  
(State or Other Jurisdiction of Incorporation or Organization)

**251811499**  
(I.R.S. Employer Identification No.)

**44 Hersha Drive, Harrisburg, PA**  
(Address of Registrant's Principal Executive Offices)

**17102**  
(Zip Code)

Registrant's telephone number, including area code: **(717) 236-4400**

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
<b>Class A Common Shares of Beneficial Interest, par value \$.01 per share</b>	<b>American Stock Exchange</b>
<b>Series A Cumulative Redeemable Preferred Shares, par value \$.01 per share</b>	<b>American Stock Exchange</b>

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

**None**

(Title of class)

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

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

Indicate by check mark whether the registrant (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.  x

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

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 Act).  Yes  No

The aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant, as of June 30, 2006, was approximately \$259.8 million.

As of March 15, 2007, the number of Class A common shares of beneficial interest outstanding was 40,676,593.

Documents Incorporated By Reference: Portions of the proxy statement for the registrant's Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

## HERSHA HOSPITALITY TRUST

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**CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, without limitation, statements containing the words, “believes,” “anticipates,” “expects” and words of similar import. Such forward-looking statements relate to future events, our future financial performance, and involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers should specifically consider the various factors identified in this report including, but not limited to those discussed in the sections entitled “Risk Factors,” “Growth Strategy” and “Management’s Discussion and Analysis of Financial Conditions and Results of Operations” that could cause actual results to differ. We disclaim any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments, except as required by law.

**Item 1.**

**Business**

**OVERVIEW**

Hersha Hospitality Trust is a self-advised Maryland real estate investment trust, or REIT, that was organized in 1998 and completed its initial public offering in January of 1999. Our common shares are traded on the American Stock Exchange under the symbol “HT”. We invest primarily in institutional grade hotels in central business districts, primary suburban office markets and stable destination and secondary markets in the Northeastern United States and select markets on the West Coast. Our primary strategy is to continue to acquire high quality, upscale, mid-scale and extended-stay hotels in metropolitan markets with high barriers to entry in the Northeastern United States and other markets with similar characteristics.

As of December 31, 2006, our portfolio consisted of 48 wholly owned limited and full service properties and 18 limited and full service properties in which we have joint venture investments. Of the 18 limited and full service properties in which we have our joint ventures investments, four are consolidated. These 66 properties, with a total of 8,641 rooms, are located in Arizona, California, Connecticut, Delaware, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island and Virginia and operate under leading brands, such as Marriott®, Courtyard by Marriott®, Residence Inn®, Fairfield Inn®, Hilton®, Hilton Garden Inn®, Springhill Suites®, Hampton Inn®, Holiday Inn®, Holiday Inn Express®, Comfort Inn®, Mainstay Suites®, Sleep Inn®, Hawthorne Suites®, Homewood Suites®, Four Points by Sheraton® and Hyatt Summerfield Suites®.

We are structured as an umbrella partnership REIT, or UPREIT, and we own our hotels and our investments in joint ventures through our operating partnership, Hersha Hospitality Limited Partnership, or HHLP, for which we serve as general partner. Our hotels are managed by qualified independent management companies, including Hersha Hospitality Management, L.P., or HHMLP. HHMLP is a private management company owned by certain of our trustees, officers and other third party investors. All of our wholly owned hotels are leased to 44 New England Management Company, or 44 New England, our wholly-owned taxable REIT subsidiary, or TRS. In addition, all of the hotels we own through investments in joint ventures are leased to TRSs owned by the respective venture or to corporations owned in part by our wholly owned TRS.

**AVAILABLE INFORMATION**

Our address is 44 Hersha Drive, Harrisburg, PA 17102. Our telephone number is (717) 236-4400. Our Internet website address is: [www.hersha.com](http://www.hersha.com). We make available free of charge through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or

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furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such documents are electronically filed with, or furnished to, the SEC. The information available on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filings we make with the SEC.

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Our operating strategy focuses on increasing hotel performance for our portfolio. The key elements of this strategy are:

- working together with our hotel management companies to increase occupancy levels and revenue per available room, or "RevPAR", through active property-level management, including intensive marketing efforts to tour groups, corporate and government extended stay customers and other wholesale customers and expanded yield management programs, which are calculated to better match room rates to room demand; and
- positioning our hotels to capitalize on increased demand in the high quality, upper-upscale, upscale, mid-scale and extended-stay lodging segment, which we believe can be expected to follow from improving economic conditions, by managing costs and thereby maximizing earnings.

As of December 31, 2006, we owned interests in the following 66 hotels:

<b>Name</b>	<b>Rooms</b>	<b>Ownership %</b>	<b>Consolidated/ Unconsolidated</b>
<b>Marriott</b>			
Mystic, CT	285	66.7%	Unconsolidated JV
Hartford, CT	409	15.0%	Unconsolidated JV
<b>Hilton</b>			
Hartford, CT	393	8.8%	Unconsolidated JV
<b>Courtyard</b>			
Alexandria, VA	203	100.0%	Consolidated
Scranton, PA	120	100.0%	Consolidated
Langhorne, PA	118	100.0%	Consolidated
Brookline/Boston, MA	188	100.0%	Consolidated
Norwich, CT	144	66.7%	Unconsolidated JV
South Boston, MA	164	50.0%	Unconsolidated JV
Wilmington, DE	78	100.0%	Consolidated
Warwick, RI	92	66.7%	Unconsolidated JV
Ewing/Princeton, NJ	130	50.0%	Unconsolidated JV
<b>Hampton Inn</b>			
Brookhaven, NY	161	100.0%	Consolidated
Philadelphia, PA	250	80.0%	Consolidated JV
Chelsea/Manhattan, NY	144	100.0%	Consolidated
Linden, NJ	149	100.0%	Consolidated
Hershey, PA	110	100.0%	Consolidated
Carlisle, PA	95	100.0%	Consolidated
Danville, PA	72	100.0%	Consolidated
Selinsgrove, PA	75	100.0%	Consolidated
Herald Square, Manhattan, NY	136	100.0%	Consolidated
<b>Residence Inn</b>			
North Dartmouth, MA	96	100.0%	Consolidated
Tysons Corner, VA	96	100.0%	Consolidated
Danbury, CT	78	66.7%	Unconsolidated JV
Framingham, MA	125	100.0%	Consolidated
Greenbelt, MD	120	100.0%	Consolidated

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Mystic, CT	133	66.7%	Unconsolidated JV
Southington, CT	94	44.7%	Unconsolidated JV
Williamsburg, VA	108	75.0%	Consolidated JV
Norwood, MA	96	100.0%	Consolidated

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Name	Rooms	Ownership %	Consolidated/ Unconsolidated
<b>Summerfield Suites</b>			
White Plains, NY	159	100.0%	Consolidated
Bridgewater, NJ	128	100.0%	Consolidated
Gaithersburg, MD	140	100.0%	Consolidated
Pleasant Hill, CA	142	100.0%	Consolidated
Pleasanton, CA	128	100.0%	Consolidated
Scottsdale, AZ	164	100.0%	Consolidated
Charlotte, NC	144	100.0%	Consolidated
<b>Homewood Suites</b>			
Glastonbury, CT	136	40.0%	Unconsolidated JV
<b>Holiday Inn Express</b>			
Hauppauge, NY	133	100.0%	Consolidated
Cambridge, MA	112	100.0%	Consolidated
Hershey, PA	85	100.0%	Consolidated
New Columbia, PA	81	100.0%	Consolidated
Malvern, PA	88	100.0%	Consolidated
Oxford Valley, PA	88	100.0%	Consolidated
South Boston, MA	118	50.0%	Unconsolidated JV
<b>Hilton Garden Inn</b>			
JFK Airport, NY	188	100.0%	Consolidated
Edison, NJ	132	100.0%	Consolidated
Glastonbury, CT	150	40.0%	Unconsolidated JV
Gettysburg, PA	88	100.0%	Consolidated
<b>Springhill Suites</b>			
Waterford, CT	80	66.7%	Unconsolidated JV
Williamsburg, VA	120	75.0%	Consolidated JV
<b>Holiday Inn Express &amp; Suites</b>			
Harrisburg, PA	77	100.0%	Consolidated
King of Prussia, PA	155	100.0%	Consolidated
<b>Four Points - Sheraton</b>			
Revere/Boston, MA	180	55.0%	Consolidated JV
<b>Mainstay</b>			
Valley Forge, PA	69	100.0%	Consolidated
Frederick, MD	72	100.0%	Consolidated
<b>Holiday Inn</b>			
Harrisburg, PA	196	100.0%	Consolidated (1)
<b>Comfort Inn</b>			
North Dartmouth, MA	84	100.0%	Consolidated
Harrisburg, PA	81	100.0%	Consolidated
Frederick, MD	73	100.0%	Consolidated
<b>Fairfield Inn</b>			
Mt. Laurel, NJ	118	100.0%	Consolidated
Bethlehem, PA	103	100.0%	Consolidated
Laurel, MD	109	100.0%	Consolidated
<b>Hawthorne Suites</b>			
Franklin, MA	100	100.0%	Consolidated
<b>Independent</b>			
Wilmington, DE	71	100.0%	Consolidated



<b>Sleep Inn</b>				
	Valley Forge, PA	87	100.0%	Consolidated
<b>TOTAL</b>		<b>8,641</b>		

(1) As of July 1, 2006, the Holiday Inn, Harrisburg, PA was leased to an unrelated party under a fixed lease agreement. Prior to July 1, 2006, operating results were included in our consolidated hotel operating results.

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In addition to the direct acquisition of hotels, we may make investments in hotels through joint ventures with strategic partners. We seek to identify acquisition candidates located in markets with economic, demographic and supply dynamics favorable to hotel owners and operators. Through our extensive due diligence process, we select those acquisition targets where we believe selective capital improvements and intensive management will increase the hotel's ability to attract key demand segments, enhance hotel operations and increase long-term value.

As of December 31, 2006, we maintain ownership interest in the following 18 hotels through joint ventures with third parties:

<b>Joint Venture</b>	<b>Assets Owned by Joint Venture</b>	<b>HHLP Ownership in Asset</b>	<b>HHLP Preferred Return</b>	<b>Consolidated/Unconsolidated</b>
Mystic Partners, LLC	Hartford Marriott Downtown, Hartford, CT	15.0%	8.5%	Unconsolidated
	Mystic Marriott Hotel & Spa, Mystic, CT	66.7%	8.5%	Unconsolidated
	Danbury Residence Inn, Danbury, CT	66.7%	8.5%	Unconsolidated
	Southington Residence Inn, Southington, CT	44.7%	8.5%	Unconsolidated
	Norwich Courtyard by Marriott and Rosemont Suites, Norwich, CT	66.7%	8.5%	Unconsolidated
	Warwick Courtyard by Marriott, Warwick, RI	66.7%	8.5%	Unconsolidated
	Waterford SpringHill Suites, Waterford, CT	66.7%	8.5%	Unconsolidated
	Residence Inn by Marriott Hotel and Whitehall Mansion, Stonington, CT	66.7%	8.5%	Unconsolidated
	Hilton Hartford - Downtown, Hartford, CT	8.8%	8.5%	Unconsolidated
HT/PRA Glastonbury, LLC	Hilton Garden Inn, Glastonbury, CT	40.0%	11.0%	Unconsolidated
PRA Suites at Glastonbury, LLC	Homewood Suites, Glastonbury, CT	40.0%	10.0%	Unconsolidated
Hiren Boston, LLC	Courtyard by Marriott, South Boston, MA	50.0%	10.0%	<sup>(1)</sup> Unconsolidated
SB Partners, LLC	Holiday Inn Express, South Boston, MA	50.0%	10.0%	<sup>(1)</sup> Unconsolidated
Inn America Hospitality at Ewing, LLC	Courtyard by Marriott, Ewing, NJ	50.0%	11.0%	Unconsolidated
Logan Hospitality Associates, LLC	Four Points by Sheraton, Revere, MA	55.0%	12.0%	Consolidated
LTD Associates One, LLC	SpringHill Suites, Williamsburg, VA	75.0%	10%/12%	<sup>(2)</sup> Consolidated
		75.0%	12.0%	Consolidated

LTD Associates Two, LLC	Residence Inn, Williamsburg, VA			
Affordable Hospitality Associates, LP	Hampton Inn, Philadelphia, PA	80.0%	9.0%	Consolidated

- (1) Preferred return accrues for first two years of the venture and then results are shared pro rata thereafter. Preferred return period ends on June 30, 2007 for Hiren Boston, LLC and September 30, 2007 for SB Partners, LLC
- (2) Preferred return tier of 10.0% from November 30, 2006 through November 30, 2007 and then a 12% preferred return thereafter. Preferred return of 8.0% was in effect from the date of acquisition through November 30, 2006.

## DEVELOPMENT LOANS

We do not develop properties, but we take advantage of our relationships with hotel developers, including entities controlled by our officers or trustees, to identify development and renovation projects that may be attractive to us. While these developers bear the construction risks, we often provide secured development loans and bear economic risks through these development loans. In many instances, we maintain a first right of refusal or first right of offer to purchase the hotel for which we have provided development loan financing at fair market value.

## ACQUISITIONS

Our primary growth strategy is to selectively acquire high quality, upper- upscale, upscale, mid-scale and extended-stay hotels in metropolitan markets with high barriers-to-entry. We believe that current market conditions are creating opportunities to acquire hotels at attractive prices. In executing our disciplined acquisition program, we will consider acquiring hotels that meet the following additional criteria:

- nationally-franchised hotels operating under popular brands, such as Marriott Hotels & Resorts, Hilton Hotels, Courtyard by Marriott, Residence Inn by Marriott, Spring Hill Suites by Marriott, Hilton Garden Inn, Homewood Suites by Hilton, Hampton Inn, Sheraton Hotels & Resorts, DoubleTree, Embassy Suites and Holiday Inn Express;
- hotels in locations with significant barriers-to-entry, such as high development costs, limited availability of land and lengthy entitlement processes; and
  - hotels in our target markets where we can realize operating efficiencies and economies of scale.

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In the ordinary course of our business, we are actively considering hotel acquisition opportunities. Since our initial public offering in 1999, we have acquired, wholly or through joint ventures, a total of 71 hotels, including 19 hotels acquired from entities controlled by our officers or trustees. Of the 19 acquisitions from these entities, 16 were newly-constructed or newly-renovated by these entities prior to our acquisition. Since December, 31, 2006, we have acquired interests in the following hotels:

Brand	Location	Ownership Interest	Acquisition Date	Purchase Price
Residence Inn	Langhorne, PA	Wholly Owned	1/8/2007	\$ 15,330
Residence Inn	Carlisle, PA	Wholly Owned	1/10/2007	\$ 9,945
Holiday Inn Express	Chester, NY	Wholly Owned	1/25/2007	\$ 9,200
Hampton Inn	New York (Seaport), NY	Wholly Owned	2/1/2007	\$ 27,600
Holiday Inn Express	New York (Chelsea), NY	50%	2/1/2007	\$ 7,750

**DISPOSITIONS**

We will evaluate our hotels on a periodic basis to determine if these hotels continue to satisfy our investment criteria. We may sell hotels opportunistically based upon management's forecast and review of the cash flow potential for the hotel and re-deploy the proceeds into debt reduction or acquisitions of hotels. We utilize several criteria to determine the long-term potential of our hotels. Hotels are identified for sale based upon management's forecast of the strength of the hotel's cash flows and its ability to remain accretive to our portfolio. Our decision to sell an asset is often predicated upon the size of the hotel, strength of the franchise, property condition and related costs to renovate the property, strength of market demand generators, projected supply of hotel rooms in the market, probability of increased valuation and geographic profile of the hotel. All asset sales are reviewed by our Board of Trustees, including our independent trustees. A majority of the independent trustees must approve the terms of all asset sales. Since our initial public offering in 1999, we have sold a total of 17 hotels.

**FINANCING**

The relative stability of the mid-scale and upscale segment of the limited service lodging industry allows us to increase returns to our shareholders through the prudent application of leverage. Our debt policy is to limit consolidated indebtedness to less than 67% of the fair market values for the hotels in which we invest. We may employ a higher amount of leverage at a specific hotel to achieve a desired return when warranted by that hotel's historical operating performance and may use modestly greater leverage across our portfolio if and when warranted by prevailing market conditions.

**PROPERTY MANAGEMENT**

We work closely with our hotel management companies to operate our hotels and increase same hotel performance for our portfolio. Through our TRS and our investment in joint ventures, we have retained the following management companies to operate our hotels, as of December 31, 2006:

Manager	Wholly Owned		Joint Ventures		Total	
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms
HHMLP	40	4,369	5	846	45	5,215
Waterford Hotel Group	-	-	9	1,708	9	1,708
LodgeWorks	7	1,005	-	-	7	1,005
Jiten Management	-	-	2	282	2	282

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LTD Management	-	-	2	228	2	228
Marriott	1	203	-	-	1	203
Total	48	5,577	18	3,064	66	8,641

Each management agreement provides for a set term and is subject to early termination upon the occurrence of defaults and certain other events described therein. As required under the REIT qualification rules, all managers, including HHMLP, must qualify as an “eligible independent contractor” during the term of the management agreements.

Under the management agreements, the manager generally pays the operating expenses of our hotels. All operating expenses or other expenses incurred by the manager in performing its authorized duties are reimbursed or borne by our TRS to the extent the operating expenses or other expenses are incurred within the limits of the applicable approved hotel operating budget. Our managers are not obligated to advance any of their own funds for operating expenses of a hotel or to incur any liability in connection with operating a hotel.

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For their services, the managers receive a base management fee, and if a hotel meets and exceeds certain thresholds, an additional incentive management fee. The base management fee for a hotel is due monthly and is generally equal to 3% of the gross revenues associated with that hotel for the related month.

**CAPITAL IMPROVEMENTS, RENOVATION AND REFURBISHMENT**

We have established capital reserves for our hotels to maintain the hotels in a condition that complies with their respective franchise licenses among other requirements. In addition, we may upgrade the hotels in order to capitalize on opportunities to increase revenue, and as deemed necessary by our management to seek to meet competitive conditions and preserve asset quality. We will also renovate hotels when we believe the investment in renovations will provide an attractive return to us through increased revenues and profitability and is in the best interests of our shareholders. We maintain a capital expenditures policy by which replacements and renovations are monitored to determine whether they qualify as capital improvements. All items that are deemed to be repairs and maintenance costs are expensed and recorded in Hotel Operating Expenses.

**OPERATING PRACTICES**

Our managers utilize centralized accounting and data processing systems, which facilitate financial statement and budget preparation, payroll management, quality control and other support functions for the on-site hotel management team. Our managers also provide centralized control over purchasing and project management (which can create economies of scale in purchasing) while emphasizing local discretion within specific guidelines.

**DISTRIBUTIONS**

We have made thirty two consecutive quarterly distributions to the holders of our common shares since our initial public offering in January 1999 and intend to continue to make regular quarterly distributions to our shareholders.

<b>Quarter to which Distribution Relates</b>	<b>Class A Common Per Share Distribution Amount</b>	<b>Record Date</b>	<b>Payment Date</b>	<b>Series A Preferred Per Share Distribution Amount</b>	<b>Record Date</b>	<b>Payment Date</b>
<b>2006</b>						
First Quarter	\$ 0.18	03/31/2006	04/21/2006	\$ 0.50	04/01/2006	04/17/2006
Second Quarter	\$ 0.18	06/30/2006	07/17/2006	\$ 0.50	07/01/2006	07/17/2006
Third Quarter	\$ 0.18	09/29/2006	10/17/2006	\$ 0.50	10/01/2006	10/16/2006
Fourth Quarter	\$ 0.18	12/29/2006	1/16/2007	\$ 0.50	01/01/2007	1/16/2007
<b>2005</b>						
First Quarter	\$ 0.18	03/31/2005	04/15/2005	\$ -	-	-
Second Quarter	\$ 0.18	06/20/2005	07/15/2005	\$ -	-	-
Third Quarter	\$ 0.18	09/15/2005	10/14/2005	\$ 0.39	10/01/2005	10/17/2005
Fourth Quarter	\$ 0.18	12/30/2005	01/16/2006	\$ 0.50	01/01/2006	01/16/2006

Our Board of Trustees will determine the amount of our future distributions and its decision will depend on a number of factors, including the amount of adjusted funds from operations, our partnership's financial condition, debt service requirements, capital expenditure requirements for our hotels, the annual distribution requirements under the REIT provisions of the Code and such other factors as the trustees deem relevant. Our ability to make distributions will depend on the profitability and cash flow available from our hotels.

## **SEASONALITY**

Our hotels' operations historically have been seasonal in nature, reflecting higher occupancy rates during the second and third quarters. This seasonality can be expected to cause fluctuations in our quarterly operating revenues and profitability. Hotel revenue is generally greater in the second and third quarters than in the first and fourth quarters. To the extent that cash flow from operating activities is insufficient to provide all of the estimated quarterly distributions, we anticipate that we will be able to fund any such deficit from future working capital. We expect to use excess cash flow from the second and third quarters to fund distribution shortfalls in the first and fourth quarters. There are no assurances we will be able to continue to make quarterly distributions at the current rate.

Index**COMPETITION**

The upscale and mid-scale, limited service segment of the hotel business is highly competitive. Among many other factors, our hotels compete on the basis of location, room rates, quality, service levels, reputation, and reservation systems. There are many competitors in our market segments and new hotels are always being constructed. Additions to supply create new competitors, in some cases without corresponding increases in demand for hotel rooms.

We also compete for hotel acquisitions with entities that have investment objectives similar to ours. 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.

**EMPLOYEES**

As of December 31, 2006, we had 21 employees who were principally engaged in managing the affairs of the company unrelated to property management. Our relations with our employees are satisfactory.

**FRANCHISE AGREEMENTS**

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. Our hotels operate under franchise licenses from national hotel franchisors, including:

Franchisor	Franchise
Marriott International	Marriott, Residence Inn, Springhill Suites, Courtyard by Marriott, Fairfield Inn
Hilton Hotels Corporation	Hilton, Hilton Garden Inn, Hampton Inn, Homewood Suites
Intercontinental Hotel Group	Holiday Inn, Holiday Inn Express, Holiday Inn Express & Suites
Global Hyatt Corporation	Hyatt Summerfield Suites, Hawthorn Suites
Starwood Hotels	Four Points by Sheraton
Choice Hotels International	Comfort Inn, Comfort Suites, Sleep Inn, Mainstay Suites

We anticipate that most of the hotels in which we invest will be operated pursuant to franchise licenses.

The franchise licenses generally specify certain management, operational, record-keeping, accounting, reporting and marketing standards and procedures with which the franchisee must comply. The franchise licenses obligate our lessees to comply with the franchisors' standards and requirements with respect to training of operational personnel, safety, maintaining specified insurance, the types of services and products ancillary to guest room services that may be provided by our lessees, display of signage, and the type, quality and age of furniture, fixtures and equipment included in guest rooms, lobbies and other common areas.

**TAX STATUS**

We have elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code, commencing with our taxable year ending December 31, 1999. As long as we qualify for taxation as a REIT, we generally will not be subject to Federal income tax on the portion of our income that is currently distributed to shareholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to Federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate tax rates. Even if we qualify for taxation as a REIT, we may be subject to certain state and local taxes on our income and



property and to Federal income and excise taxes on our undistributed income.

We may own up to 100% of one or more taxable REIT subsidiaries (“TRS”). A TRS is a taxable corporation that may lease hotels under certain circumstances, provide services to us, and perform activities such as third party management, development, and other independent business activities. Overall, no more than 20% of the value of our assets may consist of securities of one or more TRS. In addition, no more than 25% of our taxable income for any year, excluding all TRS revenues, may consist of dividends from one or more TRSs and other income from non-real estate related sources.

A TRS is permitted to lease hotels from us as long as the hotels are operated on behalf of the TRS by a third party manager who satisfies the following requirements:

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1. such manager is, or is related to a person who is, actively engaged in the trade or business of operating “qualified lodging facilities” for any person unrelated to us and the TRS;
2. such manager does not own, directly or indirectly, more than 35% of our common shares;
3. no more than 35% of such manager is owned, directly or indirectly, by one or more persons owning 35% or more of our common shares; and
4. we do not directly or indirectly derive any income from such manager.

The Internal Revenue Code limits the deductibility of interest paid or accrued by a TRS to us to assure that the TRS is subject to an appropriate level of corporate taxation. The Internal Revenue Code also imposes a 100% excise tax on transactions between a TRS and us or our tenants that are not on an arm’s length basis.

Earnings and profits, which will determine the taxability of dividends to shareholders, will differ from net income reported for financial reporting purposes due to the differences for federal tax purposes in the estimated useful lives and methods used to compute depreciation. The following table sets forth certain per share information regarding the Company’s common and preferred share distributions for the years ended December 31, 2006, 2005 and 2004.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Common Shares</b>			
Ordinary income	28.27%	60.83%	66.60%
Return of Capital	65.85%	29.24%	33.40%
Capital Gain Distribution	5.88%	9.93%	-
<b>Preferred Shares</b>			
Ordinary income	83.05%	85.96%	-
Capital Gain Distribution	16.95%	14.04%	-

**FINANCIAL INFORMATION ABOUT SEGMENTS**

We are in the business of acquiring equity interests in hotels, and we manage our business in one reportable segment. See Item 8 of this Annual Report on Form 10-K for segment financial information.

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**Item 1A.**

**Risk Factors**

You should carefully consider the following risks, together with the other information included in this Annual Report on Form 10-K. If any of the following risks actually occur, our business, financial condition or results of operations may suffer. As a result, the trading price of our securities could decline, and you may lose all or part of any investment you have in our securities.

**RISKS RELATING TO OUR BUSINESS AND OPERATIONS**

*We have previously determined that we had material weaknesses related to our internal control over financial reporting.*

In connection with our annual assessment of internal control over financial reporting for the year ended December 31, 2005, management identified certain material weaknesses in internal control over financial reporting, which are described in our Annual Report on Form 10-K for the year ended December 31, 2005. In response to the material weaknesses identified by the Company, the Company and HHMLP have taken certain remedial measures. As a result of these remedial measures, we believe such internal controls are designed and operating effectively; however, we cannot guarantee that in the future we will not discover additional material weaknesses in internal control over financial reporting.

*We may be unable to integrate acquired hotels into our operations or otherwise manage our planned growth, which may adversely affect our operating results.*

We have recently acquired a substantial number of hotels. We cannot assure you that we, HHMLP or other management companies we employ will be able to adapt our management, administrative, accounting and operational systems and arrangements, or hire and retain sufficient operational staff to successfully integrate these investments into our portfolio and manage any future acquisitions of additional assets without operational disruptions or unanticipated costs. Acquisition of hotels generates additional operating expenses that we will be required to pay. As we acquire additional hotels, we will be subject to the operational risks associated with owning new lodging properties. Our failure to integrate successfully 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 shareholders or make other payments in respect of securities issued by us.

*Acquisition of hotels with limited operating history may not achieve desired results.*

Many of our recent acquisitions are newly-developed hotels. Newly-developed or newly-renovated hotels do not have the operating history that would allow our management to make pricing decisions in acquiring these hotels based on historical performance. The purchase prices of these hotels are based upon management's expectations as to the operating results of such hotels, subjecting us to risks that such hotels may not achieve anticipated operating results or may not achieve these results within anticipated time frames. As a result, we may not be able to generate enough cash flow from these hotels to make debt payments or pay operating expenses. In addition, room revenues may be less than that required to provide us with our anticipated return on investment. In either case, the amounts available for distribution to our shareholders could be reduced.

*Our acquisitions may not achieve expected performance, which may harm our financial condition and operating results.*

We anticipate that acquisitions will largely be financed with the net proceeds of securities offerings and through externally generated funds such as borrowings under credit facilities and other secured and unsecured debt financing.

Acquisitions entail risks that investments will fail to perform in accordance with expectations and that estimates of the cost of improvements necessary to acquire and market properties will prove inaccurate, as well as general investment risks associated with any new real estate investment. Because we must distribute annually at least 90% of our taxable income to maintain our qualification as a REIT, our ability to rely upon income or cash flow from operations to finance our growth and acquisition activities will be limited. Accordingly, were we unable to obtain funds from borrowings or the capital markets to finance our growth and acquisition activities, our ability to grow could be curtailed, amounts available for distribution to shareholders could be adversely affected and we could be required to reduce distributions.

***We own a limited number of hotels and significant adverse changes at one hotel may impact our ability to make distributions to shareholders.***

As of December 31, 2006, our portfolio consisted of 48 wholly-owned limited and full service properties and joint venture investments in 18 hotels with a total of 8,641 rooms. Significant adverse changes in the operations of any one hotel could have a material adverse effect on our financial performance and, accordingly, on our ability to make expected distributions to our shareholders.

***We focus on acquiring hotels operating under a limited number of franchise brands, which creates greater risk as the investments are more concentrated.***

We place particular emphasis in our acquisition strategy on hotels similar to our current hotels. We invest in hotels operating under a few select franchises and therefore will be subject to risks inherent in concentrating investments in a particular franchise brand, which could have an adverse effect on amounts available for distribution to shareholders. These risks include, among others, the risk of a reduction in hotel revenues following any adverse publicity related to a specific franchise brand.

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***Most of our hotels are located in the Eastern United States and many are located in the area from Pennsylvania to Connecticut, which may increase the effect of any regional or local economic conditions.***

Most of our hotels are located in the Eastern United States. Twenty-eight of our wholly owned hotels and twelve of our joint venture hotels are located in the states of Pennsylvania, New Jersey, New York and Connecticut. As a result, regional or localized adverse events or conditions, such as an economic recession around these hotels, could have a significant adverse effect on our operations, and ultimately on the amounts available for distribution to shareholders.

***We face risks associated with the use of debt, including refinancing risk.***

At December 31, 2006, we had long-term debt, excluding capital leases, outstanding of \$556.5 million. We may borrow additional amounts from the same or other lenders in the future. Some of these additional borrowings may be secured by our hotels. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis, and our Board of Trustees' policy is to limit indebtedness to no more than 67% of the fair market value of the hotels in which we have invested. However, our declaration of trust (as amended and restated, our "Declaration of Trust") does not limit the amount of indebtedness we may incur. We cannot assure you that we will be able to meet our debt service obligations and, to the extent that we cannot, we risk the loss of some or all of our hotels to foreclosure. There is also a risk that we may not be able to refinance existing debt or that the terms of any refinancing will not be as favorable as the terms of the existing debt. If principal payments due at maturity cannot be refinanced, extended or repaid with proceeds from other sources, such as new equity capital or sales of properties, our cash flow may not be sufficient to repay all maturing debt in years when significant "balloon" payments come due.

***We do not operate our hotels and, as a result, we do not have complete control over implementation of our strategic decisions.***

In order for us to satisfy certain REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must engage an independent management company to operate our hotels. As of December 31, 2006, our TRS's have engaged an independent management company, HHMLP, as the property manager for all of our wholly owned hotels and our joint venture partnerships have retained eligible independent management companies to operate the respective hotels for the joint ventures, as required by the REIT qualification rules. HHMLP and the management companies operating the hotels owned in our joint ventures make and implement strategic business decisions with respect to these hotels, such as decisions with respect to the repositioning of a franchise or food and beverage operations and other similar decisions. Decisions made by HHMLP and the management companies operating the hotels may not be in the best interests of a particular hotel or of our company. Accordingly, we cannot assure you that HHMLP or the management companies operating the hotels owned in our joint ventures will operate our hotels in a manner that is in our best interests.

***We depend on a limited number of key personnel.***

We depend on the services of our existing senior management team, including Jay H. Shah, Neil H. Shah, Ashish R. Parikh and Michael R. Gillespie, to carry out our business and investment strategies. As we expand, we will continue to need to attract and retain qualified additional senior management. We have employment contracts with certain of our senior management; however, the employment agreements may be terminated under certain circumstances. The termination of an employment agreement and the loss of the services of any of our key management personnel, or our inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

***We face increasing competition for the acquisition of hotel properties and other assets, which may impede our ability to make future acquisitions or may increase the cost of these acquisitions.***

We face competition for investment opportunities in high quality, upscale and mid-scale limited service and extended-stay hotels from entities organized for purposes substantially similar to our objectives, as well as other purchasers of hotels. We compete for such investment opportunities with entities that have substantially greater financial resources than we do, including access to capital or better relationships with franchisors, sellers or lenders. Our competitors may generally be able to accept more risk than we can manage prudently and may be able to borrow the funds needed to acquire hotels. Competition may generally reduce the number of suitable investment opportunities offered to us and increase the bargaining power of property owners seeking to sell.

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

We may enter into hedging transactions to protect us from the effects of interest rate fluctuations on floating rate debt and also to protect our portfolio of mortgage assets from interest rate and prepayment rate fluctuations. Our hedging transactions may include entering into interest rate swaps, caps, and floors, options to purchase such items, and futures and forward contracts. 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 could adversely affect us because, among other things:

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- 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 owning 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 accounting rules to reflect changes in fair value.

***Downward adjustments, or “mark-to-market losses,” would reduce our shareholders’ equity.***

Hedging involves risk and typically involves costs, including transaction costs, which may reduce returns on our investments. These costs increase as the period covered by the hedging increases and during periods of rising and volatile interest rates. These costs will also limit the amount of cash available for distribution to shareholders. The REIT qualification rules may also limit our ability to enter into hedging transactions. We generally intend to hedge as much of our interest rate risk as our management determines is in our best interests given the cost of such hedging transactions and the requirements applicable to REITs. If we are unable to hedge effectively because of the cost of such hedging transactions or the limitations imposed by the REIT rules, we will face greater interest risk exposure than may be commercially prudent.

***If we cannot access the capital markets, we may not be able to grow the Company at our historical growth rates.***

We may not be able to access the capital markets to obtain capital to fund future acquisitions and investments. If we lack the capital to make future acquisitions or investments, we may not be able to continue to grow at historical rates.

**RISKS RELATING TO CONFLICTS OF INTEREST**

***Due to conflicts of interest, many of our existing agreements may not have been negotiated on an arm’s-length basis and may not be in our best interest.***

Some of our officers and trustees have ownership interests in HHMLP and in entities with which we have entered into transactions, including hotel acquisitions and dispositions and certain financings. Consequently, the terms of our agreements with those entities, including hotel contribution or purchase agreements, the Administrative Services Agreement between us and HHMLP pursuant to which HHMLP provides certain administrative services, the Option Agreement between the operating partnership and some of the trustees and officers and our property management agreements with HHMLP may not have been negotiated on an arm’s-length basis and may not be in the best interest of all our shareholders.

***Conflicts of interest with other entities may result in decisions that do not reflect our best interests.***

The following officers and trustees own collectively approximately 94% of HHMLP: Hasu P. Shah, Jay H. Shah, Neil H. Shah, David L. Desfor, K.D. Patel and Kiran P. Patel. The following officers and trustees serve as officers of HHMLP: David L. Desfor, Kiran P. Patel and K.D. Patel. Conflicts of interest may arise in respect of the ongoing acquisition, disposition and operation of our hotels including, but not limited to, the enforcement of the contribution and purchase agreements, the Administrative Services Agreement, the Option Agreement and our property management agreements with HHMLP. Consequently, the interests of shareholders may not be fully represented in all decisions made or actions taken by our officers and trustees.

***Conflicts of interest relating to sales or refinancing of hotels acquired from some of our trustees and officers may lead to decisions that are not in our best interest.***

Some of our trustees and officers have unrealized gains associated with their interests in the hotels we have acquired from them and, as a result, any sale of these hotels or refinancing or prepayment of principal on the indebtedness assumed by us in purchasing these hotels may cause adverse tax consequences to such of our trustees and officers. Therefore, our interests and the interests of these individuals may be different in connection with the disposition or refinancing of these hotels.

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***Additional hotels owned or acquired by some of our trustees and officers may hinder these individuals from spending adequate time on our business.***

Some of our trustees and officers own hotels and may develop or acquire new hotels, subject to certain limitations. Such ownership, development or acquisition activities may materially affect the amount of time these officers and trustees devote to our affairs. Some of our trustees and officers operate hotels that are not owned by us, which may materially affect the amount of time that they devote to managing our hotels. Pursuant to the Option Agreement, as amended, we have an option to acquire any hotels developed by our officers and trustees.

***Need for certain consents from the limited partners may not result in decisions advantageous to shareholders.***

Under our operating partnership's amended and restated partnership agreement, the holders of at least two-thirds of the interests in the partnership must approve a sale of all or substantially all of the assets of the partnership or a merger or consolidation of the partnership. Some of our officers and trustees will own an approximately [8.7%] interest in the operating partnership on a fully-diluted basis. Their large ownership percentage may make it less likely that a merger or sale of our company that would be in the best interests of our shareholders will be approved.

## **RISKS RELATING TO OUR CORPORATE STRUCTURE**

***Our ownership limitation may restrict business combination opportunities.***

To qualify as a REIT under the Code, no more than 50% of the value of our outstanding shares of beneficial interest may be owned, directly or indirectly, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities) during the last half of each taxable year. To preserve our REIT qualification, our Declaration of Trust generally prohibits direct or indirect ownership of more than 9.9% of (i) the number of outstanding common shares of any class or series of common shares or (ii) the number of outstanding preferred shares of any class or series of preferred shares. Generally, common shares owned by affiliated owners will be aggregated for purposes of the ownership limitation. The ownership limitation could have the effect of delaying, deterring or preventing a change in control or other transaction in which holders of common shares might receive a premium for their common shares over the then prevailing market price or which such holders might believe to be otherwise in their best interests.

***The Declaration of Trust contains a provision that creates staggered terms for our Board of Trustees.***

Our Board of Trustees is divided into two classes. The terms of the first and second classes expire in 2008 and 2007, respectively. Trustees of each class are elected for two-year terms upon the expiration of their current terms and each year one class of trustees will be elected by the shareholders. The staggered terms of trustees may delay, deter or prevent a tender offer, a change in control of us or other transaction, even though such a transaction might be in the best interest of the shareholders.

***Maryland Business Combination Law may discourage a third party from acquiring us.***

Under the Maryland General Corporation Law, as amended (MGCL), as applicable to REITs, certain "business combinations" (including certain issuances of equity securities) between a Maryland REIT and any person who beneficially owns ten percent or more of the voting power of the trust's shares, or an affiliate thereof, are prohibited for five years after the most recent date on which this shareholder acquired at least ten percent of the voting power of the trust's shares. Thereafter, any such business combination must be approved by two super-majority shareholder votes unless, among other conditions, the trust's common shareholders receive a minimum price (as defined in the MGCL) for their shares and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its common shares. These provisions could delay, deter or prevent a change of control or other

transaction in which holders of our equity securities might receive a premium for their shares above then-current market prices or which such shareholders otherwise might believe to be in their best interests.

***Our Board of Trustees may change our investment and operational policies without a vote of the common shareholders.***

Our major policies, including our policies with respect to acquisitions, financing, growth, operations, debt limitation and distributions, are determined by our Board of Trustees. The Trustees may amend or revise these and other policies from time to time without a vote of the holders of the common shares.

***Our Board of Trustees and management make decisions on our behalf, and shareholders have limited management rights.***

Our shareholders have no right or power to take part in our management except through the exercise of voting rights on certain specified matters. The board of trustees is responsible for our management and strategic business direction, and our management is responsible for our day-to-day operations. Certain policies of our board of trustees may not be consistent with the immediate best interests of our securityholders.

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***Holders of our outstanding Series A preferred shares have dividend, liquidation, and other rights that are senior to the rights of the holders of our common shares.***

Our Board of Trustees has the authority to designate and issue preferred shares with liquidation, dividend and other rights that are senior to those of our common shares. As of December 31, 2006, 2,400,000 shares of our Series A preferred shares were issued and outstanding. The aggregate liquidation preference with respect to the outstanding preferred shares is approximately \$60.0 million, and annual dividends on our outstanding preferred shares are approximately \$4.8 million. Holders of our Series A preferred shares are entitled to cumulative dividends before any dividends may be declared or set aside on our common shares. Upon our voluntary or involuntary liquidation, dissolution or winding up, before any payment is made to holders of our common shares, holders of our Series A preferred shares are entitled to receive a liquidation preference of \$25.00 per share plus any accrued and unpaid distributions. This will reduce the remaining amount of our assets, if any, available to distribute to holders of our common shares. In addition, holders of our Series A preferred shares have the right to elect two additional trustees to our Board of Trustees whenever dividends are in arrears in an aggregate amount equivalent to six or more quarterly dividends, whether or not consecutive.

***Our Board of Trustees may issue additional shares that may cause dilution or prevent a transaction that is in the best interests of our shareholders.***

Our Declaration of Trust authorizes the Board of Trustees, without shareholder approval, to:

- amend the Declaration of Trust to increase or decrease the aggregate number of shares of beneficial interest or the number of shares of beneficial interest of any class or series that we have the authority to issue;
  - cause us to issue additional authorized but unissued common shares or preferred shares; and
- classify or reclassify any unissued common or preferred shares and to set the preferences, rights and other terms of such classified or reclassified shares, including the issuance of additional common shares or preferred shares that have preference rights over the common shares with respect to dividends, liquidation, voting and other matters.

Any one of these events could cause dilution to our common shareholders, delay, deter or prevent a transaction or a change in control that might involve a premium price for the common shares or otherwise not be in the best interest of holders of common shares.

***Future offerings of equity securities, which would dilute our existing shareholders and may be senior to our common shares for the purposes of dividend distributions, may adversely affect the market price of our common shares.***

In the future, we may attempt to increase our capital resources by making additional offerings of equity securities, including classes of preferred or common shares. Upon liquidation, holders of our preferred shares and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common shares. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common shares, or both. Our preferred shares, if issued, 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 shares. 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 shareholders bear the risk of our future offerings reducing the market price of our common shares and diluting their share holdings in us.

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

We intend to pay quarterly dividends and to make distributions to our shareholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. However, our ability to pay dividends may be adversely affected by the risk factors described in this annual report. All distributions will be made at the discretion of our Board of Trustees and will depend upon our earnings, our financial condition, maintenance of our REIT status and such other factors as our board 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.

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

One of the factors that 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 common shares likely will be based primarily on the earnings and return that we derive from our investments and income with respect to our properties and our related distributions to shareholders, 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 common shares. For instance, if interest rates rise without an increase in our dividend rate, the market price of our common shares could decrease because potential investors may require a higher dividend yield on our common shares 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.

**RISKS RELATED TO OUR TAX STATUS**

***If we fail to qualify as a REIT, our dividends will not be deductible to us, and our income will be subject to taxation.***

We have operated and intend to continue to operate so as to qualify as a REIT for federal income tax purposes. Our continued qualification as a REIT will depend on our continuing ability to meet various requirements concerning, among other things, the ownership of our outstanding shares of beneficial interest, the nature of our assets, the sources of our income, and the amount of our distributions to our shareholders. If we were to fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we would not be allowed a deduction for distributions to our shareholders in computing our taxable income and would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Unless entitled to relief under certain Internal Revenue Code provisions, we also would be disqualified from treatment as a REIT for the four taxable years following the year during which qualification was lost. As a result, amounts available for distribution to shareholders would be reduced for each of the years involved. Although we currently intend to operate in a manner designed to qualify as a REIT, it is possible that future economic, market, legal, tax or other considerations may cause the trustees, with the consent of holders of two-thirds of the outstanding shares, to revoke the REIT election.

***Failure to make required distributions would subject us to tax.***

In order to qualify as a REIT, each year we must distribute to our shareholders at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. 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 income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any year are less than the sum of:

- 85% of our net ordinary income for that year;
- 95% of our net capital gain net income for that year; and
- 100% of our undistributed taxable income from prior years.

We have paid out, and intend to continue to pay out, our income to our shareholders in a manner intended to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax. Differences in timing between the recognition of income and the related cash receipts or the effect of required debt amortization

payments could require us to borrow money or sell assets to pay out enough of our taxable income to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax in a particular year. In the past we have borrowed, and in the future we may borrow, to pay distributions to our shareholders and the limited partners of our operating partnership. Such borrowings subject us to risks from borrowing as described herein.

***The taxation of corporate dividends may adversely affect the value of our common shares.***

Legislation enacted in 2003 and 2006, among other things, generally reduced to 15% the maximum marginal rate of tax payable by domestic noncorporate taxpayers on dividends received from a regular C corporation and certain Foreign corporations through 2010. This reduced tax rate, however, does not apply to dividends paid to domestic noncorporate taxpayers by a REIT on its shares, except for certain limited amounts. Although the earnings of a REIT that are distributed to its shareholders are still generally subject to less federal income taxation than earnings of a non-REIT C corporation that are distributed to its shareholders net of corporate-level income tax, this legislation could cause domestic noncorporate investors to view the shares of regular C corporations as more attractive relative to the shares of a REIT than was the case prior to the enactment of the legislation, because the dividends from regular C corporations are generally taxed at a lower rate while dividends from REITs are generally taxed at the same rate as the individual's other ordinary income. We cannot predict what effect, if any, the enactment of this legislation may have on the value of the shares of REITs in general or on our shares in particular, either in terms of price or relative to other investments.

***The U.S. federal income tax laws governing REITs are complex.***

We intend to continue to operate in a manner that will qualify us as a real estate investment trust, or REIT, under the U.S. federal income tax laws. The REIT qualification requirements are extremely complex, however, and interpretations of the U.S. federal income tax laws governing qualification as a REIT are limited. Accordingly, we cannot be certain that we will be successful in operating so we can continue to qualify as a REIT. At any time, new laws, interpretations, or court decisions may change the federal tax laws or the U.S. federal income tax consequences of our qualification as a REIT.

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

To qualify as a REIT, we must satisfy certain requirements with respect to the character of our assets. 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 (by, possibly, selling assets notwithstanding their prospects as an investment) to avoid losing our REIT status. If we fail to comply with these requirements at the end of any calendar quarter, and the failure exceeds a de minimis threshold, we may be able to preserve our REIT status if (a) the failure was due to reasonable cause and not to willful neglect, (b) we dispose of the assets causing the failure within six months after the last day of the quarter in which we identified the failure, (c) we file a schedule with the IRS describing each asset that caused the failure, and (d) we pay an additional tax of the greater of \$50,000 or the product of the highest applicable tax rate multiplied by the net income generated on those assets. As a result, we may be required to liquidate otherwise attractive investments.

***Our share ownership limitation may prevent certain transfers of our shares.***

In order to maintain our qualification as a REIT, not more than 50% in value of our outstanding shares of beneficial interest may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities). Our Declaration of Trust prohibits direct or indirect ownership (taking into account applicable ownership provisions of the Internal Revenue Code) of more than (a) 9.9% of the aggregate number of outstanding common shares of any class or series or (b) 9.9% of the aggregate number of outstanding preferred shares of any class or series of outstanding preferred shares by any shareholder or group (the "Ownership Limitation"). Generally, the shares of beneficial interest owned by related or affiliated owners will be aggregated for purposes of the Ownership Limitation.

Any transfer of shares of beneficial interest that would violate the Ownership Limitation, cause us to have fewer than 100 shareholders, cause us to be “closely held” within the meaning of Section 856(h) of the Internal revenue Code or cause us to own, directly or indirectly, 10% or more of the ownership interest in any tenant (other than a taxable REIT subsidiary) will be void, the intended transferee of such shares will be deemed never to have had an interest in such shares, and such shares will be designated “shares-in-trust.” Further, we will be deemed to have been offered shares-in-trust for purchase at the lesser of the market price (as defined in the Declaration of Trust) on the date we accept the offer and the price per share in the transaction that created such shares-in-trust (or, in the case of a gift, devise or non-transfer event (as defined in the Declaration of Trust), the market price on the date of such gift, devise or non-transfer event). Therefore, the holder of shares of beneficial interest in excess of the Ownership Limitation will experience a financial loss when such shares are purchased by us, if the market price falls between the date of purchase and the date of redemption.

We have, in limited instances from time to time, permitted certain owners to own shares in excess of the Ownership Limitation. The Board of Trustees has waived the Ownership Limitation for such owners after following procedures set out in our Declaration of Trust, under which the owners requesting the waivers provided certain information and our counsel provided certain legal opinions. These waivers established levels of permissible share ownership for the owners requesting the waivers that are higher than the Ownership Limitation. If the owners acquire shares in excess of the higher limits, those shares are subject to the risks described above in the absence of further waivers. The Board of Trustees is not obligated to grant such waivers and has no current intention to do so with respect to any owners who (individually or aggregated as the Declaration of Trust requires) do not currently own shares in excess of the Ownership Limitation.

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**RISKS RELATED TO THE HOTEL INDUSTRY**

***The value of our hotels depends on conditions beyond our control.***

Our hotels are subject to varying degrees of risk generally incident to the ownership of hotels. The underlying value of our hotels, our income and ability to make distributions to our shareholders are dependent upon the operation of the hotels in a manner sufficient to maintain or increase revenues in excess of operating expenses. Hotel revenues may be adversely affected by adverse changes in national economic conditions, adverse changes in local market conditions due to changes in general or local economic conditions and neighborhood characteristics, competition from other hotels, changes in interest rates and in the availability, cost and terms of mortgage funds, the impact of present or future environmental legislation and compliance with environmental laws, the ongoing need for capital improvements, particularly in older structures, changes in real estate tax rates and other operating expenses, adverse changes in governmental rules and fiscal policies, civil unrest, acts of terrorism, acts of God, including earthquakes, hurricanes and other natural disasters, acts of war, adverse changes in zoning laws, and other factors that are beyond our control. In particular, general and local economic conditions may be adversely affected by the recent terrorist incidents in New York and Washington, D.C. Our management is unable to determine the long-term impact, if any, of these incidents or of any acts of war or terrorism in the United States or worldwide, on the U.S. economy, on us or our hotels or on the market price of our common shares.

***Our hotels are subject to general hotel industry operating risks, which may impact our ability to make distributions to shareholders.***

Our hotels are subject to all operating risks common to the hotel industry. The hotel industry has experienced volatility in the past, as have our hotels, and there can be no assurance that such volatility will not occur in the future. These risks include, among other things, competition from other hotels; over-building in the hotel industry that could adversely affect hotel revenues; increases in operating costs due to inflation and other factors, which may not be offset by increased room rates; reduction in business and commercial travel and tourism; strikes and other labor disturbances of hotel employees; increases in energy costs and other expenses of travel; adverse effects of general and local economic conditions; and adverse political conditions. These factors could reduce revenues of the hotels and adversely affect our ability to make distributions to our shareholders.

***Competition for guests is highly competitive.***

The hotel industry is highly competitive. Our hotels compete with other existing and new hotels in their geographic markets. Many of our competitors have substantially greater marketing and financial resources than we do. If their marketing strategies are effective, we may be unable to make distributions to our shareholders.

***Our investments are concentrated in a single segment of the hotel industry.***

Our current business strategy is to own and acquire hotels primarily in the high quality, upscale and mid-scale limited service and extended-stay segment of the hotel industry. We are subject to risks inherent in concentrating investments in a single industry and in a specific market segment within that industry. The adverse effect on amounts available for distribution to shareholders resulting from a downturn in the hotel industry in general or the mid-scale segment in particular could be more pronounced than if we had diversified our investments outside of the hotel industry or in additional hotel market segments.

***The hotel industry is seasonal in nature.***



The hotel industry is seasonal in nature. Generally, hotel revenues are greater in the second and third quarters than in the first and fourth quarters. Our hotels' operations historically reflect this trend. We believe that we will be able to make distributions necessary to maintain REIT status through cash flow from operations; but if we are unable to do so, we may not be able to make the necessary distributions or we may have to generate cash by a sale of assets, increasing indebtedness or sales of securities to make the distributions. Risks of operating hotels under franchise licenses, which may be terminated or not renewed, may impact our ability to make distributions to shareholders.

***Risks of operating hotels under franchise licenses, which may be terminated or not renewed, may impact our ability to make distributions to shareholders.***

The continuation of the franchise licenses is subject to specified operating standards and other terms and conditions. All of the franchisors of our hotels periodically inspect our hotels to confirm adherence to their operating standards. The failure of our partnership or HHMLP to maintain such standards or to adhere to such other terms and conditions could result in the loss or cancellation of the applicable franchise license. It is possible that a franchisor could condition the continuation of a franchise license on the completion of capital improvements that the trustees determine are too expensive or otherwise not economically feasible in light of general economic conditions, the operating results or prospects of the affected hotel. In that event, the trustees may elect to allow the franchise license to lapse or be terminated.

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There can be no assurance that a franchisor will renew a franchise license at each option period. If a franchisor terminates a franchise license, we, our partnership, and HHMLP may be unable to obtain a suitable replacement franchise, or to successfully operate the hotel independent of a franchise license. The loss of a franchise license could have a material adverse effect upon the operations or the underlying value of the related hotel because of the loss of associated name recognition, marketing support and centralized reservation systems provided by the franchisor. Our loss of a franchise license for one or more of the hotels could have a material adverse effect on our partnership's revenues and our amounts available for distribution to shareholders.

***Operating costs and capital expenditures for hotel renovation may be greater than anticipated and may adversely impact distributions to shareholders.***

Hotels generally have an ongoing need for renovations and other capital improvements, particularly in older structures, including periodic replacement of furniture, fixtures and equipment. Under the terms of our management agreements with HHMLP, we are obligated to pay the cost of expenditures for items that are classified as capital items under GAAP that are necessary for the continued operation of our hotels. If these expenses exceed our estimate, the additional cost could have an adverse effect on amounts available for distribution to shareholders. In addition, we may acquire hotels in the future that require significant renovation. Renovation of hotels involves certain risks, including the possibility of environmental problems, construction cost overruns and delays, uncertainties as to market demand or deterioration in market demand after commencement of renovation and the emergence of unanticipated competition from hotels.

***The increasing use of Internet travel intermediaries by consumers may adversely affect our profitability.***

Some of our hotel rooms are booked through Internet travel intermediaries such as Travelocity.com, Expedia.com and Priceline.com. As these Internet bookings increase, these intermediaries may be able to obtain higher commissions, reduced room rates or other significant concessions from us. Moreover, some Internet travel intermediaries offer hotel rooms as a commodity, by increasing the importance of price and general indicators of quality (such as "three-star downtown hotel") at the expense of brand identification. These intermediaries hope that consumers will eventually develop brand loyalties to their reservation systems rather than to the lodging brands with which our hotels are affiliated. Although most of the business for our hotels is expected to be derived from traditional channels, if the amount of sales made through Internet intermediaries increases significantly, room revenues may flatten or decrease and our profitability may be adversely affected.

## **RISKS RELATED TO REAL ESTATE INVESTMENT GENERALLY**

***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.***

Real estate investments are relatively illiquid. Our ability to vary our portfolio in response to changes in operating, economic and other conditions will be limited. No assurances can be given that the fair market value of any of our hotels will not decrease in the future.

***If we suffer losses that are not covered by insurance or that are in excess of our insurance coverage limits, we could lose investment capital and anticipated profits.***

We require comprehensive insurance to be maintained on each of our hotels, including liability and fire and extended coverage in amounts sufficient to permit the replacement of the hotel in the event of a total loss, subject to applicable deductibles. However, there are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, hurricanes and acts of terrorism, that may be uninsurable or not economically insurable. Inflation,

changes in building codes and ordinances, environmental considerations and other factors also might make it impracticable to use insurance proceeds to replace the applicable hotel after such applicable hotel has been damaged or destroyed. Under such circumstances, the insurance proceeds received by us might not be adequate to restore our economic position with respect to the applicable hotel. If any of these or similar events occur, it may reduce the return from the attached property and the value of our investment.

***REITs are subject to property taxes.***

Each hotel is subject to real and personal property taxes. The real and personal property taxes on hotel properties in which we invest may increase as property tax rates change and as the properties are assessed or reassessed by taxing authorities. Many state and local governments are facing budget deficits which has led many of them, and may in the future lead others to, increase assessments and/or taxes. If property taxes increase, our ability to make expected distributions to our shareholders could be adversely affected.

***Environmental matters could adversely affect our results.***

Operating costs may be affected by the obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of future legislation. Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances on, under or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. The cost of complying with environmental laws could materially adversely affect amounts available for distribution to shareholders. Phase I environmental assessments have been obtained on all of our hotels. Nevertheless, it is possible that these reports do not reveal all environmental liabilities or that there are material environmental liabilities of which we are unaware.

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*Costs associated with complying with the Americans with Disabilities Act may adversely affect our financial condition and operating results.*

Under the Americans with Disabilities Act of 1993 (ADA), all public accommodations are required to meet certain federal requirements related to access and use by disabled persons. While we believe that our hotels are substantially in compliance with these requirements, a determination that we are not in compliance with the ADA could result in imposition of fines or an award of damages to private litigants. In addition, changes in governmental rules and regulations or enforcement policies affecting the use and operation of the hotels, including changes to building codes and fire and life-safety codes, may occur. If we were required to make substantial modifications at the hotels to comply with the ADA or other changes in governmental rules and regulations, our ability to make expected distributions to our shareholders could be adversely affected.

**Item 1B.**

**Unresolved Staff Comments**

None.

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The following table sets forth certain information with respect to the hotels we wholly owned as of December 31, 2006.

<b>Twelve Months Ended December 31, 2006</b>							
<b>Name</b>	<b>Year Opened</b>	<b>Number of Rooms</b>	<b>Room Revenue</b>	<b>Other Revenue (1)</b>	<b>Occupancy</b>	<b>Average Daily Rate</b>	<b>RevPAR (2)</b>
<b>Comfort Inn</b>							
North Dartmouth, MA (3)	1986	84	\$ 1,200,881	\$ 12,532	68.84%	\$ 84.77	\$ 58.35
Harrisburg, PA	1998	81	\$ 1,665,431	\$ 45,581	66.27%	\$ 86.06	\$ 57.04
Frederick, MD	2004	73	\$ 1,438,261	\$ 26,172	63.21%	\$ 85.41	\$ 53.98
<b>Courtyard</b>							
Alexandria, VA (4)	2006	203	\$ 1,144,480	\$ 157,015	51.46%	\$ 119.09	\$ 61.28
Scranton, PA (5)	1996	120	\$ 2,345,890	\$ 196,886	68.46%	\$ 85.50	\$ 58.53
Langhorne, PA (6)	2002	118	\$ 3,830,847	\$ 481,195	75.02%	\$ 119.21	\$ 89.43
Brookline/Boston, MA	2003	188	\$ 8,906,184	\$ 759,116	81.57%	\$ 159.11	\$ 129.79
Wilmington, DE	1999	78	\$ 2,506,225	\$ 102,623	73.45%	\$ 119.85	\$ 88.03
<b>Fairfield Inn</b>							