



SUNSTONE
HOTEL INVESTORS

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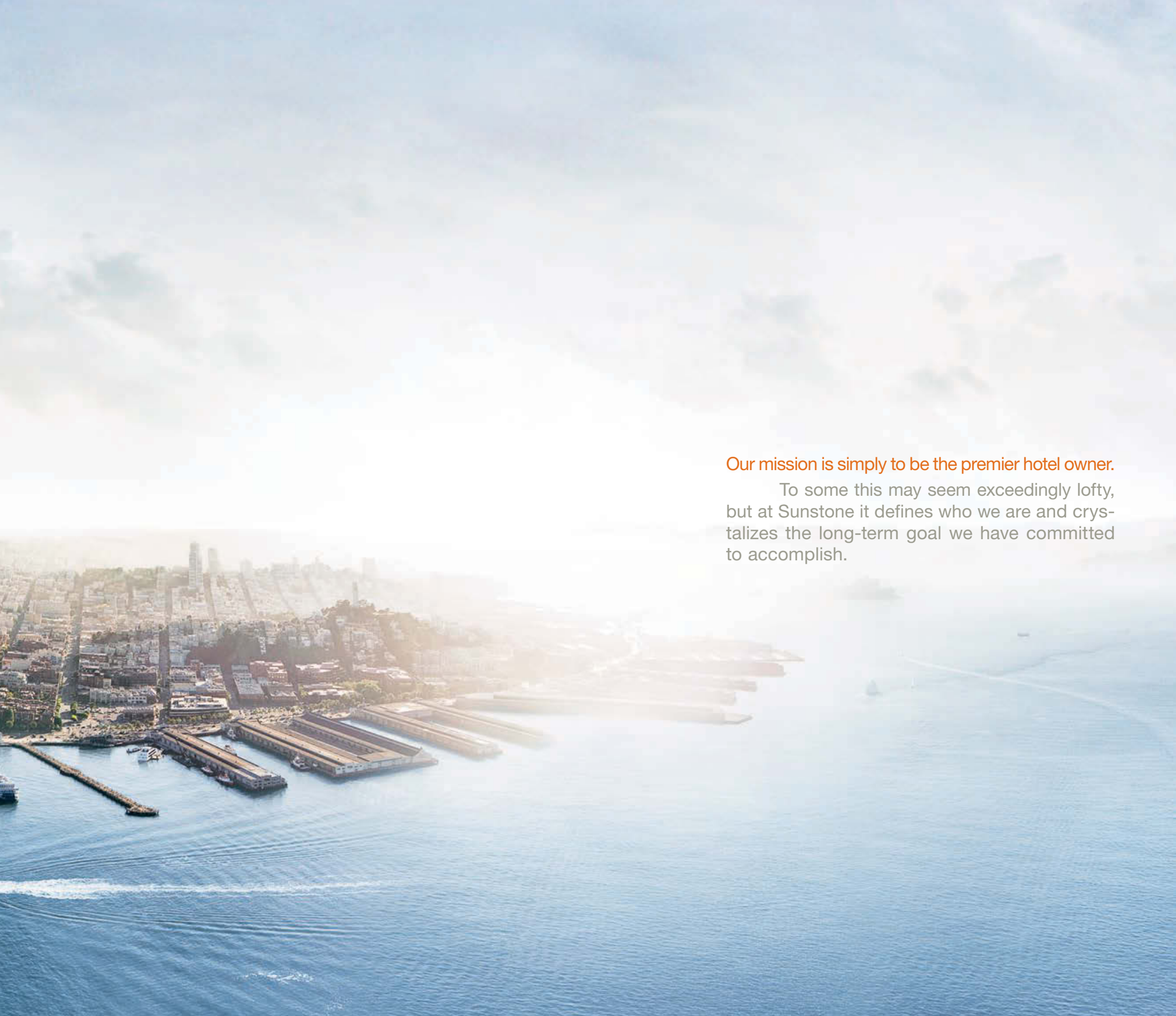
2013 ANNUAL REPORT

An aerial photograph of San Francisco, showing the city skyline, the bay, and the Golden Gate Bridge. The text "ng the course!" is overlaid in white. A circular graphic element is visible in the lower right quadrant of the image.

ng the course!

Hyatt Regency San Francisco

—
Acquired December 2013
802 Rooms



Our mission is simply to be the premier hotel owner.

To some this may seem exceedingly lofty, but at Sunstone it defines who we are and crystallizes the long-term goal we have committed to accomplish.





CREATING SHAREHOLDER VALUE— Our 2013 strategy focused on creating shareholder value through improvements in the quality and scale of our institutional-quality portfolio and gradually deleveraging our balance sheet. Our strategic initiatives in 2013 delivered a 4.5% growth in Adjusted 28 Hotel Comparable Portfolio RevPAR, a 5% increase in Pro Forma 29 Hotel Comparable Corporate Adjusted EBITDA and a 26.1% total shareholder return. We also continued to reduce our pro rata debt and preferred equity to total capitalization, which declined by 16.7 percentage points from 54.1% to 37.4%.

Hyatt Regency San Francisco

—
Lobby



We completed three hotel acquisitions during 2013: Hilton New Orleans St. Charles (May 2013), Boston Park Plaza (July 2013) and Hyatt Regency San Francisco (December 2013).

Each acquisition increased the quality and scale of our portfolio while also advancing our corporate objectives to improve financial flexibility and reduce leverage. The acquisition of the Hyatt Regency San Francisco was highly consistent with our external growth strategy.

Hyatt Regency San Francisco

—
Building Exterior

29

Institutional-quality, upper-upscale hotels

CALIFORNIA

OREGON

UTAH

TEXAS

ILLINOIS

LOUISIANA

Courtyard by Marriott Los Angeles

Marriott Portland

Marriott Park City

Hilton Houston—North

Embassy Suites Chicago

*Hilton New Orleans
St. Charles*

Embassy Suites La Jolla

Marriott Houston

*Hilton Garden Inn Chicago
Downtown/Magnificent Mile*

JW Marriott New Orleans

Fairmont Newport Beach

Hyatt Chicago Magnificent Mile

Hilton San Diego Bayfront

Hyatt Regency Newport Beach

Hyatt Regency San Francisco

Renaissance Long Beach

Renaissance Los Angeles Airport

Sheraton Cerritos

Rooms with concentrations in
top lodging markets across the country

13,744

FLORIDA

Renaissance Orlando at SeaWorld®

MARYLAND/D.C./VIRGINIA

*Renaissance Baltimore—
Harborplace*

Renaissance Washington D.C.

Marriott Tysons Corner

PENNSYLVANIA

Marriott Philadelphia

NEW YORK

*Doubletree Guest Suites
Times Square*

Hilton Times Square

Renaissance Westchester

MASSACHUSETTS

Boston Park Plaza

Marriott Boston Long Wharf

Marriott Quincy

We have developed strategic concentrations of well-located, well-capitalized hotels in primary markets, such as Boston, New York, Washington D.C., Chicago, New Orleans, San Francisco, Los Angeles and San Diego.

We anticipate each of these markets—collectively representing approximately two-thirds of our pro forma EBITDA—to generate superior RevPAR growth over the coming few years. Such concentrations also enable us to leverage our asset management efforts across multiple hotels.

Boston Park Plaza

—
Acquired July 2013
1,053 Rooms





Hilton New Orleans St. Charles

—
Acquired May-2013
250 Rooms



HILTON NEW ORLEANS ST. CHARLES





We seek to improve the competitive positioning of our hotels through select renovations.

In 2013, we invested \$118 million into our portfolio. Focusing on our three hotels centrally-located near Chicago's Magnificent Mile district, we completed transformative renovations at both the 419-room Hyatt Chicago Magnificent Mile and the 368-room Embassy Suites Chicago. We recently completed a full guestroom renovation at our 357-room Hilton Garden Inn Chicago Downtown/ Magnificent Mile. The following pages showcase some of the "Before"/"After" transformations.





Hyatt Chicago Magnificent Mile
—
Renovated Lobby



BEFORE RENOVATION



BEFORE RENOVATION



Hyatt Chicago Magnificent Mile
Renovated Great Room/Bar







Hyatt Chicago Magnificent Mile
—
Renovated Library & Computer Lounge



BEFORE RENOVATION



BEFORE RENOVATION



Embassy Suites Chicago

Renovated Lobby





Embassy Suites Chicago

Renovated Breakfast Buffet



BEFORE RENOVATION





In a cyclical business such as lodging real estate, the most important and lasting opportunities to create value occur at the inflection points of our business cycle.

We continued to execute on our stated plan in 2013, making appropriate tactical adjustments as the external environment changed. Our mid-term objective is to achieve low leverage and high financial flexibility by the time the current economic cycle peaks.

Hilton San Diego Bayfront

Pool



HILTON SAN DIEGO BAYFRONT





Hilton San Diego Bayfront

Pool Club



We plan to stay the course in 2014.

We will continue to execute on our plan to carefully build shareholder value by improving the quality and scale of our portfolio while gradually deleveraging our balance sheet.

Hilton San Diego Bayfront

—

Pool Club

Dear Shareholders,

We are staying the course. As we continue to navigate the middle years of what we believe will be a prolonged period of cyclical growth for lodging companies, our long-term goal is unchanged: build shareholder value by improving the quality and scale of our portfolio while gradually deleveraging our balance sheet. Over the past several years, we have demonstrated that our long-term goal is not self-contradictory: a lodging REIT *can* create meaningful shareholder value while materially deleveraging its balance sheet.

WE MADE SOLID PROGRESS IN 2013

We've worked to achieve our long-term goal by executing on a strategic plan comprised of four pillars: proactive portfolio management, intensive asset management, disciplined external growth and measured balance sheet improvement. We are proud of the progress we made in each of these areas in 2013.

Proactive Portfolio Management—We seek to maximize the long-term value of our investments by taking steps to enhance our portfolio quality, increase our exposure to key markets, reduce our exposure to slower-growth markets and improve the effectiveness and efficiency of our decision making. Examples of our 2013 portfolio management initiatives include:

- Sold four, low RevPAR, low growth hotels and a commercial laundry in Rochester, Minnesota for a gross sale price of \$230 million (12.8x trailing hotel EBITDA on allocated hotel purchase price).
- Continued to implement a portfolio-wide energy efficiency program, which helped reduce our overall energy costs per occupied room by 5% in 2013 and 16% since 2012.
- Developed new proprietary decision support models supporting our asset management, acquisitions and finance disciplines.

Intensive Asset Management—We work closely with our third-party hotel operators to develop and implement long-term strategic plans for each of our hotels, which seek to maximize both the competitiveness of our hotels and our returns on invested capital. On a day-to-day basis, our asset managers work directly with our third-party operators

to refine revenue management strategies and develop new operating efficiencies. Examples of our 2013 asset management initiatives include:

- Completed approximately \$118 million of hotel-level capital investments, including major renovations of our Hilton Times Square, Hyatt Chicago Magnificent Mile, Hyatt Regency Newport Beach and Renaissance Westchester.
- Created non-rooms revenue maximization plans for each hotel.

Disciplined External Growth—We seek to invest in institutional-quality hotels that generate returns in excess of our cost of capital, that are additive to the quality of our portfolio, that have attractive growth potential and that may benefit from our asset management competencies. We seek to structure our acquisitions in ways that will not only create shareholder value but will also advance our other corporate objectives, such as improving our financial flexibility and reducing our leverage. In 2013, we acquired the following three hotels:

- Hilton New Orleans St. Charles (250 rooms): Acquired on May 1, 2013 for a net purchase price of \$59 million.
- Boston Park Plaza (1,053 rooms): Acquired on July 2, 2013 for a net purchase price of \$248 million.
- Hyatt Regency San Francisco (802 rooms): Acquired on December 2, 2013 for a net purchase price of \$263 million.

Measured Balance Sheet Improvement—We believe that a low overall cost of capital and significant financial flexibility are critical mid-term objectives. Accordingly, our long-term capital plan sets forth annual credit milestones to be achieved in conjunction with our portfolio management and growth objectives. Our 2013 finance transactions included:

- In January 2013, we retired the remaining \$58 million of our 4.60% Senior Exchangeable Notes.
- In February 2013, we issued approximately \$295 million of common stock at an attractive price relative to our internally estimated net asset value. We used the proceeds to redeem all of our 8.0% Series A Cumulative Redeemable Preferred Stock and all of our Series C Cumulative Convertible Redeemable Preferred Stock, as well as to

partially fund our acquisitions of the Hilton New Orleans St. Charles and the Boston Park Plaza.

- In November 2013, we issued approximately \$271 million of common stock at an attractive price relative to our internally estimated net asset value. We used the proceeds from this offering to acquire the Hyatt Regency San Francisco and for general corporate purposes.

During 2013, our various strategic initiatives helped to drive a 4.5% improvement in Adjusted 28 Hotel Comparable Portfolio RevPAR, a 5% increase in Pro Forma 29 Hotel Comparable Corporate Adjusted EBITDA, a 16.7 percentage point reduction in our pro rata debt and preferred equity to total capitalization and a 26.1% total shareholder return. Over the past two years, we have reduced our pro rata debt and preferred equity to total capitalization by 28.9 percentage points from 66.3% to 37.4% while generating total shareholder returns of 66%.

OUR COMMITMENTS FOR 2014

We believe we are in the middle innings of a potentially prolonged growth phase. While we will make appropriate tactical adjustments based on changes in our macro and competitive environments, we plan to stay the course in 2014. In other words, we will continue to execute on our stated plan to carefully build shareholder value by improving the quality and scale of our portfolio while gradually deleveraging our balance sheet. Our business plan for 2014 encompasses the following:

- We will carefully grow the quality and scale of our portfolio through select acquisitions where hotels can be acquired at attractive valuations relative to our cost of capital.
- We will selectively deploy capital into our hotels in order to maximize the competitiveness of our hotels while generating strong returns on our capital.
- We will evaluate selective divestitures of assets that no longer meet our investment criteria or which can be sold at material premiums to our hold values.
- We will identify and implement new property-level efficiency measures and ancillary revenue sources.
- And finally, we will look to further improve on our best-in-class investor communications.

CYCLICAL STRATEGY

Following the last downturn we were faced with a clear choice: either learn to ride the cyclical wave or eventually be crushed by it. We've now benefitted from four years of rising demand for lodging. Our portfolio occupancy levels are above all-time highs, our average daily room rates are approaching (and in many cases exceeding) all-time highs, new hotel supply trends in many of our markets remain muted, and capital costs remain low. Times are good and continue to improve. So why does our strategy call for continued deleveraging? Why don't we finance our growth with inexpensive and increasingly borrower-friendly debt? Simply put: while our industry is currently healthy and fundamentals clearly point to continued growth, our business remains inherently cyclical and highly sensitive to changes in the economy. Additionally, our business carries substantial operating leverage. These qualities tend to intensify industry profit growth during periods of cyclical recovery such as the one we've experienced for the last four years. These same qualities tend to aggravate cash flow compression during periods of cyclical decline.

While we see no signs of an impending cyclical peak or industry downturn, the lessons learned during the last cyclical downturn guide our current strategy. We have taken and will continue to take proactive, methodical steps toward achieving low leverage and high financial flexibility while the cyclical wave continues to build over what we believe will be at least the next several years. We expect this strategy will position us to capitalize on opportunities to create significant value by acquiring distressed assets, securities and hotel portfolios at deep discounts when such opportunities arise following the next cyclical peak.

Thank you again for your commitment to Sunstone.

Sincerely,



Ken Cruse
Chief Executive Officer

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SELECTED FINANCIAL DATA

The following table sets forth selected financial information for the Company that has been derived from the consolidated financial statements and notes. This information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes included elsewhere in this Annual Report.

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
(\$ in thousands)					
OPERATING DATA:					
REVENUES					
Room	\$ 653,955	\$ 576,146	\$ 501,183	\$ 351,039	\$ 336,981
Food and beverage	213,346	200,810	175,103	138,188	134,319
Other operating	56,523	52,128	45,508	26,373	30,241
Total revenues	923,824	829,084	721,794	515,600	501,541
OPERATING EXPENSES					
Room	170,361	147,932	128,225	92,101	85,879
Food and beverage	147,713	139,106	126,139	98,889	96,755
Other operating	16,819	16,162	14,004	11,535	11,786
Advertising and promotion	47,306	42,474	37,226	27,326	26,404
Repairs and maintenance	35,884	32,042	29,067	22,608	22,437
Utilities	27,006	25,596	25,537	19,117	18,879
Franchise costs	32,932	30,067	25,595	18,032	17,435
Property tax, ground lease and insurance	79,004	66,830	58,010	35,280	37,058
Property general and administrative	103,454	94,642	85,293	61,753	58,675
Corporate overhead	26,671	24,316	25,453	21,751	25,072
Depreciation and amortization	137,476	130,907	113,708	79,633	78,790
Impairment loss	—	—	10,862	—	2,823
Total operating expenses	824,626	750,074	679,119	488,025	481,993
Operating income	99,198	79,010	42,675	27,575	19,548
Equity in net earnings (losses) of unconsolidated joint ventures	—	—	21	555	(27,801)
Interest and other income	2,821	297	3,115	112	1,378
Interest expense	(72,239)	(76,821)	(74,195)	(58,931)	(62,137)
Gain (loss) on extinguishment of debt	(44)	(191)	—	—	54,506
Gain on remeasurement of equity interests	—	—	69,230	—	—
Income (loss) before income taxes and discontinued operations	29,736	2,295	40,846	(30,689)	(14,506)
Income tax provision	(8,145)	(1,148)	—	—	—
Income (loss) from continuing operations	21,591	1,147	40,846	(30,689)	(14,506)
Income (loss) from discontinued operations	48,410	48,410	40,453	69,231	(255,102)
NET INCOME (LOSS)	70,001	49,557	81,299	38,542	(269,608)
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)	—	—
Distributions to non-controlling interest	(32)	(31)	(30)	—	—
Dividends paid on unvested restricted stock compensation	(201)	—	—	—	(447)
Preferred stock dividends, redemption charges and accretion	(19,013)	(29,748)	(27,321)	(20,652)	(20,749)
Undistributed income allocated to unvested restricted stock compensation	(235)	(203)	(636)	(102)	—
INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS	\$ 46,507	\$ 17,814	\$ 53,000	\$ 17,788	\$ (290,804)
Income (loss) from continuing operations available (attributable) to common stockholders per diluted common share	\$ (0.01)	\$ (0.24)	\$ 0.11	\$ (0.52)	\$ (0.51)
Cash dividends declared per common share	\$ 0.10	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
BALANCE SHEET DATA:					
Investment in hotel properties, net ⁽¹⁾	\$3,231,382	\$2,681,877	\$2,532,232	\$1,666,180	\$1,670,164
Total assets	\$3,508,798	\$3,136,675	\$3,101,240	\$2,436,106	\$2,513,530
Total debt ⁽¹⁾	\$1,404,075	\$1,363,389	\$1,416,890	\$ 973,810	\$ 968,816
Total liabilities	\$1,556,399	\$1,517,362	\$1,675,946	\$1,236,807	\$1,526,867
Equity	\$1,952,399	\$1,519,313	\$1,325,294	\$1,099,299	\$ 886,767

(1) Does not include hotels or debt which have been reclassified to discontinued operations, or which have been classified as held for sale.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report.

OVERVIEW

Sunstone Hotel Investors, Inc. is a Maryland corporation. We operate as a self-managed and self-administered real estate investment trust, or REIT. A REIT is a legal entity that directly or indirectly owns real estate assets. REITs generally are not subject to federal income taxes at the corporate level as long as they pay stockholder dividends equivalent to 100% of their taxable income. REITs are required to distribute to stockholders at least 90% of their taxable income. We own, directly or indirectly, 100% of the interests of Sunstone Hotel Partnership, LLC (the "Operating Partnership"), which is the entity that directly or indirectly owns our hotel properties. We also own 100% of the interests of our taxable REIT subsidiary, Sunstone Hotel TRS Lessee, Inc., which leases all of our hotels from the Operating Partnership, and engages independent third-parties to manage our hotels. In addition, we own BuyEfficient, LLC ("BuyEfficient"), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment.

We own primarily upper upscale hotels in the United States. As of December 31, 2013, we had interests in 29 hotels, which are currently held for investment (the "29 hotels"). Of the 29 hotels, we classify 27 as upscale or upper upscale and two as luxury as defined by Smith Travel Research, Inc. All but one (the Boston Park Plaza) of our 29 hotels are operated under nationally recognized brands such as Marriott, Hilton, Hyatt, Fairmont and Sheraton, which are among the most respected and widely recognized brands in the lodging industry. While independent hotels may do well in strong market locations, we believe the largest and most stable segment of travelers prefer the consistent service and quality associated with nationally recognized brands.

We seek to own hotels primarily in urban locations that benefit from significant barriers to entry by competitors. All of our 29 hotels are considered business, convention, or airport hotels, as opposed to resort or leisure hotels. The hotels comprising our 29 hotel portfolio average 474 rooms in size.

Our mission is to create meaningful value for our stockholders by becoming the premier hotel owner. Our values include transparency, trust, ethical conduct, communication and discipline. As demand for lodging generally fluctuates with the overall economy (we refer to these changes in demand as the lodging cycle), we seek to employ a balanced, cycle-appropriate corporate strategy. Our strategy over the next several years, during what we believe will be the middle/mature phase of the lodging cycle, is to improve the quality and scale of our portfolio while gradually deleveraging our balance sheet. Our goal is to achieve low leverage and high financial flexibility by the time the current cycle peaks. We believe if we are successful in executing on this strategy, we will position the Company to create value during the next successive cyclical trough by aggressively acquiring distressed assets or securities. Our strategic plan encompasses several elements, including proactive portfolio management, intensive asset management, disciplined external growth and measured balance sheet improvement as detailed below:

» *Proactive Portfolio Management.* The leaders of each of our core disciplines function as a portfolio management team. The portfolio management team's purpose is to strategically maximize the long-term value of our assets by enhancing our portfolio quality and scale, optimizing our exposure to key markets, and improving the effectiveness and efficiency of our decision making. Accordingly, the team is responsible for developing a portfolio-wide strategy related to brand and operator relationships, asset quality and scale, target markets, capital investments, and portfolio capitalizations. Our portfolio strategy may also include the disposition of certain hotels.

» *Intensive Asset Management.* Through all phases of the lodging cycle, our strategy emphasizes internal growth and value enhancements through proactive asset management, which entails working closely with our third-party hotel operators to develop and implement long-term strategic plans for each hotel designed to enhance revenues, minimize operational expenses and asset risk, maximize the appeal of our hotels to travelers and maximize our return on invested capital. We also focus on improving the appeal and growth potential of our existing hotels through internally-managed hotel renovations.

» *Disciplined External Growth.* By gradually increasing the scale and quality of our portfolio, we may provide our stockholders with greater exposure to key growth markets, improved liquidity and broader access to value-adding transactions. Accordingly, our strategy emphasizes disciplined external growth during the recovery phase of the lodging cycle. Our external growth plan is oriented around investing in institutional-quality hotels that generate returns in excess of our cost of capital, that are additive to the quality of our portfolio, that have attractive growth potential and that may benefit from our asset management competencies. We endeavor to structure our acquisitions in ways that will not only increase the value of our shares of common stock, but also will advance our other corporate objectives, such as improving our financial flexibility and reducing our leverage. During periods of cyclical decline, our strategy may emphasize opportunistically investing in distressed assets and the repurchase of our equity or debt securities. In addition to hotel acquisitions, we may seek to grow our portfolio by making investments in defaulted and/or distressed debt positions in loan-to-own hotel transactions, utilizing our REIT structure to effect strategic combinations with select property owners, effecting portfolio purchases from institutional and other owners seeking portfolio liquidity, and by providing capital solutions to illiquid owners facing debt maturities or capital requirements.

» *Measured Balance Sheet Improvement.* We believe that a low overall cost of capital and significant financial flexibility are very important to the successful execution of our strategy. Our balance sheet strategy is oriented toward maximizing financial flexibility especially during cyclical declines. Accordingly, our financial objectives include the measured improvement of our credit ratios and the maintenance of appropriate levels of liquidity throughout the cyclical recovery phase. Our financial objectives are integral to our overall corporate strategy and, accordingly, we have developed our financial objectives in conjunction with our portfolio management and growth objectives. The lodging industry is economically sensitive. Therefore, our financial objectives are aimed at reducing the potentially negative impact of combining high operating leverage with high financial leverage, while preserving access to multiple capital sources and minimizing our weighted-average cost of capital. We seek to capitalize our acquisitions in a way that will advance our financial objectives. During the mature phase of the lodging cycle, our financial objectives may include increasing our liquidity position as a means to enhance financial flexibility in the event of a subsequent period of cyclical decline. Our liquidity improvement objective may be accomplished through selective hotel dispositions, capital raises or by retaining excess cash generated by our operations.

During the past four years, demand for lodging in the U.S. has increased, which has resulted in improved hotel revenues and profits. In light of increasing demand for lodging and generally muted supply of new hotel development, we believe we are currently in the middle phase of a cyclical lodging recovery. Hotels acquired during the early stages of past cyclical recoveries have benefited from multi-year increases in profitability. Accordingly, during the past three years, we selectively acquired interests in eight hotels: the Doubletree Guest Suites Times Square in January 2011; the JW Marriott New Orleans in February 2011; the Hilton San Diego Bayfront in April 2011; the Hyatt Chicago Magnificent Mile in June 2012; the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012; the Hilton New Orleans St. Charles in May 2013; the Boston Park Plaza in July 2013; and the Hyatt Regency San Francisco in December 2013. Based on our purchase prices, the combined asset value of these eight hotels totals \$1.5 billion, or \$299,000 per key. In addition, we purchased the outside 50.0% equity interest in our BuyEfficient joint venture in January 2011. Our acquisition program is aimed at generating attractive risk-adjusted returns on our investment dollars. We, therefore, may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. We intend to select the brands and operators for our hotels that we believe will lead to the highest returns.

On May 1, 2013, we purchased the 250-room Hilton New Orleans St. Charles for a net purchase price of \$59.1 million, including \$0.2 million of proration credits and unrestricted cash received from the seller. The acquisition was funded with \$53.2 million of proceeds generated by our January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota, as well as with proceeds received from our February 2013 issuance of common stock.

On July 2, 2013, we purchased the 1,053-room Boston Park Plaza for a net purchase price of \$248.0 million, including \$2.0 million of proration credits, unrestricted and restricted cash and other adjustments received from the seller. The acquisition was funded with \$92.3 million of proceeds generated by our January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota, the assumption of a \$119.2 million non-recourse loan secured by the hotel, as well as with proceeds received from the Company's February 2013 issuance of common stock and with cash on hand. The mortgage we assumed in conjunction with our purchase of the Boston Park Plaza bears interest at a fixed rate of 4.4%, and matures in February 2018.

On December 2, 2013, we purchased the 802-room Hyatt Regency San Francisco for a net purchase price of \$262.5 million, including \$5.5 million of purchase price adjustments comprised of restricted cash and other adjustments received from the seller. The acquisition was funded with proceeds generated by our November 2013 issuance of common stock.

The scope of our acquisitions program may include large hotel portfolios or hotel loans. Future acquisitions may be funded by our issuance of additional debt or equity securities, including our common and preferred OP units, or by draws on our \$150.0 million senior corporate credit facility. However, in light of our long-term financial objectives, we expect to fund the majority of our near-term acquisitions with a greater proportion of equity capital than debt capital.

We have from time to time divested of assets that no longer fit our target profile, will not offer long-term returns in excess of our cost of capital, or that have high risk relative to their anticipated return expectations. In connection with this strategy, during the past three years, we sold 10 hotels: the Royal Palm Miami Beach in April 2011; the Valley River Inn located in Eugene, Oregon in October 2011; the Marriott Del Mar in August 2012; the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, and the Marriott Troy in September 2012; and the Kahler Grand, the Kahler Inn & Suites, the Marriott Rochester and the Residence Inn by Marriott Rochester (the "Rochester Hotels") in January 2013. Based on our sales prices, the combined asset value of these 10 hotels totals \$547.2 million, or \$182,000 per key. In addition, during the past three years, we sold the following non-hotel assets: a commercial laundry facility located in Salt Lake City, Utah in July 2011; an office building adjacent to the Marriott Troy in September 2012; and a commercial laundry facility located in Rochester, Minnesota in January 2013.

In January 2013, we sold the Rochester Hotels and a commercial laundry facility (together with the Rochester Hotels, the "Rochester Portfolio") in Rochester, Minnesota, to an unaffiliated third party, for net proceeds of \$195.6 million, of which \$145.7 million was deposited with an accommodator in order to facilitate tax-deferred exchanges. During 2013, all of the cash held by an accommodator was utilized to partially fund the tax-deferred exchanges of the Hilton New Orleans St. Charles and the Boston Park Plaza. The Rochester Hotels include the 660-room Kahler Grand, the 271-room Kahler Inn & Suites, the 202-room Marriott Rochester and the 89-room Residence Inn by Marriott Rochester. We recognized a net gain on the sale of \$51.6 million. We retained a \$25.0 million preferred equity investment (the "Preferred Equity Investment") in the Rochester Hotels that yields an 11% dividend, resulting in a deferred gain on the sale of \$25.0 million. The \$25.0 million gain will be deferred until the Preferred Equity Investment is repaid. We also provided a \$3.7 million working cash advance to the buyer, resulting in a deferred gain on the sale of \$3.7 million. The \$3.7 million gain will be deferred until we are repaid from the Rochester Portfolio's available cash flow. In addition, we retained a \$14.0 million liability related to the Rochester Portfolio's pension plan, which could be triggered in certain circumstances, including termination of the pension plan. The recognition of the \$14.0 million pension plan liability reduced our gain on the sale of the Rochester Portfolio. The \$14.0 million gain will be recognized, if at all, when and to the extent we are released from any potential liability related to the Rochester Portfolio's pension plan. Concurrent with the Rochester Portfolio sale, we extinguished the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of \$29.8 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of \$3.1 million which is included in discontinued operations.

In January 2013, we repurchased \$42.0 million of our Operating Partnership's 4.60% exchangeable senior notes (the "Senior Notes") pursuant to a tender offer, and redeemed the remaining \$16.0 million of the Senior Notes. We funded the total \$58.0 million in Senior Note redemptions with available cash, leaving no future amounts outstanding related to the Senior Notes. We recognized a loss of \$44,000 on this early extinguishment of debt.

In February 2013, we issued 25,300,000 shares of our common stock, including the underwriters' over-allotment of 3,300,000 shares, for net proceeds of \$294.9 million. We used these proceeds to redeem all of our Series A preferred stock and all of our Series C preferred stock, as well as to partially fund our acquisitions of the Hilton New Orleans St. Charles and the Boston Park Plaza.

In March 2013, we used a portion of the proceeds we received from our February 2013 common stock offering to redeem all 7,050,000 shares of our Series A preferred stock for an aggregate redemption price of \$178.6 million, including \$2.3 million in accrued dividends. An additional redemption charge of \$4.6 million was recognized related to the original issuance costs of the

Series A preferred stock, which were previously included in additional paid in capital. After the redemption date, we have no outstanding shares of Series A preferred stock, and all rights of the holders of such shares were terminated. Because we redeemed the Series A preferred stock in full, trading of the Series A preferred stock on the New York Stock Exchange ceased after the redemption date.

In May 2013, in anticipation of our acquisition of the Boston Park Plaza and the \$119.2 million mortgage debt we assumed, we used a portion of the proceeds we received from our February 2013 common stock offering to redeem all 4,102,564 shares of our Series C preferred stock for an aggregate redemption price of \$101.1 million, including \$1.1 million in accrued dividends. An additional redemption charge of \$0.1 million was recognized related to the original issuance costs of the Series C preferred stock, which were previously included in additional paid in capital. After the redemption date, we have no outstanding shares of Series C preferred stock, and all rights of the holders of such shares were terminated.

In November 2013, we issued 20,000,000 shares of our common stock for net proceeds of \$270.9 million. We used a portion of the net proceeds from this offering to purchase the Hyatt Regency San Francisco, and intend to use the remaining proceeds for potential future acquisitions, capital investment in our portfolio and other general corporate purposes, including working capital.

As of December 31, 2013, the weighted average term to maturity of our debt is approximately four years, and 70.7% of our debt is fixed rate with a weighted average interest rate of 5.4%. The weighted average interest rate on all of our debt, which includes our variable-rate debt obligations based on variable rates at December 31, 2013, is 4.9%.

OPERATING ACTIVITIES

Operating Performance Indicators. The following performance indicators are commonly used in the hotel industry:

- » *Occupancy*;
- » *Average daily room rate*, or ADR;
- » *Revenue per available room*, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;
- » *Comparable RevPAR*, which we define as the RevPAR generated by hotels we owned as of the end of the reporting period, but excluding those hotels that we classified as held for sale and those hotels whose room counts have materially changed during either the current or prior year. For hotels that were not owned for the entirety of the comparison periods, comparable RevPAR is calculated using RevPAR generated during periods of prior ownership. We refer to this subset of our hotels used to calculate comparable RevPAR as our “Comparable Portfolio.” Currently our Comparable Portfolio includes all hotels in which we have interests as of December 31, 2013, excluding the Boston Park Plaza due to the hotel adding 12 rooms in September 2012, and an additional 100 rooms in January 2013. In addition, our Comparable Portfolio includes prior ownership results for the Doubletree Guest Suites Times Square, the JW Marriott New Orleans, the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile and the Hyatt Regency San Francisco;
- » *RevPAR index*, which is the quotient of a hotel’s RevPAR divided by the average RevPAR of its competitors, multiplied by 100. A RevPAR index in excess of 100 indicates a hotel is achieving higher RevPAR than the average of its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;
- » *Operating flow through*, which is the comparison between reporting periods of the change in hotel EBITDA divided by the change in hotel revenues;
- » *EBITDA*, which is net income (loss) excluding: non-controlling interests; interest expense; provision for income taxes, including income taxes applicable to sale of assets; and depreciation and amortization;
- » *Adjusted EBITDA*, which includes EBITDA but excludes: amortization of deferred stock compensation; the impact of any gain or loss from asset sales; impairment charges; prior year property tax assessments or credits; and any other identified adjustments;
- » *Funds from operations*, or FFO, which includes net income (loss), excluding non-controlling interests, gains and losses from sales of property, plus real estate-related depreciation and amortization (excluding amortization of deferred financing costs) and real estate-related impairment losses, and after adjustment for unconsolidated partnerships and joint ventures; and
- » *Adjusted FFO*, which includes FFO but excludes penalties, written-off deferred financing costs, non-real estate-related impairment losses and any other identified adjustments.

Revenues. Substantially all of our revenues are derived from the operation of our hotels. Specifically, our revenues consist of the following:

- » *Room revenue*, which is the product of the number of rooms sold and the ADR;
- » *Food and beverage revenue*, which is comprised of revenue realized in the hotel food and beverage outlets as well as banquet and catering events; and
- » *Other operating revenue*, which includes ancillary hotel revenue and other items primarily driven by occupancy such as telephone, transportation, parking, spa, entertainment and other guest services. Additionally, this category includes, among other things, operating revenue from BuyEfficient (subsequent to our purchase of the outside 50.0% equity interest in January 2011), and hotel space leased by third parties.

Expenses. Our expenses consist of the following:

- » *Room expense*, which is primarily driven by occupancy and, therefore, has a significant correlation with room revenue;
- » *Food and beverage expense*, which is primarily driven by food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenue;
- » *Other operating expense*, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities, and franchise costs;
- » *Property tax, ground lease and insurance expense*, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense, but property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality;
- » *Property general and administrative expense*, which includes our property-level general and administrative expenses, such as payroll and related costs, contract and professional fees, credit and collection expenses, employee recruitment, relocation and training expenses, travel expenses, and management fees. Additionally, this category includes general and administrative expense for BuyEfficient (subsequent to our purchase of the outside 50.0% equity interest in January 2011);

- » *Corporate overhead expense*, which includes our corporate-level expenses, such as payroll and related costs, amortization of deferred stock compensation, acquisition and due diligence costs, legal expenses, contract and professional fees, bad debt, relocation, entity-level state franchise and minimum taxes, travel expenses and office rent;
- » *Depreciation and amortization expense*, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment, along with amortization on our franchise fees and certain intangibles. Additionally, this category includes depreciation and amortization related to both our corporate office and BuyEfficient's fixtures, equipment and intangibles (subsequent to our purchase of the outside 50.0% equity interest in January 2011); and
- » *Impairment loss*, which includes the charges we have recognized to reduce the carrying value of assets on our balance sheets to their fair value.

Other Revenue and Expense. Other revenue and expense consists of the following:

- » *Equity in earnings of unconsolidated joint ventures*, which includes our portion of earnings from our two joint ventures, BuyEfficient and Doubletree Guest Suites Times Square, prior to our acquisitions of the outside interests in both joint ventures in January 2011. Subsequent to these acquisitions, both entities are now presented on a consolidated basis;
- » *Interest and other income*, which includes interest we have earned on our restricted and unrestricted cash accounts, the Preferred Equity Investment, and the Royal Palm note (which was sold in 2011), as well as any gains or losses we have recognized on sales of assets other than real estate investments;
- » *Interest expense*, which includes interest expense incurred on our outstanding fixed and variable-rate debt, capital lease obligation, accretion of the Senior Notes, amortization of deferred financing fees, any write-offs of deferred financing fees, gains or losses on derivatives and any loan penalties and fees incurred on our debt;
- » *Loss on extinguishment of debt*, which includes the loss we recognized on the repurchase and cancellation of the Senior Notes;
- » *Gain on remeasurement of equity interests*, which includes the gain we recognized to mark up the equity interests in our BuyEfficient and Doubletree Guest Suites Times Square joint ventures to fair market value upon our purchases of the outside equity interests in these joint ventures, as well as our gain to mark up the mezzanine loan to its fair value in connection with the acquisition of the outside equity interest in the Doubletree Guest Suites Times Square joint venture;
- » *Income tax provision*, which includes federal and state income taxes charged to the Company, and any adjustments to unrecognized tax positions, along with any related interest and penalties incurred;
- » *Income from discontinued operations*, which includes the results of operations for any hotels or other real estate investments sold during the reporting period, along with the gain or loss realized on the sale of these assets and any extinguishments of related debt;
- » *Income from consolidated joint venture attributable to non-controlling interest*, which includes net income attributable to the outside 25.0% interest in the joint venture that owns the Hilton San Diego Bayfront;
- » *Distributions to non-controlling interest*, which includes preferred dividends earned by investors from an entity that owns the Doubletree Guest Suites Times Square, including related administrative fees;
- » *Dividends paid on unvested restricted stock compensation*, which includes dividends earned on our unvested restricted stock awards;
- » *Preferred stock dividends and redemption charges*, which includes dividends earned on our Series A preferred stock and Series C preferred stock up until their redemptions in March 2013 and May 2013, respectively, and 8.0% Series D Cumulative Redeemable Preferred Stock ("Series D preferred stock"), as well as redemption charges for preferred stock redemptions made in excess of net carrying values; and
- » *Undistributed income allocated to unvested restricted stock compensation*, which includes undistributed income allocated to unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) pursuant to the two-class method.

Factors Affecting Our Operating Results. The primary factors affecting our operating results include overall demand for hotel rooms, the pace of new hotel development, or supply, the effectiveness of our operators in increasing revenue and controlling hotel operating expenses and the timing and scope of renovations.

- » *Demand.* The demand for lodging generally fluctuates with the overall economy. Demand for our hotels has improved each year since 2010. In 2011, our Comparable Portfolio RevPAR increased 8.2% as compared to 2010, with a 290 basis point increase in portfolio occupancy. Demand continued to improve in 2012 and 2013. As a result, our Comparable Portfolio RevPAR increased 5.6% in 2012 as compared to 2011, and 4.3% in 2013 as compared to 2012. Comparable Portfolio occupancy increased 240 basis points in 2012 as compared to 2011, and increased an additional 80 basis points in 2013 as compared to 2012. Our operating statistics improved in 2013 as compared to both 2012 and 2011, even as several of our hotels were under major room renovations during 2013. Consistent with prior trends, we anticipate that lodging demand will continue to improve as the U.S. economy continues to strengthen. Historically, cyclical troughs are followed by extended periods of relatively strong demand, resulting in a cyclical lodging growth phase. While growth is not expected to be uniform, we expect hotel demand to remain strong over the next several years if the U.S. economy continues to grow and employment levels continue to improve.
- » *Supply.* The addition of new competitive hotels affects the ability of existing hotels to drive RevPAR and profits. The development of new hotels is largely driven by construction costs and expected performance of existing hotels. The recession and credit crisis which occurred in 2008 and 2009, served to restrict credit and tighten lending standards, which resulted in a curtailment of funding for new hotel construction projects. Moreover, with same-property hotel profitability still below peak levels and hotel trading values generally well below replacement cost, new supply in many markets is difficult to justify economically. Accordingly, we believe hotel development will be constrained until such time as the construction financing markets recover, and operating trends and trading values of existing hotels improve to levels where developer return targets can be achieved. Given the one-to-three-year timeline needed to construct a typical hotel that would compete with our hotels, we expect a window of several years during which aggregate U.S. hotel supply, as indicated by the number of new hotel openings, will be below historical levels. On a market-by-market basis, some markets may experience new hotel room openings at or greater than historic levels, including in New York City, Washington, D.C. and Chicago where there are currently higher-than-average supplies of new hotel room openings. In addition, lenders are seeking higher yielding instruments, which may lead to riskier lending practices, including lending on new hotel construction.
- » *Revenues and expenses.* We believe that marginal improvements in RevPAR index, even in the face of declining revenues, are a good indicator of the relative quality and appeal of our hotels, and our operators' effectiveness in maximizing revenues. Similarly, we also evaluate our operators' effectiveness in minimizing incremental operating expenses in the context of increasing revenues or, conversely, in reducing operating expenses in the context of declining revenues.

With respect to improving RevPAR index, we continue to work with our hotel operators to optimize revenue management initiatives while taking into consideration market demand trends and the pricing strategies of competitor hotels in our markets. We also develop capital investment programs designed to ensure each of our hotels is well renovated and positioned to appeal to groups and individual travelers fitting target guest profiles. Increased capital investment in our properties may lead to short-term revenue disruption and negatively impact RevPAR index. Our revenue management initiatives are generally oriented towards maximizing ADR even if the result may be lower occupancy than may be achieved through lower ADR. Increases in RevPAR attributable to increases in ADR may be accompanied by minimal additional expenses, while increases in RevPAR attributable to higher occupancy may result in higher variable expenses such as housekeeping, labor and utilities expense. Thus, increases in RevPAR associated with higher ADR may result in higher hotel EBITDA margins. Increases in RevPAR associated with higher occupancy may result in more muted hotel EBITDA margin improvement. Our Comparable Portfolio RevPAR index was 111.0 in 2011, decreasing approximately 10 basis points in 2012 to 110.9 due to several capital investment programs at our hotels. Our 2013 Comparable Portfolio RevPAR index, which was also negatively impacted by several capital investment programs at our hotels, decreased 60 basis points to 110.3.

With respect to maximizing operating flow through, we continue to work with our operators to identify operational efficiencies designed to reduce expenses while minimally affecting guest experience. Key asset management initiatives include optimizing hotel staffing levels, increasing the efficiency of the hotels, such as installing energy efficient management and inventory control systems, and selectively combining food and beverage outlets. Our operational efficiency initiatives may be difficult to implement, as most categories of variable operating expenses, such as utilities and housekeeping labor costs, fluctuate with changes in occupancy. Furthermore, our hotels operate with significant fixed costs, such as general and administrative expense, insurance, property taxes, and other expenses associated with owning hotels, over which our operators have little control. We have experienced either currently or in the past, increases in hourly wages, employee benefits (especially health insurance), utility costs and property insurance, which have negatively affected our operating margins. Moreover, there are limits to how far our operators can reduce expenses without affecting brand standards or the competitiveness of our hotels. Our Comparable Portfolio operating flow through was 48% in 2012 as compared to 2011, and 39% in 2013 as compared to 2012.

Operating Results. The following table presents our operating results for our total portfolio for the years ended December 31, 2013 and 2012, including the amount and percentage change in the results between the two periods. The table presents the results of operations included in the consolidated statements of operations, and includes the 29 hotels (13,744 rooms) as of December 31, 2013 and 26 hotels (11,632 rooms) as of December 31, 2012, as well as discontinued operations for 4 hotels (1,222 rooms) as of December 31, 2013 and 8 hotels (2,342 rooms) as of December 31, 2012. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report.

	2013	2012	Change \$	Change %
<i>(dollars in thousands, except statistical data)</i>				
REVENUES				
Room	\$653,955	\$576,146	\$77,809	13.5%
Food and beverage	213,346	200,810	12,536	6.2%
Other operating	56,523	52,128	4,395	8.4%
Total revenues	923,824	829,084	94,740	11.4%
OPERATING EXPENSES				
Hotel operating	557,025	500,209	56,816	11.4%
Property general and administrative	103,454	94,642	8,812	9.3%
Corporate overhead	26,671	24,316	2,355	9.7%
Depreciation and amortization	137,476	130,907	6,569	5.0%
Total operating expenses	824,626	750,074	74,552	9.9%
OPERATING INCOME	99,198	79,010	20,188	25.6%
Interest and other income	2,821	297	2,524	849.8%
Interest expense	(72,239)	(76,821)	4,582	6.0%
Loss on extinguishment of debt	(44)	(191)	147	77.0%
Income before income taxes and discontinued operations	29,736	2,295	27,441	1,195.7%
Income tax provision	(8,145)	(1,148)	(6,997)	(609.5)%
INCOME FROM CONTINUING OPERATIONS	21,591	1,147	20,444	1,782.4%
Income from discontinued operations	48,410	48,410	—	0.0%
NET INCOME	70,001	49,557	20,444	41.3%
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(2,252)	(127.9)%
Distributions to non-controlling interest	(32)	(31)	(1)	(3.2)%
Dividends paid on unvested restricted stock compensation	(201)	—	(201)	(100.0)%
Preferred stock dividends and redemption charges	(19,013)	(29,748)	10,735	36.1%
Undistributed income allocated to unvested restricted stock compensation	(235)	(203)	(32)	(15.8)%
INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 46,507	\$ 17,814	\$28,693	161.1%

The following table presents our operating results for our total portfolio for the years ended December 31, 2012 and 2011, including the amount and percentage change in the results between the two periods. The table presents the results of operations included in the consolidated statements of operations, and includes continuing operations for 26 hotels (11,632 rooms) as of December 31, 2012 and 24 hotels (10,857 rooms) as of December 31, 2011, as well as discontinued operations for 8 hotels (2,342 rooms) as of December 31, 2012 and 10 hotels (3,017 rooms) as of December 31, 2011. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report.

	2012	2011	Change \$	Change %
<i>(dollars in thousands, except statistical data)</i>				
REVENUES				
Room	\$576,146	\$501,183	\$ 74,963	15.0%
Food and beverage	200,810	175,103	25,707	14.7%
Other operating	52,128	45,508	6,620	14.5%
Total revenues	829,084	721,794	107,290	14.9%
OPERATING EXPENSES				
Hotel operating	500,209	443,803	56,406	12.7%
Property general and administrative	94,642	85,293	9,349	11.0%
Corporate overhead	24,316	25,453	(1,137)	(4.5)%
Depreciation and amortization	130,907	113,708	17,199	15.1%
Impairment loss	—	10,862	(10,862)	(100.0)%
Total operating expenses	750,074	679,119	70,955	10.4%
OPERATING INCOME	79,010	42,675	36,335	85.1%
Equity in earnings of unconsolidated joint ventures	—	21	(21)	(100.0)%
Interest and other income	297	3,115	(2,818)	(90.5)%
Interest expense	(76,821)	(74,195)	(2,626)	(3.5)%
Loss on extinguishment of debt	(191)	—	(191)	(100.0)%
Gain on remeasurement of equity interests	—	69,230	(69,230)	(100.0)%
Income before income taxes and discontinued operations	2,295	40,846	(38,551)	(94.4)%
Income tax provision	(1,148)	—	(1,148)	(100.0)%
INCOME FROM CONTINUING OPERATIONS	1,147	40,846	(39,699)	(97.2)%
Income from discontinued operations	48,410	40,453	7,957	19.7%
NET INCOME	49,557	81,299	(31,742)	(39.0)%
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	(1,449)	(464.4)%
Distributions to non-controlling interest	(31)	(30)	(1)	(3.3)%
Preferred stock dividends and redemption charges	(29,748)	(27,321)	(2,427)	(8.9)%
Undistributed income allocated to unvested restricted stock compensation	(203)	(636)	433	68.1%
INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 17,814	\$ 53,000	\$ (35,186)	(66.4)%

Operating Statistics. The following tables include comparisons of the key operating metrics for our portfolio, including prior ownership results as applicable for the Doubletree Guest Suites Times Square, the JW Marriott New Orleans, the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco.

	2013			2012			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Total Hotel Portfolio (29 hotels)	80.5%	\$183.05	\$147.36	79.8%	\$178.04	\$142.08	70 bps	2.8%	3.7%
Comparable Hotel Portfolio (28 hotels) ⁽¹⁾	80.2%	\$184.65	\$148.09	79.4%	\$178.75	\$141.93	80 bps	3.3%	4.3%
Comparable Hotel Portfolio adjusted for change in Marriott calendar (28 hotels) ⁽²⁾	80.2%	\$184.79	\$148.20	79.4%	\$178.64	\$141.84	80 bps	3.4%	4.5%

	2012			2011			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Total Hotel Portfolio (29 hotels)	79.8%	\$178.04	\$142.08	77.2%	\$173.26	\$133.76	260 bps	2.8%	6.2%
Comparable Hotel Portfolio (28 hotels) ⁽¹⁾	79.4%	\$178.75	\$141.93	77.0%	\$174.51	\$134.37	240 bps	2.4%	5.6%
Comparable Hotel Portfolio adjusted for change in Marriott calendar (28 hotels) ⁽²⁾	79.4%	\$178.64	\$141.84	77.0%	\$174.49	\$134.36	240 bps	2.4%	5.6%

(1) Includes all the hotels in which we have interests as of December 31, 2013, except the Boston Park Plaza due to the hotel adding 12 rooms in September 2012, and an additional 100 rooms in January 2013.

(2) Includes the 28 hotel Comparable Portfolio adjusted for the effects of converting the operating statistics for our ten Marriott-managed hotels from a 13-period basis as reported in 2012 and 2011 to a standard 12-month calendar basis.

Non-GAAP Financial Measures. We use the following “non-GAAP financial measures” that we believe are useful to investors as key supplemental measures of our operating performance: EBITDA, Adjusted EBITDA, FFO and Adjusted FFO. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP. EBITDA, Adjusted EBITDA, FFO and Adjusted FFO, as calculated by us, may not be comparable to other companies that do not define such terms exactly as the Company. These non-GAAP measures are used in addition to and in conjunction with results presented in accordance with GAAP. They should not be considered as alternatives to operating profit, cash flow from operations, or any other operating performance measure prescribed by GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with our GAAP results and the reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

EBITDA is a commonly used measure of performance in many industries. We believe EBITDA is useful to investors in evaluating our operating performance because this measure helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization) from our operating results. We also believe the use of EBITDA facilitates comparisons between us and other lodging REITs, hotel owners who are not REITs and other capital-intensive companies. In addition, certain covenants included in our indebtedness use EBITDA as a measure of financial compliance. We also use EBITDA as a measure in determining the value of hotel acquisitions and dispositions.

Historically, we have adjusted EBITDA when evaluating our performance because we believe that the exclusion of certain additional items described below provides useful information to investors regarding our operating performance and that the presentation of Adjusted EBITDA, when combined with the primary GAAP presentation of net income, is beneficial to an investor's complete understanding of our operating performance. We adjust EBITDA for the following items, which may occur in any period, and refer to this measure as Adjusted EBITDA:

- » *Amortization of deferred stock compensation:* we exclude the non-cash expense incurred with the amortization of deferred stock compensation as this expense does not reflect the underlying performance of our hotels.
- » *Amortization of favorable and unfavorable contracts:* we exclude the non-cash amortization of the favorable management contract asset recorded in conjunction with our acquisition of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, along with the favorable tenant lease assets recorded in conjunction with our acquisitions of the Hilton New Orleans St. Charles and the Hyatt Regency San Francisco, and the unfavorable tenant lease liabilities recorded in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile and the Hyatt Regency San Francisco. The amortization of favorable and unfavorable contracts does not reflect the underlying performance of our hotels.
- » *Ground rent adjustments:* we exclude the non-cash expense incurred from straightlining our ground lease obligations as this expense does not reflect the underlying performance of our hotels. We do, however, include an adjustment for the cash ground lease expense recorded on the Hyatt Chicago Magnificent Mile's building lease. Upon acquisition of this hotel, we determined that the building lease was a capital lease, and, therefore, we include a portion of the capital lease payment each month in interest expense. We include an adjustment for ground lease expense on capital leases in order to more accurately reflect the operating performance of the Hyatt Chicago Magnificent Mile.
- » *Real estate transactions:* we exclude the effect of gains and losses on the disposition of depreciable assets because we believe that including them in Adjusted EBITDA is not consistent with reflecting the ongoing performance of our assets. In addition, material gains or losses from the depreciated value of the disposed assets could be less important to investors given that the depreciated asset value often does not reflect its market value.
- » *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired because, like interest expense, their removal helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure.
- » *Acquisition costs:* under GAAP, costs associated with completed acquisitions are expensed in the year incurred. We exclude the effect of these costs because we believe they are not reflective of the ongoing performance of the Company.
- » *Consolidated partnership adjustments:* we deduct the non-controlling partner's pro rata share of any EBITDA adjustments related to our consolidated Hilton San Diego Bayfront partnership.
- » *Cumulative effect of a change in accounting principle:* from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting principle. We exclude these one-time adjustments because they do not reflect our actual performance for that period.
- » *Impairment losses:* we exclude the effect of impairment losses because we believe that including them in Adjusted EBITDA is not consistent with reflecting the ongoing performance of our remaining assets. In addition, we believe that impairment charges, which are based off of historical cost account values, are similar to gains (losses) on dispositions and depreciation expense, both of which are also excluded from Adjusted EBITDA.
- » *Other adjustments:* we exclude other adjustments such as lawsuit settlement costs (or the reversal of these costs), prior year property tax assessments and/or credits, management company transition costs, and departmental closing costs, including severance, because we do not believe these costs reflect our actual performance for that period and/or the ongoing operations of our hotels.

The following table reconciles our net income to EBITDA and Adjusted EBITDA for our hotel portfolio for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	2013	2012	2011
Net income	\$ 70,001	\$ 49,557	\$ 81,299
Operations held for investment:			
Depreciation and amortization	137,476	130,907	113,708
Amortization of lease intangibles	4,112	4,113	3,979
Interest expense	72,239	76,821	74,195
Income tax provision	8,145	1,148	—
Non-controlling interests:			
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)
Depreciation and amortization	(3,956)	(5,685)	(4,014)
Interest expense	(2,341)	(2,477)	(1,753)
Unconsolidated joint ventures:			
Depreciation and amortization	—	—	3
Discontinued operations:			
Depreciation and amortization	—	13,164	16,188
Amortization of lease intangibles	—	14	28
Interest expense	99	6,490	9,337
EBITDA	281,762	272,291	292,658
Operations held for investment:			
Amortization of deferred stock compensation	4,858	3,466	2,745
Amortization of favorable and unfavorable contracts, net	320	206	—
Non-cash straightline lease expense	2,055	2,777	2,398
Capital lease obligation interest—cash ground rent	(1,404)	(819)	—
(Gain) loss on sale of other assets, net	(12)	18	(83)
Gain on remeasurement of equity interests	—	—	(69,230)
Loss on extinguishment of debt	44	191	—
Closing costs—completed acquisitions	1,678	1,965	3,403
Impairment loss	—	—	10,862
Lawsuit settlement costs, net	358	158	1,553
Prior year property tax and CAM adjustments, net	106	621	—
Hotel laundry closing costs	—	623	—
Non-controlling interests:			
Non-cash straightline lease expense	(450)	(450)	(354)
Prior year property tax adjustments, net	—	(202)	—
Unconsolidated joint ventures:			
Amortization of deferred stock compensation	—	—	2
Discontinued operations:			
Gain on sale of assets, net	(51,620)	(38,292)	(14,912)
Impairment loss	—	—	1,495
(Gain) loss on extinguishment of debt	3,115	—	(18,145)
Lawsuit settlement (reversal) costs	—	(48)	67
	(40,952)	(29,786)	(80,199)
Adjusted EBITDA	\$240,810	\$242,505	\$212,459

Adjusted EBITDA was \$240.8 million in 2013 as compared to \$242.5 million in 2012 and \$212.5 million in 2011. Adjusted EBITDA decreased \$1.7 million in 2013 as compared to 2012 as additional earnings generated by the three hotels we acquired during 2013 (the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco), and the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile) were mostly offset by a decrease in earnings caused by major room renovations at four of our hotels: the Hilton Times Square; the Hyatt Chicago Magnificent Mile; the Hyatt Regency Newport Beach; and the Renaissance Westchester. These renovations were substantially completed by June 30, 2013.

Adjusted EBITDA increased \$30.0 million in 2012 as compared to 2011 due to additional earnings generated by the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile), and the three hotels we acquired or purchased interests in during 2011 (the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront), combined with increased earnings at our other hotels.

We believe that the presentation of FFO provides useful information to investors regarding our operating performance because it is a measure of our operations without regard to specified non-cash items such as real estate depreciation and amortization, amortization of lease intangibles, any real estate impairment loss and any gain or loss on sale of real estate assets, all of which are based on historical cost accounting and may be of lesser significance in evaluating our current performance. We believe the use of FFO facilitates comparisons between us and other lodging REITs.

We also present Adjusted FFO when evaluating our operating performance because we believe that the exclusion of certain additional items described below provides useful supplemental information to investors regarding our ongoing operating performance, and may facilitate comparisons of operating performance between periods and our peer companies. We adjust FFO for the following items, which may occur in any period, and refer to this measure as Adjusted FFO:

- » *Amortization of favorable and unfavorable contracts:* we exclude the non-cash amortization of the favorable management contract asset recorded in conjunction with our acquisition of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, along with the favorable tenant lease assets recorded in conjunction with our acquisitions of the Hilton New Orleans St. Charles and the Hyatt Regency San Francisco, and the unfavorable tenant lease liabilities recorded in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile and the Hyatt Regency San Francisco. The amortization of favorable and unfavorable contracts does not reflect the underlying performance of our hotels.
- » *Non-cash ground rent adjustments:* we exclude the non-cash expense incurred from straightlining our ground lease obligations as this expense does not reflect the underlying performance of our hotels.
- » *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired. We also exclude the non-cash gains or losses on our derivatives, as well as the original issuance costs associated with the redemption of preferred stock. We believe that these items are not reflective of our ongoing finance costs.
- » *Acquisition costs:* under GAAP, costs associated with completed acquisitions are expensed in the year incurred. We exclude the effect of these costs because we believe they are not reflective of the ongoing performance of the Company.
- » *Impairment losses:* we exclude the effect of non-real estate impairment losses because we believe that including them in Adjusted FFO is not consistent with reflecting the ongoing performance of our remaining assets.
- » *Consolidated partnership adjustments:* we deduct the non-controlling partner's pro rata share of any FFO adjustments related to our consolidated Hilton San Diego Bayfront partnership.
- » *Other adjustments:* we exclude other adjustments such as lawsuit settlement costs (or the reversal of these costs), prior year property tax assessments and/or credits, management company transition costs, departmental closing costs, including severance, and income tax provisions associated with the application of net operating loss carryforwards because we do not believe these costs reflect our actual performance for that period and/or the ongoing operations of our hotels.

The following table reconciles our net income to FFO and Adjusted FFO for our hotel portfolio for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	2013	2012	2011
Net income	\$ 70,001	\$ 49,557	\$ 81,299
Preferred stock dividends and redemption charges	(19,013)	(29,748)	(27,321)
Operations held for investment:			
Real estate depreciation and amortization	136,047	129,668	112,539
Amortization of lease intangibles	4,112	4,113	3,979
(Gain) loss on sale of other assets, net	(12)	18	(83)
Non-controlling interests:			
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)
Real estate depreciation and amortization	(3,956)	(5,685)	(4,014)
Discontinued operations:			
Real estate depreciation and amortization	—	13,164	16,188
Amortization of lease intangibles	—	14	28
Gain on sale of assets, net	(51,620)	(38,292)	(14,912)
FFO	<u>131,546</u>	<u>121,048</u>	<u>167,391</u>
Operations held for investment:			
Amortization of favorable and unfavorable contracts, net	320	206	—
Non-cash straightline lease expense	2,055	2,777	2,398
Write-off of deferred financing fees	—	3	21
Non-cash interest related to (gain) loss on derivatives, net	(525)	406	2,655
Gain on remeasurement of equity interests	—	—	(69,230)
Loss on extinguishment of debt	44	191	—
Closing costs—completed acquisitions	1,678	1,965	3,403
Lawsuit settlement costs, net	358	158	1,553
Prior year property tax and CAM adjustments, net	106	621	—
Hotel laundry closing costs	—	623	—
Impairment loss	—	—	10,862
Income tax provision	8,145	1,148	—
Preferred stock redemption charges	4,770	—	—
Non-controlling interests:			
Non-cash straightline lease expense	(450)	(450)	(354)
Non-cash interest related to loss on derivative, net	(3)	(1)	(31)
Prior year property tax adjustments, net	—	(202)	—
Discontinued operations:			
(Gain) loss on extinguishment of debt	3,115	—	(18,145)
Write-off of deferred financing fees	—	185	42
Impairment loss	—	—	1,495
Lawsuit settlement (reversal) costs	—	(48)	67
	<u>19,613</u>	<u>7,582</u>	<u>(65,264)</u>
Adjusted FFO	<u>\$151,159</u>	<u>\$128,630</u>	<u>\$102,127</u>

Adjusted FFO was \$151.2 million in 2013 as compared to \$128.6 million in 2012 and \$102.1 million in 2011. Adjusted FFO increased \$22.5 million in 2013 as compared to 2012 due to additional earnings generated by the three hotels we acquired during 2013 (the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco), and the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile), combined with a decrease in preferred stock dividends and interest expense. These increases to Adjusted FFO were partially offset by a decrease in earnings caused by major room renovations at four of our hotels: the Hilton Times Square; the Hyatt Chicago Magnificent Mile; the Hyatt Regency Newport Beach; and the Renaissance Westchester. These renovations were substantially completed by June 30, 2013.

Adjusted FFO increased \$26.5 million in 2012 as compared to 2011 due to additional earnings generated by the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile), and the three hotels we acquired or purchased interests in during 2011 (the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront), combined with increased earnings at our other hotels.

Room revenue. Room revenue increased \$77.8 million, or 13.5%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. We acquired the Hilton New Orleans St. Charles in May 2013, the Boston Park Plaza in July 2013, the Hyatt Regency San Francisco in December 2013, the Hyatt Chicago Magnificent Mile in June 2012, and the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012. These five hotels acquired in 2013 and 2012 (the “five 2013–2012 acquired hotels”) contributed additional room revenue of \$54.3 million during 2013. Room revenue at the Hyatt Chicago Magnificent Mile was negatively impacted during 2013 by a major renovation, which caused 13,601 room nights to be out of service, displacing approximately \$2.4 million in room revenue based on the hotel achieving a potential 74.9% occupancy rate and RevPAR of \$127.70 without the renovation. In addition, room revenue during 2013 increased as compared to the same period in 2012 due to a change in the financial reporting calendar used by one of our third-party managers, subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”), who manage 10 of our 29 hotels. Beginning in 2013, Marriott switched from using a 13-fiscal period accounting calendar to a standard 12-month calendar, which caused there to be an additional three days and approximately \$1.6 million more in room revenue for the Marriott-managed hotels during 2013 as compared to 2012. Room revenue generated by the 24 hotels we owned prior to January 1, 2012 (our “existing portfolio”) increased \$21.9 million during 2013 as compared to 2012 due to increases in both occupancy (\$7.7 million) and ADR (\$14.2 million). The increases in occupancy and ADR were driven by an additional 58,248 transient room nights, partially offset by 14,435 fewer group room nights. Room revenue in our existing portfolio was negatively impacted during 2013 by major room renovations at three hotels in our existing portfolio (the “three renovation hotels”): the Hilton Times Square; the Hyatt Regency Newport Beach; and the Renaissance Westchester. These major room renovations caused a total of 26,686 room nights to be out of service during 2013, displacing approximately \$5.2 million in room revenue based on the three renovation hotels achieving a combined potential 81.6% occupancy rate and RevPAR of \$169.76 without the renovations. This 2013 displacement compares to our 2012 displacement caused by major room renovations at the Renaissance Washington DC and the Hyatt Regency Newport Beach. The major room renovation at the Renaissance Washington DC caused 13,656 room nights to be out of service during the last six months of 2012, displacing approximately \$2.9 million in room revenue based on the hotel achieving a potential 72.7% occupancy rate and RevPAR of \$148.24 without the renovation. The major room renovation at the Hyatt Regency Newport Beach caused 4,333 room nights to be out of service during the last two months of 2012, displacing approximately \$0.5 million in room revenue based on the hotel achieving a potential 85.0% occupancy rate and RevPAR of \$110.96 without the renovation.

Room revenue increased \$75.0 million, or 15.0%, for the year ended December 31, 2012 as compared to the year ended December 31, 2011. We acquired the Hyatt Chicago Magnificent Mile in June 2012 and the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012. In addition, we acquired the outside 62.0% equity interests in the Doubletree Guest Suites Times Square in January 2011 (resulting in our 100% ownership of the hotel) and the JW Marriott New Orleans in February 2011. We also purchased a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront in April 2011. These five hotels acquired in 2012 and 2011 (the “five 2012–2011 acquired hotels”) contributed additional room revenue of \$57.4 million during the year ended December 31, 2012. Room revenue in our five 2012–2011 acquired hotels was negatively impacted in 2012 by Hurricane Sandy, which caused a loss in room revenue of approximately \$0.3 million. Room revenue generated by the 21 hotels we owned prior to January 1, 2011 (our “prior year existing portfolio”) increased \$17.6 million during 2012 as compared to 2011 due to an increase in occupancy (\$14.8 million) combined with an increase in ADR (\$2.8 million). The increase in occupancy was driven by an additional 22,641 group room nights sold combined with an additional 72,391 transient room nights sold. As discussed above in the discussion regarding 2013 and 2012, room revenue in our prior year existing portfolio was impacted during 2012 by major room renovations at both the Renaissance Washington DC and the Hyatt Regency Newport Beach. Room revenue in our prior year existing portfolio was also negatively impacted in 2012 by Hurricane Sandy, which caused a loss in room revenue of approximately \$1.4 million.

Food and beverage revenue. Food and beverage revenue increased \$12.5 million, or 6.2%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. The five 2013–2012 acquired hotels contributed an additional \$11.3 million to food and beverage revenue during 2013, though food and beverage revenue generated by the Hyatt Chicago Magnificent Mile was negatively affected by the hotel’s major renovation. Marriott’s additional three days in 2013 generated approximately \$0.6 million in food and beverage revenue for the Marriott-managed hotels during 2013 as compared to 2012. Food and beverage revenue in our existing portfolio increased \$0.6 million during 2013 as compared to 2012, due to increased outlet and room service revenue caused by the increase in occupancy, partially offset by decreased banquet revenue at several of our hotels caused by 14,435 fewer group room nights, as well as the negative impact of the three renovation hotels. The decrease in group room nights during 2013 as compared to 2012 was further exaggerated by the fact that the type of group shifted from corporate and citywide business with a higher number of banquet functions during the first few months of 2012 to associations with fewer banquet functions during the first few months of 2013. The decrease in food and beverage revenue in our existing portfolio was partially offset by increased revenue generated during 2013 by the Renaissance Washington DC, which was under a major room renovation during 2012, causing revenue to decrease in outlets, banquets and room service during 2012.

Food and beverage revenue increased \$25.7 million, or 14.7%, for the year ended December 31, 2012 as compared to the year ended December 31, 2011. The five 2012–2011 acquired hotels contributed an additional \$17.5 million to food and beverage revenue during 2012. Food and beverage revenue in our prior year existing portfolio increased \$8.2 million during 2012 as compared to 2011, primarily due to increased occupancy and group room nights in our hotels, which drove revenue growth in both outlets and banquets. In addition, outlet and banquet revenue increased during 2012 as compared to 2011 as many outlets and meeting spaces were under renovation during 2011. Food and beverage revenue in our prior year existing portfolio was negatively impacted by a major room renovation at the Renaissance Washington DC, which caused 13,656 room nights to be out of service during the last six months of 2012, decreasing revenue in both outlets and banquets. Food and beverage revenue in our prior year existing portfolio was also negatively impacted in 2012 by Hurricane Sandy, which caused a loss in food and beverage revenue of approximately \$0.8 million.

Other operating revenue. Other operating revenue increased \$4.4 million, or 8.4%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. Our five 2013–2012 acquired hotels contributed an additional \$3.5 million to other operating revenue during 2013. In addition, BuyEfficient's revenue increased \$0.5 million during 2013 as compared to 2012 due to increased transaction and development fees. Other operating revenue in our existing portfolio increased \$0.4 million during 2013 as compared to 2012, due to Marriott's three additional days during 2013, combined with increased parking and spa revenue. These increases were partially offset by decreased telephone/internet revenue, cancellation, attrition, and third-party lease revenue.

Other operating revenue increased \$6.6 million, or 14.5%, for the year ended December 31, 2012 as compared to the year ended December 31, 2011. Our five 2012–2011 acquired hotels contributed an additional \$4.8 million to other operating revenue during 2012. In addition, other operating revenue increased \$0.3 million in 2012 as compared to 2011 due to the consolidation of BuyEfficient with our operations due to the purchase of the outside 50.0% equity interest in the joint venture in January 2011. Previously, our 50.0% portion of BuyEfficient's net income was included in equity in earnings of unconsolidated joint ventures. BuyEfficient contributed an additional \$0.3 million in other operating revenue during 2012 as compared to 2011 due to increased transaction and development fees. In addition, other operating revenue in our prior year existing portfolio increased \$1.2 million during 2012 as compared to 2011, due to increased cancellation, attrition, parking, spa and third-party lease revenue at our hotels, partially offset by decreased telephone/internet revenue.

Hotel operating expenses. Hotel operating expenses increased \$56.8 million, or 11.4%, during the year ended December 31, 2013 as compared to the year ended December 31, 2012. The five 2013–2012 acquired hotels contributed \$46.3 million to hotel operating expenses during 2013. Hotel operating expenses in our existing portfolio increased \$10.5 million during 2013 as compared to 2012, primarily related to the corresponding increase in room revenue, combined with the Marriott-managed hotels' three additional days in 2013 as compared to 2012. In addition, hotel operating expenses in our existing portfolio increased during 2013 as compared to 2012 due to increases in property taxes, property and liability insurance premiums and ground lease expense.

Hotel operating expenses increased \$56.4 million, or 12.7%, during the year ended December 31, 2012 as compared to the year ended December 31, 2011. Our five 2012–2011 acquired hotels contributed an additional \$45.0 million to hotel operating expenses during 2012. Hotel operating expenses in our prior year existing portfolio increased \$11.4 million during 2012 as compared to 2011. This increase in hotel operating expenses is primarily related to the corresponding increases in room, food and beverage, parking and spa revenue. In addition, hotel operating expenses in our prior year existing portfolio increased during 2012 as compared to 2011 due to increases in the following expenses: advertising and repairs and maintenance as the hotels increased spending due to the improved economy; franchise fees and assessments due to the increased revenue; property and liability insurance due to increased premiums; and ground lease due to increased contingent rent resulting from the increased revenue at several of our hotels. These increases were partially offset by decreases in the following expenses: utilities due to reduced consumption and lower rates at many of our hotels during 2012; real estate property taxes due to lower assessments received at several of our hotels; and common area maintenance charges due to a settlement received at one of our hotels.

Property general and administrative expense. Property general and administrative expense increased \$8.8 million, or 9.3%, during the year ended December 31, 2013 as compared to the year ended December 31, 2012. The five 2013–2012 acquired hotels contributed \$7.6 million to property general and administrative expense during 2013. In addition, BuyEfficient contributed an additional \$0.2 million in property general and administrative expense during 2013 as compared to 2012 due to increases in payroll and related expenses, including deferred stock compensation expense. Property general and administrative expense in our existing portfolio increased \$1.0 million during 2013 as compared to 2012, primarily due to the Marriott-managed hotels' three additional days in 2013 as compared to 2012, combined with increased management fees, and credit and collection expenses due to the increase in revenue. Property general and administrative expenses also increased due to higher costs related to licenses and permits, and security expenses, partially offset by decreased payroll and related costs, contract and professional fees, employee relations, recruitment, training, sales tax audit fees, operating supplies and travel.

Property general and administrative expense increased \$9.3 million, or 11.0%, during the year ended December 31, 2012 as compared to the year ended December 31, 2011. Our five 2012–2011 acquired hotels contributed an additional \$7.1 million to property general and administrative expense during 2012. In addition, property general and administrative expense increased \$0.2 million in 2012 as compared to 2011 due to the consolidation of BuyEfficient with our operations due to the purchase of the outside 50.0% equity interest in the joint venture in January 2011. Previously, our 50.0% portion of BuyEfficient's net income was included in equity in earnings of unconsolidated joint ventures. BuyEfficient contributed an additional \$0.4 million in property general and administrative expense during 2012 as compared to 2011 due to the corresponding increase in revenue. Property general and administrative expense in our prior year existing portfolio increased \$1.6 million during 2012 as compared to 2011, primarily due to increased payroll and related costs, management fees, and credit and collection expenses due to the increase in revenue, combined with increased computer hardware/software costs, employee relocation, recruitment and training, partially offset by decreased contract and professional fees.

Corporate overhead expense. Corporate overhead expense increased \$2.4 million, or 9.7%, during the year ended December 31, 2013 as compared to the year ended December 31, 2012, primarily due to the following increases: payroll and related expenses (\$1.0 million); deferred stock compensation (\$1.3 million); contract and professional fees (\$0.6 million); legal (\$0.3 million); conferences and travel (\$0.2 million); and entity-level state franchise and minimum taxes (\$0.2 million). These increases were partially offset by a \$1.1 million decrease in acquisition and due diligence costs and a \$0.1 million decrease in donations. During 2013, we incurred acquisition and due diligence costs of \$1.7 million related to our completed acquisitions, and an additional \$0.1 million related to in-process-or-abandoned projects. During 2012, we incurred acquisition and due diligence costs of \$2.0 million related to our completed acquisitions, and an additional \$0.9 million related to in-process-or-abandoned projects.

Corporate overhead expense decreased \$1.1 million, or 4.5%, during the year ended December 31, 2012 as compared to the year ended December 31, 2011, primarily due to decreased legal costs combined with decreased acquisition and due diligence costs. Legal costs decreased \$1.5 million in 2012 as compared to 2011 primarily due to our accrual in 2011 of \$1.6 million for settlement costs related to litigation involving three separate claims by certain employees at three of the 26 hotels. Regarding acquisition and due diligence costs, during 2012 we incurred due diligence costs of \$2.0 million related to our completed acquisitions, and an additional \$0.9 million related to in-process or abandoned projects. During 2011 we incurred due diligence costs of \$3.4 million related to our completed acquisitions, and an additional \$0.3 million related to in-process or abandoned projects. Corporate overhead expense also decreased during 2012 as compared to 2011 due to a \$1.0 million decrease in entity-level state franchise and minimum tax expense and a \$0.2 million decrease in relocation expenses. These decreases were partially offset by a \$1.0 million increase in payroll and related costs, a \$0.5 million increase in amortization of deferred stock compensation, a \$0.5 million increase in contract and professional fees, a \$0.1 million increase in donations expense, a \$0.1 million increase in employee relations, and a \$0.2 million increase in bad debt expense. Bad debt expense increased in 2012 as compared to 2011 due to our reserving the entire \$0.2 million outstanding balance of a subordinate note secured by a boutique hotel known as the Twelve Atlantic Station in Atlanta, Georgia, as the note is currently in default. We are currently working with the borrower and the special servicer to bring the note current, at which time we may reverse the bad debt expense we recorded in 2012.

Depreciation and amortization expense. Depreciation and amortization increased \$6.6 million, or 5.0%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. The five 2013–2012 acquired hotels contributed \$11.3 million to depreciation and amortization during 2013. Depreciation and amortization expense in our existing portfolio decreased \$4.7 million during 2013 as compared to 2012 primarily due to advanced bookings recorded in conjunction with our purchases of the JW Marriott New Orleans and the Hilton San Diego Bayfront that were fully amortized as of February 2013 and April 2013, respectively. This decrease in amortization was partially offset by additional depreciation recognized on hotel renovations and purchases of furniture, fixtures and equipment (“FF&E”) for our existing portfolio.

Depreciation and amortization increased \$17.2 million, or 15.1%, for the year ended December 31, 2012 as compared to the year ended December 31, 2011. Our five 2012–2011 acquired hotels contributed an additional \$15.2 million to depreciation and amortization expense during 2012. Depreciation and amortization expense in our prior year existing portfolio increased \$2.0 million during 2012 as compared to 2011 due to additional depreciation recognized on hotel renovations and purchases of FF&E for our prior year existing portfolio.

Impairment loss. Impairment loss totaled zero for both of the years ended December 31, 2013 and 2012, and \$10.9 million for the year ended December 31, 2011. During 2011, we recognized an impairment loss of \$10.9 million on our Royal Palm note due to its sale in October 2011.

Equity in earnings of unconsolidated joint ventures. Equity in earnings of unconsolidated joint ventures totaled zero for both of the years ended December 31, 2013 and 2012, and \$21,000 for the year ended December 31, 2011. In January 2011, we acquired 100% interests in both the Doubletree Guest Suites Times Square and BuyEfficient joint ventures. Post-acquisition, therefore, we present both of these investments on a consolidated basis. Prior to our January 14, 2011 acquisition date, we did not recognize any earnings on our Doubletree Guest Suites Times Square joint venture during 2011 because the joint venture had cumulative losses in excess of our investment, and we reduced our interest in this partnership to zero at December 31, 2009. The excess cumulative losses resulted primarily from the hotel’s fourth quarter 2009 impairment charge. Prior to our purchase of the outside 50.0% equity interest in the BuyEfficient joint venture on January 21, 2011, we recognized income of \$21,000 in 2011 on our BuyEfficient joint venture.

Interest and other income. Interest and other income totaled \$2.8 million for the year ended December 31, 2013, \$0.3 million for the year ended December 31, 2012, and \$3.1 million for the year ended December 31, 2011. In 2013, we recognized \$2.8 million in interest income, including \$2.6 million on the Preferred Equity Investment. In 2012, we recognized \$0.2 million in interest income, and \$0.1 million in other miscellaneous income. In 2011, we recognized \$2.9 million in interest income, including \$2.7 million related to the Royal Palm note. We sold this Royal Palm note in October 2011 for net proceeds of approximately \$79.2 million. In anticipation of this sale, we recorded an impairment loss of \$10.9 million in September 2011. In addition, during 2011, we recognized income of \$0.1 million on sales and dispositions of surplus FF&E located in several of our hotels and \$0.1 million in other miscellaneous income.

Interest expense. Interest expense is as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Interest expense	\$69,806	\$71,664	\$67,319
(Gain) loss on derivatives, net	(525)	406	2,655
Accretion of Senior Notes	3	1,058	1,062
Amortization of deferred financing fees	2,955	3,690	3,138
Write-off of deferred financing fees	—	3	21
	<u>\$72,239</u>	<u>\$76,821</u>	<u>\$74,195</u>

Interest expense decreased \$4.6 million, or 6.0%, during the year ended December 31, 2013 as compared to the year ended December 31, 2012. The decrease in interest expense in 2013 as compared to 2012 is comprised of the following: a decrease in expense on our debt and capital lease obligations (\$1.9 million); a decrease in expense related to our derivatives (\$0.9 million); a decrease in accretion of Senior Notes (\$1.1 million); and a decrease in amortization of deferred financing fees (\$0.7 million). Interest expense on our debt and capital lease obligations decreased \$1.9 million during 2013 as compared to 2012 due to reduced loan balances related to scheduled amortization, a repayment of debt in April 2012 and a repurchase of debt in January 2013. In April 2012, we repaid a \$32.2 million loan secured by the Renaissance Long Beach, and in January 2013, we repurchased \$58.0 million of our Senior Notes. These decreases in our debt obligations and related decreases in interest expense were partially offset by an increase in capital lease obligations and related interest expense due to our acquisition of the Hyatt Chicago Magnificent Mile in June 2012, which included the assumption of a building lease that we determined should be accounted for as a capital lease. Interest expense on our debt and capital lease obligations also increased during 2013 as compared to 2012 due to our assumption of a \$119.2 million loan in conjunction with our purchase of the Boston Park Plaza in July 2013. Interest expense related to our derivatives decreased \$0.9 million during 2013 as compared to 2012 due to our recording a net gain on our interest rate cap and swap agreements in 2013 as compared to a loss during 2012. Interest expense related to the accretion of our Senior Notes decreased \$1.1 million during 2013 as compared to 2012 due to the fact that the Senior Notes were fully accreted to their face value as of the first put date in January 2013. Interest expense related to amortization of deferred financing fees decreased \$0.7 million during 2013 as compared to 2012 due to the repayment of the loan secured by the Renaissance Long Beach in April 2012, combined with the fact that the deferred financing fees related to the Senior Notes were fully amortized as of the first put date in January 2013, partially offset by an increase in deferred financing fees incurred to amend our line of credit in September 2012 and to assume the Boston Park Plaza debt.

Interest expense increased \$2.6 million, or 3.5%, during the year ended December 31, 2012 as compared to the year ended December 31, 2011. Interest expense incurred on our debt and capital lease obligations increased \$4.3 million during 2012 as compared to 2011 primarily due to increased loan balances as we assumed \$270.0 million of non-recourse senior mortgage and mezzanine debt in connection with our acquisition of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture in January 2011 (which loan we refinanced in October 2011 with a new \$180.0 million non-recourse loan), and a \$42.2 million loan in connection with our acquisition of the JW Marriott New Orleans. Our loan balances also increased due to a \$240.0 million loan entered into by our Hilton San Diego Bayfront joint venture in April 2011. These increases in our loan balances were partially offset by our repayment in April 2012 of a \$32.2 million loan secured by the Renaissance Long Beach. Interest expense on our debt obligations also increased due to increases in the variable interest rates on our non-recourse loans secured by the Doubletree Guest Suites Times Square and Hilton San Diego Bayfront. Interest expense on our capital lease obligation also increased during 2012 as compared to 2011 due to our acquisition of the Hyatt Chicago Magnificent Mile, which included the assumption of a building lease that we determined should be accounted for as a capital lease. In addition, interest expense increased during 2012 as compared to 2011 due to a \$0.5 million increase in amortization of deferred financing fees related to additional fees paid in 2011 in association with our Doubletree Guest Suites Times Square, JW Marriott New Orleans and Hilton San Diego Bayfront acquisitions, as well as to fees incurred on our refinancing of the Doubletree Guest Suites Times Square and to amend our line of credit. These increases were partially offset during 2012 as compared to 2011 by a \$2.2 million decrease in interest expense related to our interest rate cap and swap agreements due to a \$1.8 million reduction in loss on our interest rate swap agreement combined with a \$0.4 million decrease in losses on our interest rate cap agreements.

Our weighted average interest rate per annum on debt included in our continuing operations, including our variable-rate debt obligations, was approximately 4.9% at both December 31, 2013 and 2012, and 5.0% at December 31, 2011. At December 31, 2013, approximately 70.7% of the outstanding notes payable included in our continuing operations had fixed interest rates. At December 31, 2012, approximately 69.6% of the outstanding notes payable included in our continuing operations had fixed interest rates. At December 31, 2011, approximately 70.5% of the outstanding notes payable included in our continuing operations had fixed interest rates.

Loss on extinguishment of debt. Loss on extinguishment of debt totaled \$44,000 for the year ended December 31, 2013, \$0.2 million for the year ended December 31, 2012, and zero for the year ended December 31, 2011. During 2013, we recognized a loss of \$44,000 due to the repurchase and redemption of the remaining \$58.0 million aggregate principal amount of the Senior Notes. During 2012, we recognized a loss of \$0.2 million due to the repurchase and cancellation of \$4.5 million in aggregate principal amount of the Senior Notes.

Gain on remeasurement of equity interests. Gain on remeasurement of equity interests totaled zero for both the years ended December 31, 2013 and 2012, and \$69.2 million for the year ended December 31, 2011. In January 2011, we purchased the outside interests in both our Doubletree Guest Suites Times Square joint venture and our BuyEfficient joint venture, and became the sole owner of both entities. Previously, our investment in the Doubletree Guest Suites Times Square joint venture consisted of a 38.0% equity interest in the hotel and a \$30.0 million, 8.5% mezzanine loan maturing in January 2017 secured by the equity interests in the hotel. During the fourth quarter of 2009, the Doubletree Guest Suites Times Square recorded an impairment loss, effectively reducing our investment in the partnership to zero as of December 31, 2009. In conjunction with the acquisition of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square in January 2011, we adjusted both our investment in the Doubletree Guest Suites Times Square joint venture and the mezzanine loan to their fair market values, and recorded gains totaling \$60.5 million on the remeasurement. In addition, in conjunction with the acquisition of the outside 50.0% equity interest in the BuyEfficient joint venture in January 2011, we adjusted our investment up to its fair market value, and recorded a gain of \$8.7 million on the remeasurement.

Income tax provision. Income tax provision totaled \$8.1 million for the year ended December 31, 2013, \$1.1 million for the year ended December 31, 2012, and zero for the year ended December 31, 2011. During 2013, we recognized income tax expense of \$4.7 million due to a resolution reached with the Internal Revenue Service ("IRS"). The Company leases its hotels to the TRS Lessee and its subsidiaries, which are subject to federal and state income taxes. In the first quarter of 2013, the IRS issued a notice of proposed adjustment to us, challenging certain aspects of our leases with our TRS Lessee and its subsidiaries. Though we believe our leases comply with all Code requirements, we determined that the costs associated with defending our position were greater than the benefits that might result therefrom. As such, we accrued \$4.7 million in 2013 related to the IRS's audit of tax years 2008, 2009 and 2010, including \$0.6 million in accrued interest. We recorded additional income tax expense of \$1.5 million during 2013 based on the ongoing evaluations of our uncertain tax positions related to the year ended December 31, 2012, and as a result of our recent resolution of outstanding issues with the IRS. During 2013, we recorded additional tax expense of \$1.9 million related to estimated 2013 federal alternative minimum tax resulting from our use of net operating loss carryforwards, as well as state income tax where our use of net operating loss carryforwards was either limited or unavailable. During 2012, our federal alternative minimum tax resulting from our use of net operating loss carryforwards combined with our state income tax expense where the use of net operating loss carryforwards was either limited or unavailable to total \$1.1 million of income tax expense.

Income from discontinued operations. As described under “—Investing Activities—Dispositions” and in accordance with the Property, Plant and Equipment Topic of the FASB ASC, income from discontinued operations included the results of operations, along with any gains on extinguishment of debt, gains or losses on sales and impairments recognized for the following properties:

Hotels and Other Assets	Rooms	Disposition Date
2013:		
Kahler Grand, Minnesota ⁽¹⁾	660	January 25, 2013
Kahler Inn & Suites, Minnesota	271	January 25, 2013
Marriott Rochester, Minnesota ⁽¹⁾	202	January 25, 2013
Residence Inn by Marriott Rochester, Minnesota	89	January 25, 2013
Textile Care Services Rochester, Minnesota	—	January 25, 2013
2012:		
Marriott Del Mar, California	284	August 23, 2012
Doubletree Guest Suites Minneapolis, Minnesota	229	September 14, 2012
Hilton Del Mar, California	257	September 14, 2012
Marriott Troy, Michigan	350	September 14, 2012
Office building adjacent to the Marriott Troy, Michigan	—	September 14, 2012
2011:		
Royal Palm Miami Beach, Florida	409	April 8, 2011
Textile Care Services Salt Lake City, Utah	—	July 8, 2011
Valley River Inn, Oregon	257	October 26, 2011
Total rooms	<u>3,008</u>	

(1) During 2012, the Company subtracted eight rooms from the Kahler Grand and one room from the Marriott Rochester, bringing the hotel room counts to 660 and 202, respectively.

Income from discontinued operations for the year ended December 31, 2013 includes activity for the four hotels and one commercial laundry facility sold in 2013. Income from discontinued operations for the year ended December 31, 2012 includes activity for the four hotels and one commercial laundry facility sold in 2013, and the four hotels and one office building sold in 2012. Income from discontinued operations for 2012 also includes property tax refunds and reimbursements for certain transaction related invoices for the Royal Palm Miami Beach, which we sold in April 2011. Income from discontinued operations for the year ended December 31, 2011 includes activity for the four hotels and one commercial laundry facility sold in 2013, the four hotels and one office building sold in 2012, and the two hotels and one commercial laundry facility sold in 2011. Income from discontinued operations for the years ended December 31, 2013, 2012 and 2011 is as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Operating revenues	\$ 3,690	\$100,861	\$130,997
Operating expenses	(3,686)	(71,089)	(96,581)
Interest expense	(99)	(6,490)	(9,337)
Depreciation and amortization expense	—	(13,164)	(16,188)
Impairment loss	—	—	(1,495)
Gain (loss) on extinguishment of debt	(3,115)	—	18,145
Gain on sale of hotels and other assets, net	51,620	38,292	14,912
Income from discontinued operations	<u>\$48,410</u>	<u>\$ 48,410</u>	<u>\$ 40,453</u>

Income from consolidated joint venture attributable to non-controlling interest. Income from consolidated joint venture attributable to non-controlling interest totaled \$4.0 million for the year ended December 31, 2013, \$1.8 million for the year ended December 31, 2012, and \$0.3 million for the year ended December 31, 2011. In April 2011, we purchased a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. Consistent with the Presentation Topic of the FASB ASC, our net income for the years ended December 31, 2013, 2012 and 2011 includes 100% of the net income generated during our ownership period by the entity that owns the Hilton San Diego Bayfront. The outside 25.0% interest in the entity that owns the Hilton San Diego Bayfront earned net income of \$4.0 million, \$1.8 million and \$0.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Distributions to non-controlling interest. Distributions to non-controlling interest totaled \$32,000 for the year ended December 31, 2013, \$31,000 for the year ended December 31, 2012, and \$30,000 for the year ended December 31, 2011. We purchased the outside 62.0% common stock equity interest in our Doubletree Guest Suites Times Square joint venture in January 2011, and, as a result, we became the sole common stockholder of the captive REIT that owns the hotel. Preferred dividends earned by investors from the entity that owns the Doubletree Guest Suites Times Square, net of related administrative fees, totaled \$32,000, \$31,000 and \$30,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Dividends paid on unvested restricted stock compensation. Common stock dividends earned on our unvested restricted stock awards totaled \$0.2 million for the year ended December 31, 2013, and zero for both the years ended December 31, 2012 and 2011.

Preferred stock dividends and redemption charges. Preferred stock dividends decreased \$10.7 million, or 36.1%, during the year ended December 31, 2013 as compared to the year ended December 31, 2012. Pursuant to our strategy of gradually reducing our leverage, during 2013 we redeemed all 7,050,000 shares of our Series A preferred stock and all 4,102,564 shares of our Series C preferred stock in March and May, respectively. As such, our total Series A and Series C preferred dividends decreased \$15.5 million in 2013 as compared to 2012. This decrease in our Series A and Series C preferred stock dividends was partially offset by a \$4.6 million redemption charge recognized on our Series A preferred stock and a \$0.1 million redemption charge recognized on our Series C preferred stock related to the original issuance costs of these shares, which were previously included in additional paid in capital.

Preferred stock dividends and redemption charges increased \$2.4 million, or 8.9%, during the year ended December 31, 2012 as compared to the year ended December 31, 2011 due to our issuance of Series D preferred stock in April 2011. Dividends paid on our Series D preferred stock increased \$2.4 million in 2012 to \$9.2 million, as compared to \$6.8 million in 2011.

Undistributed income allocated to unvested restricted stock compensation. In accordance with the Earnings Per Share Topic of the FASB ASC, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. As such, undistributed income of \$0.2 million for both the years ended December 31, 2013 and 2012, and \$0.6 million for the year ended December 31, 2011 was allocated to the participating securities.

INVESTING ACTIVITIES

Acquisitions. We believe we are in the middle phase of a potentially prolonged cyclical lodging industry recovery. Accordingly, we further believe that hotels acquired over the next several quarters are likely to benefit from a multi-year recovery in hotel profitability, and may create long-term value in excess of our investment hurdles. During 2011, 2012 and 2013, we made several hotel acquisitions as detailed below:

Hotels	Rooms	Acquisition Date
2013:		
Hilton New Orleans St. Charles, Louisiana	250	May 1, 2013
Boston Park Plaza, Massachusetts	1,053	July 2, 2013
Hyatt Regency San Francisco, California	802	December 2, 2013
2012:		
Hyatt Chicago Magnificent Mile, Illinois ⁽¹⁾	417	June 4, 2012
Hilton Garden Inn Chicago Downtown/Magnificent Mile, Illinois	357	July 19, 2012
2011:		
Doubletree Guest Suites Times Square, New York	460	January 14, 2011
JW Marriott New Orleans, Louisiana ⁽¹⁾	494	February 15, 2011
Hilton San Diego Bayfront, California	<u>1,190</u>	April 15, 2011
Total rooms	<u>5,023</u>	

(1) Subsequent to these acquisitions, the Company added two additional rooms to both the Hyatt Chicago Magnificent Mile and the JW Marriott New Orleans, increasing their room counts to 419 and 496, respectively.

The total cost for these eight hotel acquisitions was approximately \$1.5 billion, including shares of the Company's common stock valued at \$51.2 million for accounting purposes, or \$299,000 per room. Each of these acquisitions is discussed below.

In May 2013, we purchased the 250-room Hilton New Orleans St. Charles for a net purchase price of \$59.1 million, including \$0.2 million of proration credits and unrestricted cash received from the seller. The acquisition was funded with \$53.2 million of proceeds generated by our January 2013 sale of the Rochester Portfolio, as well as with proceeds received from our February 2013 issuance of common stock.

In July 2013, we purchased the 1,053-room Boston Park Plaza for a net purchase price of \$248.0 million, including \$2.0 million of proration credits, unrestricted and restricted cash and other adjustments received from the seller. The acquisition was funded with \$92.3 million of proceeds generated by our January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota, the assumption of a \$119.2 million non-recourse loan secured by the hotel, as well as with proceeds received from the Company's February 2013 issuance of common stock and with cash on hand. The mortgage we assumed in conjunction with our purchase of the Boston Park Plaza bears interest at a fixed rate of 4.4%, and matures in February 2018.

In December 2013, we purchased the 802-room Hyatt Regency San Francisco for a net purchase price of \$262.5 million, including \$5.5 million of purchase price adjustments comprised of restricted cash and other adjustments received from the seller. The acquisition was funded with proceeds generated by our November 2013 issuance of common stock.

In June 2012, we purchased the leasehold interest in the 417-room Wyndham Chicago located in Chicago, Illinois for a contractual purchase price of \$88.425 million. The acquisition was funded with \$29.7 million of cash on hand (including \$0.3 million of proration credits) and the issuance of 5,454,164 shares of our common stock, the "Wyndham stock consideration." The Wyndham stock consideration was determined by dividing \$58.425 million by the product of (1) the closing price of \$10.40 on the NYSE of our common stock on May 2, 2012 and (2) 1.03. In connection with this acquisition, we entered into a registration rights agreement requiring us to register the Wyndham stock consideration. We prepared the registration statement on Form S-3, which we filed with the SEC as required on June 4, 2012. Based on the \$9.38 closing price of the Company's common stock on the NYSE on June 4, 2012, the date the acquisition closed, the total purchase price of the Wyndham Chicago hotel for accounting purposes was \$81.16 million, excluding proration adjustments and closing costs. Upon closing, we terminated the existing management agreement and entered into a new management agreement with Davidson Hotels & Resorts. We rebranded the hotel the Hyatt Chicago Magnificent Mile and immediately commenced planning for a \$25.0 million renovation program (a portion of which was funded by Hyatt Corporation).

In July 2012, we purchased the 357-room Hilton Garden Inn Chicago Downtown/Magnificent Mile located in Chicago, Illinois for a net purchase price of \$90.3 million. The acquisition was funded with a portion of the \$126.2 million net proceeds we received from the issuance of 12,143,273 shares of our common stock in June 2012.

In January 2011, we purchased the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture for \$37.5 million, and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square located in New York City, New York. The hotel was encumbered by \$270.0 million of non-recourse senior mortgage and mezzanine debt which was to mature in January 2012, and which bore a blended interest rate of 3-month LIBOR plus 115 basis points. We refinanced this debt in October 2011 with a new \$180.0 million non-recourse mortgage which matures in October 2018, and bears interest at a floating rate of 3-month LIBOR plus 325 basis points. We funded the remainder of the repayment of the prior loan with approximately \$90.0 million of our unrestricted cash. The hotel was encumbered by an additional \$30.0 million mezzanine loan that was owned by the Company, and, therefore, eliminated in consolidation on our balance sheets until the mezzanine loan was satisfied in conjunction with our refinancing of the debt secured by the Doubletree Guest Suites Times Square in October 2011. In conjunction with the purchase of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture, we recognized a gain of \$30.1 million on the remeasurement of our equity interest in this joint venture to its fair market value, and a gain of \$30.4 million on the remeasurement of our investment in the \$30.0 million mezzanine loan, which we purchased in April 2010 for \$3.45 million, to its fair market value.

In February 2011, we purchased the 494-room JW Marriott New Orleans located in New Orleans, Louisiana for approximately \$51.6 million in cash and the assumption of a \$42.2 million floating-rate, non-recourse senior mortgage. The mortgage, which matures in September 2015, has been swapped to a fixed rate of 5.45%, and is subject to a 25-year amortization schedule. Subsequent to this acquisition, we added two additional rooms to this hotel, increasing the room count to 496.

In April 2011, we paid \$182.8 million to acquire a 75.0% majority interest in the joint venture that owns the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California, which implied a gross value of approximately \$475.0 million. Concurrent with the acquisition, the joint venture entered into a new \$240.0 million mortgage financing secured by the hotel. The mortgage bears a floating rate of interest of 3-month LIBOR plus 325 basis points, matures in April 2016 and is subject to a 30-year amortization schedule.

In addition to the above noted hotels, we deployed a portion of our excess cash in January 2011 towards the purchase of the outside 50.0% equity interest in our BuyEfficient joint venture for a gross purchase price of \$9.0 million. As a result, we are now the sole owner of BuyEfficient. In conjunction with this purchase, we recognized a gain of \$8.7 million on the remeasurement of our equity interest in this joint venture to its fair market value.

While our primary focus is on acquiring branded, urban, upper upscale hotels, our acquisition program is aimed at generating attractive risk-adjusted returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. We intend to select the brands and operators for our hotels that we believe will lead to the highest returns. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans. Future acquisitions may be funded by our issuance of additional debt or equity securities, including our common and preferred OP units, or by draws on our \$150.0 million senior corporate credit facility entered into in November 2010 and amended in September 2012. However, in light of our current financial objectives, we expect to fund any near term acquisitions with a greater proportion of equity capital than debt capital.

Dispositions. We have from time to time divested of assets that no longer fit our target profile, will not offer long-term returns in excess of our cost of capital, or that have high risk relative to their anticipated returns. The following table sets forth the hotels we have sold since January 1, 2011:

Hotels	Rooms	Disposition Date
2013:		
Kahler Grand, Minnesota ^{(1) (2)}	660	January 25, 2013
Kahler Inn & Suites, Minnesota ⁽¹⁾	271	January 25, 2013
Marriott Rochester, Minnesota ^{(1) (2)}	202	January 25, 2013
Residence Inn by Marriott Rochester, Minnesota ⁽¹⁾	89	January 25, 2013
2012:		
Marriott Del Mar, California	284	August 23, 2012
Doubletree Guest Suites Minneapolis, Minnesota ⁽³⁾	229	September 14, 2012
Hilton Del Mar, California ⁽³⁾	257	September 14, 2012
Marriott Troy, Michigan ⁽³⁾	350	September 14, 2012
2011:		
Royal Palm Miami Beach, Florida	409	April 8, 2011
Valley River Inn, Oregon	257	October 26, 2011
Total rooms	<u>3,008</u>	

(1) The 2013 portfolio sale of the Rochester Hotels also included a commercial laundry facility in Rochester, Minnesota.

(2) During 2012, the Company subtracted eight rooms from the Kahler Grand and one room from the Marriott Rochester, bringing the hotel room counts to 660 and 202, respectively.

(3) The 2012 portfolio sale of the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, and the Marriott Troy also included an office building adjacent to the Marriott Troy.

The aggregate net sale proceeds for these 10 hotels was \$547.2 million, or \$182,000 per room. The results of operations of all of the properties identified above and the gains or losses on dispositions and extinguishments of debt are included in discontinued operations for all periods presented through the time of sale. The cash proceeds from the sales are included in our cash flows from investing activities for the respective periods. Each of these dispositions is discussed below.

In January 2013, we sold the Rochester Portfolio to an unaffiliated third party, for net proceeds of \$195.6 million, of which \$145.7 million was deposited with an accommodator in order to facilitate our tax-deferred exchanges for the Hilton New Orleans St. Charles and the Boston Park Plaza. We recognized a net gain on the sale of \$51.6 million. We retained a \$25.0 million Preferred Equity Investment in the Rochester Hotels that yields an 11% dividend, resulting in a deferred gain on the sale of \$25.0 million. The \$25.0 million gain will be deferred until the Preferred Equity Investment is repaid. We also provided a \$3.7 million working cash advance to the buyer, resulting in a deferred gain on the sale of \$3.7 million. The \$3.7 million gain will be deferred until we are repaid from the Rochester Portfolio's available cash flow. In addition, we retained a \$14.0 million liability related to the Rochester Portfolio's pension plan, which could be triggered in certain circumstances, including termination of the pension plan. The recognition of the \$14.0 million pension plan liability reduced our gain on the sale of the Rochester Portfolio. The \$14.0 million gain will be recognized, if at all, when and to the extent we are released from any potential liability related to the Rochester Portfolio's pension plan. Concurrent with the Rochester Portfolio sale, we extinguished the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of \$29.8 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of \$3.1 million which is included in discontinued operations.

We sold four hotels and an office building adjacent to one of the hotels in 2012. In August 2012, we sold the Marriott Del Mar located in San Diego, California for net proceeds of \$17.7 million, including the assumption of the existing mortgage secured by the hotel which totaled \$47.1 million on the date of sale, and recognized a gain on the sale of \$25.5 million. In addition, we wrote off \$48,000 in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the hotel. In September 2012, we sold a portfolio of assets that included the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy (located in Minneapolis, Minnesota, San Diego, California, and Troy, Michigan, respectively) and an office building adjacent to the Marriott Troy for net proceeds of \$28.6 million, including the assumptions of three separate mortgages secured by the hotels totaling \$75.6 million, as well as a \$2.2 million liability for deferred management fees payable to the Marriott Troy's third-party manager. We recognized a net gain on the sale of \$12.7 million. In addition, we wrote off \$0.1 million in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the three hotels.

The mortgages secured by the Marriott Del Mar, Hilton Del Mar and Marriott Troy contain "cash trap" provisions that were triggered in prior years due to the decline in the performance of these hotels. Once triggered, substantially all of the excess cash flow from operations generated by the three hotels was deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lenders. Cash was distributed to us only after certain items were paid, including deposits into leasing and maintenance reserve accounts and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and leasing expenses. In 2013, a total of \$3.8 million was returned to us related to the mortgages secured by the Marriott Del Mar and the Marriott Troy. As of December 31, 2013, a total of \$4.4 million of our cash remained trapped by the lender associated with the mortgage secured by the Hilton Del Mar. In February 2014, the lender released the cash, and the entire \$4.4 million was returned to us.

We sold two hotels in 2011. In April 2011, we sold the Royal Palm Miami Beach for net proceeds of \$129.8 million, including \$40.0 million in cash and the \$90.0 million Royal Palm note, and recognized a gain on the sale of \$14.0 million. We sold the Royal Palm note in October 2011 for net proceeds of approximately \$79.2 million. In anticipation of this sale, we recorded an impairment loss of \$10.9 million in September 2011. We retained an earn-out right on the Royal Palm hotel which will enable us to receive future payments of up to \$20.0 million in the event that the hotel achieves certain return hurdles. In October 2011, we sold the Valley River Inn located in Eugene, Oregon for net proceeds of \$16.1 million, including the assumption of the existing mortgage secured by the hotel which totaled \$11.5 million on the date of sale, and recognized a gain on the sale of \$0.9 million.

In addition to the above noted hotel dispositions, in July 2011, we sold our commercial laundry facility located in Salt Lake City, Utah for net proceeds of \$0.1 million, and recognized a loss on the sale of \$0.1 million. In anticipation of this sale, we recorded an impairment loss of \$1.5 million in June 2011, which is included in discontinued operations.

The following table summarizes our portfolio and room data from January 1, 2011 through December 31, 2013, adjusted for the hotels acquired and sold during the respective periods.

	2013	2012	2011
PORTFOLIO DATA—HOTELS			
Number of hotels—beginning of period	30	32	31
Add: Acquisitions	3	2	3
Less: Dispositions	(4)	(4)	(2)
Number of hotels—end of period	29	30	32
	2013	2012	2011
PORTFOLIO DATA—ROOMS			
Number of rooms—beginning of period	12,854	13,208	11,722
Add: Acquisitions	2,105	774	2,144
Add: Room (conversions) expansions	7	(8)	8
Less: Dispositions	(1,222)	(1,120)	(666)
Number of rooms—end of period	13,744	12,854	13,208
Average rooms per hotel—end of period	474	428	413

Renovations. During 2013, we invested \$117.7 million in capital improvements to our hotel and other real estate portfolio. Consistent with our cycle-appropriate strategy, this investment in capital improvements to our portfolio was \$8.4 million more than the amount we invested in 2012 and \$17.3 million more than the amount we invested in 2011.

LIQUIDITY AND CAPITAL RESOURCES

Historical. During the periods presented, our sources of cash included our operating activities, working capital, sales of hotel properties and other assets, proceeds from issuance of notes payable and our credit facility, and proceeds from our offerings of common and preferred stock. Our primary uses of cash were for acquisitions of hotel properties and other assets, capital expenditures for hotels, operating expenses, repayment of notes payable (including repurchases of Senior Notes) and our credit facility, dividends on our preferred and common stock and distributions to our joint venture partners. We cannot be certain that traditional sources of funds will be available in the future.

Operating activities. Our net cash provided by or used in operating activities fluctuates primarily as a result of changes in RevPAR and the operating cash flow of our hotels. Our net cash provided by or used in operating activities may also be affected by changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. Net cash provided by operating activities was \$171.1 million for 2013 compared to \$171.5 million for 2012, and \$155.2 million for 2011. Operating cash decreased slightly in 2013 as compared to 2012 due to decreased cash generated by the four hotels undergoing major room renovations during the first half of 2013 (the Hilton Times Square, the Hyatt Chicago Magnificent Mile, the Hyatt Regency Newport Beach and the Renaissance Westchester) as well as increased restricted cash, mostly offset by operating cash generated by the 2013–2012 acquired hotels.

Operating cash increased in 2012 as compared to 2011 primarily due to our 2012–2011 acquired hotels, combined with increased earnings at our existing hotels.

Investing activities. Our net cash provided by or used in investing activities fluctuates primarily as a result of acquisitions, dispositions and renovations of hotels. Net cash used in investing activities in 2013, 2012 and 2011 was as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Proceeds from sales of hotel properties and other assets	\$ 195,628	\$ 46,367	\$ 44,576
Restricted cash—replacement reserve	1,272	(10,743)	(8,143)
Proceeds received from sale of note receivable	—	—	79,194
Acquisitions of hotel properties and other assets	(450,544)	(120,003)	(263,264)
Renovations and additions to hotel properties and other assets	(117,694)	(109,321)	(100,400)
Payments for interest rate derivatives	(12)	—	(1,082)
Net cash used in investing activities	<u>\$(371,350)</u>	<u>\$(193,700)</u>	<u>\$(249,119)</u>

Net cash used in investing activities was \$371.4 million in 2013, as compared to \$193.7 million in 2012, and \$249.1 million in 2011. During 2013, we received proceeds of \$195.6 million from the sale of the Rochester Portfolio. In addition, we purchased three hotels during 2013 for a total of \$450.5 million, including the Hilton New Orleans St. Charles in May 2013 (\$59.1 million), the Boston Park Plaza in July 2013 (\$128.9 million), and the Hyatt Regency San Francisco in December 2013 (\$262.5 million). During 2013, we also decreased our restricted cash by \$1.3 million, paid \$117.7 million for renovations and additions to our portfolio and paid \$12,000 for an interest rate cap agreement on our variable-rate mortgage secured by the Hilton San Diego Bayfront.

During 2012, we received total proceeds of \$46.4 million from the sales of four hotels and an office building adjacent to one of the sold hotels, including \$17.7 million for the Marriott Del Mar, \$28.6 million from the portfolio sale of the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy, and an office building adjacent to the Marriott Troy, and an additional \$37,000 from the sale of surplus FF&E. This cash inflow was offset by the following cash outflows: \$10.7 million as we increased the balance in our restricted cash replacement reserve accounts; \$120.0 million to acquire two hotels, including \$29.7 million paid to acquire the Hyatt Chicago Magnificent Mile, partially offset by \$21,000 of unrestricted cash received upon acquisition and \$90.3 million paid to acquire the Hilton Garden Inn Chicago Downtown/Magnificent Mile, partially offset by \$11,000 of unrestricted cash received upon acquisition; and \$109.3 million for renovations and additions to our portfolio.

During 2011, we received net proceeds of \$39.8 million from our sale of the Royal Palm Miami Beach, \$0.1 million from our sale of the commercial laundry facility located in Salt Lake City, Utah, \$16.1 million from our sale of the Valley River Inn partially offset by \$11.5 million of debt assigned to the buyer of the hotel and an additional \$0.1 million from the sale of surplus FF&E, for a total cash inflow of \$44.6 million. In addition, during 2011, we received net proceeds of \$79.2 million from the sale of the Royal Palm note. These cash inflows were offset as we increased the balance in our restricted cash replacement reserve accounts by \$8.1 million, paid cash of \$263.3 million to acquire hotel properties and other assets, paid cash of \$100.4 million for renovations and additions to our portfolio, and paid cash of \$1.1 million for interest rate derivative agreements. The \$263.3 million total cash paid for acquisitions during 2011 is comprised of the following: \$37.5 million for the outside 62.0% equity interests in our Doubletree Guest Suites Times Square, partially offset by \$13.0 million of unrestricted cash acquired upon acquisition; \$51.6 million for the JW Marriott New Orleans; \$182.8 million for the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront, partially offset by \$3.7 million of unrestricted cash acquired upon acquisition; and \$9.0 million for the outside 50.0% equity interest in our BuyEfficient joint venture, partially offset by \$0.9 million of unrestricted cash acquired upon acquisition.

Financing activities. Our net cash provided by or used in financing activities fluctuates primarily as a result of our issuance of common stock and our issuance and repayment of notes payable (including the repurchase of Senior Notes) and our credit facility, and our issuance and repurchase of other forms of capital, including preferred equity. Net cash provided by financing activities was \$147.4 million in 2013, as compared to net cash provided of \$30.2 million in 2012, and net cash used of \$32.8 million in 2011. Net cash provided by financing activities during 2013 consisted of \$565.8 million in net proceeds received from our issuance of common stock and \$35.8 million in proceeds received from our credit facility, partially offset by the following cash outflows: a total of \$276.3 million paid to redeem all of our Series A and Series C preferred stock; \$141.5 million in principal payments on our notes payable and credit facility, including \$58.0 million to repurchase our Senior Notes, \$26.7 million to extinguish the existing mortgage on the Kahler Grand, \$0.4 million to prepay the existing mortgage on the commercial laundry facility included in the Rochester Portfolio, \$35.8 million to repay draws on our credit facility and \$20.6 million of principal payments on our notes payable; \$3.1 million in costs incurred on our repurchase of the Senior Notes, our extinguishment of the Kahler Grand mortgage and our repayment of the commercial laundry mortgage; \$27.5 million in common and preferred dividends to our stockholders; \$5.5 million in distributions to the non-controlling interests in our hotels; and \$0.2 million in deferred financing costs paid in connection with our purchase of the interest rate cap agreement on our variable-rate mortgage secured by the Hilton San Diego Bayfront and on our assumption of the Boston Park Plaza loan.

Net cash provided by financing activities during 2012 consisted of \$126.1 million in net proceeds received from the issuance of common stock, including \$126.2 million in net proceeds received from our common stock offering offset by \$0.1 million in fees related to shares issued to the seller of the Hyatt Chicago Magnificent Mile, and \$15.0 million in proceeds received from a draw on our credit facility. These cash inflows were partially offset by \$68.8 million in principal payments on our notes payable and credit facility, including \$32.2 million to repay the existing mortgage secured by the Renaissance Long Beach, \$15.0 million to repay a draw on our credit facility and \$21.6 million of principal payments on our notes payable. In addition, we paid \$4.6 million to repurchase a portion of our Senior Notes, \$1.3 million in deferred financing costs to amend our credit facility, \$29.7 million in preferred dividends to our stockholders, and \$6.4 million in distributions to the non-controlling interests in our hotels.

Net cash used in financing activities during 2011 consisted of \$568.3 million in principal payments on notes payable and our credit facility, including \$233.8 million to repay an existing mortgage upon the acquisition of our Hilton San Diego Bayfront joint venture, \$270.0 million to repay non-recourse senior mortgage and mezzanine debt upon our refinancing of the Doubletree Guest Suites Times Square, \$40.0 million to repay a draw on our credit facility and \$24.5 million of principal payments on our notes payable. In addition, we paid \$9.0 million in deferred financing costs related to our assumptions of debt on the Doubletree Guest Suites Times Square and the JW Marriott New Orleans in connection with the acquisitions of these two hotels, the issuance of a note payable to our Hilton San Diego Bayfront joint venture, the refinancing of debt secured by the Doubletree Guest Suites Times Square, as well as costs related to our credit facility. We also paid dividends totaling \$25.0 million to our stockholders and distributions totaling \$1.3 million to partners in our joint ventures. These cash outflows were partially offset during 2011 by the receipt of \$110.9 million in net proceeds from the issuance of our Series D preferred stock, and \$460.0 million in proceeds from the issuance of notes payable and a draw on our credit facility. The \$460.0 million includes \$240.0 million received from the issuance of a note payable to our Hilton San Diego Bayfront joint venture, \$180.0 million received from the refinancing of debt on our Doubletree Guest Suites Times Square and \$40.0 million received from a draw on our credit facility.

Future. We expect our primary uses of cash to be for acquisitions of hotels, including possibly hotel portfolios, capital investments in our hotels, operating expenses, repayment of principal on our notes payable and credit facility, interest expense, and dividends on our common and preferred stock. We expect our primary sources of cash will continue to be our operating activities, working capital, notes payable and our credit facility, dispositions of hotel properties, and proceeds from public and private offerings of debt securities and common and preferred stock. Our financial objectives include the measured improvement of our credit ratios, maintenance of appropriate levels of liquidity, and a gradual reduction in our financial leverage. In light of our leverage objectives, in the near-term, we expect to fund acquisitions largely through the issuance of equity in order to grow the quality and scale of our portfolio while reducing our leverage. Consistent with this strategy, we issued common stock in June 2012 to fund our acquisitions of both the Hyatt Chicago Magnificent Mile in June 2012 and the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012. In addition, we used a portion of the proceeds we received from our February 2013 common stock offering to fund our acquisitions of both the Hilton New Orleans St. Charles in May 2013 and the Boston Park Plaza in July 2013, and we used a portion of the proceeds we received from our November 2013 common stock offering to fund our acquisition of the Hyatt Regency San Francisco in December 2013. Our ability to raise funds through the issuance of equity securities depends on, among other things, general market conditions for hotel companies and REITs and market perceptions about us. We will continue to analyze alternate sources of capital in an effort to minimize our capital costs and maximize our financial flexibility, including pursuant to the Equity Distribution Agreements (the “Agreements”) we entered into in February 2014 with Wells Fargo Securities, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated (the “Managers”). Under the terms of the Agreements, we may issue and sell from time to time through or to the Managers, as sales agents and/or principals, shares of our common stock having an aggregate offering amount of up to \$150.0 million. However, when needed, the capital markets may not be available to us on favorable terms or at all.

We believe that our current cash balance, our cash flow from operations, our access to capital markets and our unencumbered properties will provide us with sufficient liquidity to meet our current operating expenses and other expenses directly associated with our business (including payment of cash dividends on our capital stock, if declared) for the foreseeable future, and in any event for at least the next 12 months.

Debt. Concurrent with the Rochester Portfolio sale in January 2013, we extinguished the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of \$29.8 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of \$3.1 million which is included in discontinued operations.

In January 2013, we repurchased \$42.0 million of Senior Notes pursuant to a tender offer, and we redeemed the remaining \$16.0 million of the Senior Notes. We funded the total \$58.0 million in Senior Note redemptions with available cash, leaving no future amounts outstanding related to the Senior Notes. We recognized a loss of \$44,000 on this extinguishment of debt.

In conjunction with our acquisition of the Boston Park Plaza in July 2013, we assumed a \$119.2 million non-recourse mortgage secured by the hotel. The mortgage bears interest at a fixed rate of 4.4%, and matures in February 2018.

Regarding our 2012 debt activities, in February 2012, we repurchased \$4.5 million in aggregate principal amount of our Senior Notes for \$4.57 million. After the repurchase, such Senior Notes were cancelled. We wrote off \$47,000 in deferred financing fees and \$0.1 million of the Senior Notes discount, and recognized a loss of \$0.2 million on this early extinguishment of debt.

In April 2012, we used existing cash to repay the remaining \$32.2 million balance of the non-recourse mortgage secured by the Renaissance Long Beach. In connection with this repayment, we wrote off \$3,000 in deferred financing fees.

In August 2012, we completed the sale of the Marriott Del Mar for a gross sales price of \$66.0 million, including the buyer’s assumption of the \$47.1 million mortgage secured by the hotel, and wrote off \$48,000 in related deferred financing fees.

In September 2012, we completed the portfolio sale of the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and an office building adjacent to the Marriott Troy for a gross sales price of \$105.0 million, including the buyer's assumption of the three mortgages secured by the hotels totaling \$75.6 million, and wrote off \$0.1 million in related deferred financing fees.

In September 2012, we amended and restated our \$150.0 million senior unsecured revolving credit facility, which was scheduled to mature in November 2013. The pricing on the amended revolving credit facility was reduced and the 1% LIBOR floor was eliminated. The maturity of the credit facility was extended to November 2015 with an option to extend to November 2016. The amended credit facility's interest rate is based on a pricing grid with a range of 175 to 350 basis points, which represents a reduction from the previous grid that ranged from 325 to 425 basis points over LIBOR depending on our leverage ratio. The credit facility also includes an accordion option that allows us to request additional lender commitments up to a total of \$350.0 million. We paid \$1.3 million in deferred financing fees in conjunction with this amendment, which will be amortized over the term of the amended credit facility. The credit facility currently has no outstanding borrowings; however, as of December 31, 2013, we had \$0.8 million in outstanding irrevocable letters of credit backed by the credit facility.

Our 2011 debt activities involved our acquisitions of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture in January 2011, the JW Marriott New Orleans in February 2011, and a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront in April 2011. In connection with our purchase of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square in January 2011, we assumed \$270.0 million of non-recourse senior mortgage and mezzanine debt which was scheduled to mature in January 2012, and which bore a blended interest rate of 3-month LIBOR plus 115 basis points. We refinanced this debt in October 2011 with a new \$180.0 million non-recourse mortgage which matures in October 2018, and bears interest at a floating rate of 3-month LIBOR plus 325 basis points. The new mortgage required payments of interest only for the first 24 months of the term, and is subject to a 30-year amortization schedule. In conjunction with this refinancing, we entered into an interest rate protection agreement which caps the 3-month LIBOR rate on the new mortgage at 4.0% until October 2015. We funded the remainder of the repayment of the prior loan with approximately \$90.0 million of our unrestricted cash.

Our purchase of the JW Marriott New Orleans in February 2011 included the assumption of a \$42.2 million floating-rate, non-recourse senior mortgage. The mortgage, which matures in September 2015, has been swapped to a fixed rate of 5.45%, and is subject to a 25-year amortization schedule.

Concurrent with our acquisition in April 2011 of a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront, the joint venture entered into a new \$240.0 million mortgage secured by the hotel. The mortgage bears a floating rate of interest of 3-month LIBOR plus 325 basis points, matures in April 2016 and is subject to a 30-year amortization schedule. The joint venture also entered into an interest rate protection agreement which capped the 3-month LIBOR rate on the mortgage at 3.75% until April 2013, at which time we purchased a new interest rate cap agreement on the Hilton San Diego Bayfront mortgage for a cost of \$12,000. The new interest rate cap agreement extends the maturity date from April 2013 to April 2015, and continues to cap the 3-month LIBOR rate at 3.75%.

As of December 31, 2013, we had \$1.4 billion of consolidated debt, \$193.7 million of cash and cash equivalents, including restricted cash, and total assets of \$3.5 billion. We believe that by controlling debt levels, staggering maturity dates and maintaining a highly flexible capital structure, we can maintain lower capital costs than more highly leveraged companies, or companies with limited flexibility due to restrictive corporate-level financial covenants.

As of December 31, 2013, all of our outstanding debt had fixed interest rates, except the \$231.5 million non-recourse mortgage on the Hilton San Diego Bayfront and the \$179.5 million non-recourse mortgage on the Doubletree Guest Suites Times Square, both of which are subject to interest rate cap agreements. The interest rate cap agreement on the Hilton San Diego Bayfront mortgage matures in April 2015, and caps the 3-month LIBOR rate at 3.75%. The interest rate cap agreement on the Doubletree Guest Suites Times Square mortgage matures in October 2015, and caps the 3-month LIBOR rate at 4.0%. All of our mortgage debt is in the form of single asset non-recourse loans rather than in cross-collateralized multi-property pools. We currently believe this structure is appropriate for the operating characteristics of our business as it isolates risk and provides flexibility for various portfolio management initiatives, including the sale of individual hotels subject to existing debt. As evidenced by our 2009 secured debt restructuring program, in instances where asset values have declined to levels below the principal amount of the associated mortgage, non-recourse single asset mortgages may limit the degradation in the value experienced by our stockholders by shifting a portion of the asset risk to our secured lenders.

As of December 31, 2013, the weighted average term to maturity of our debt is approximately four years, and 70.7% of our debt is fixed rate with a weighted average interest rate of 5.4%. Including our variable-rate debt obligations based on the variable rates at December 31, 2013, the weighted average interest rate on this debt is 4.9%.

We may in the future seek to obtain mortgages on one or all of our 13 unencumbered hotels, all but four of which are currently held by subsidiaries whose interests are pledged to our credit facility at December 31, 2013: Courtyard by Marriott Los Angeles, Fairmont Newport Beach, Hilton Garden Inn Chicago Downtown/Magnificent Mile (not pledged to our credit facility), Hilton New Orleans St. Charles (not pledged to our credit facility), Hyatt Chicago Magnificent Mile (not pledged to our credit facility), Hyatt Regency Newport Beach, Hyatt Regency San Francisco (not pledged to our credit facility), Marriott Quincy, Marriott Portland, Renaissance Long Beach, Renaissance Los Angeles Airport, Renaissance Westchester and Sheraton Cerritos. These 13 hotels had an aggregate of 5,001 rooms as of December 31, 2013, and generated \$331.3 million in revenue during 2013, including revenue generated prior to our ownership, as applicable. Should we obtain secured financing on any or all of our 13 unencumbered hotels, the amount of capital available through our credit facility may be reduced.

Cash Balance. As of December 31, 2013, our unrestricted cash balance was \$104.4 million. By minimizing our need to access external capital by maintaining higher than typical cash balances, our financial security and flexibility are meaningfully enhanced because we are able to fund our business needs and debt maturities partially with our cash. As we believe the lodging cycle is in the middle phase of a potentially prolonged cyclical recovery, we deployed a portion of our excess cash balance in 2013 towards debt repayments and repurchases (such as the repurchase of our Senior Notes in January 2013, and our redemptions of all issued and outstanding shares of the Series A and Series C preferred stock in March 2013 and May 2013, respectively), selective acquisitions and capital investments in our portfolio. In addition, as we have made progress on our core objective to improve the quality and scale of our portfolio while gradually deleveraging our balance sheet, we have reinstituted a cash quarterly dividend on our common shares. While our primary focus is on acquiring branded, urban, upper upscale hotels, our acquisition program is aimed at generating attractive risk-adjusted returns on our investment dollars. We, therefore, may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans.

CONTRACTUAL OBLIGATIONS

The following table summarizes our payment obligations and commitments as of December 31, 2013 (in thousands):

	Payment Due by Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
Notes payable	\$1,404,075	\$ 23,289	\$585,998	\$538,147	\$256,641
Interest obligations on notes payable ⁽¹⁾	254,585	66,305	111,095	51,680	25,505
Capital lease obligations	15,621	35	10	2	15,574
Interest obligations on capital leases	102,253	1,402	2,804	2,804	95,243
Operating lease obligations	563,551	10,476	21,133	27,168	504,774
Construction commitments	43,508	43,508	—	—	—
Employment obligations	3,707	1,435	2,272	—	—
Total	\$2,387,300	\$146,450	\$723,312	\$619,801	\$897,737

(1) Interest on variable-rate debt obligations is calculated based on the variable rates at December 31, 2013 and includes the effect of our interest rate derivative agreements.

CAPITAL EXPENDITURES AND RESERVE FUNDS

We believe we maintain each of our hotels in good repair and condition and in general conformity with applicable franchise and management agreements, ground, building and air leases, laws and regulations. Our capital expenditures primarily relate to the ongoing maintenance of our hotels and are budgeted in the reserve accounts described in the following paragraph. We also incur capital expenditures for renovation and development. We invested \$117.7 million in our portfolio during 2013. As of December 31, 2013, we have contractual construction commitments totaling \$43.5 million. If we acquire, renovate or develop additional hotels in the future, our capital expenditures will increase.

With respect to our hotels that are operated under management or franchise agreements with major national hotel brands and for all of our hotels subject to first mortgage liens, we are obligated to maintain an FF&E reserve account for future planned and emergency-related capital expenditures at these hotels. The amount funded into each of these reserve accounts is determined pursuant to the management, franchise and loan agreements for each of the respective hotels, ranging between zero and 5.0% of the respective hotel's total annual revenue. As of December 31, 2013, \$45.9 million was held in FF&E reserve accounts for future capital expenditures at the 29 hotels. According to certain loan agreements, reserve funds are to be held by the lenders or managers in restricted cash accounts, and we are not required to spend the entire amount in such reserve accounts each year.

OFF-BALANCE SHEET ARRANGEMENTS

Our off-balance sheet arrangement consists of our ownership interest in the Preferred Equity Investment. For further discussion of the Preferred Equity Investment and its effect on our financial condition, results of operations and cash flows, see Note 4 to the consolidated financial statements.

SEASONALITY AND VOLATILITY

As is typical of the lodging industry, we experience some seasonality in our business as indicated in the table below. Revenue for certain of our hotels is generally affected by seasonal business patterns (e.g., the first quarter is strong in Orlando, the second quarter is strong for the Mid-Atlantic business hotels, and the fourth quarter is strong for New York City). Quarterly revenue also may be adversely affected by renovations, our managers' effectiveness in generating business and by events beyond our control, such as extreme weather conditions, terrorist attacks or alerts, public health concerns, airline strikes or reduced airline capacity, economic factors and other considerations affecting travel. Quarterly revenues prior to 2013 were also impacted by the 13-fiscal

period accounting calendar used by one of our third-party managers, subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”). Beginning in 2013, Marriott, the third-party manager of 10 of our 29 hotels switched to a standard 12-month fiscal calendar, which shifted the operating results for 20 calendar days from the fourth quarter to the first three quarters. Revenues for our 28 hotel Comparable Portfolio by quarter for 2011, 2012 and 2013 were as follows (dollars in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
REVENUES					
2011 Comparable Portfolio ⁽¹⁾	\$194,367	\$228,647	\$212,957	\$246,535	\$882,506
2011 Revenues as a percentage of total	22.0%	25.9%	24.2%	27.9%	100.0%
2012 Comparable Portfolio ⁽¹⁾	\$205,485	\$244,792	\$226,996	\$254,899	\$932,172
2012 Revenues as a percentage of total	22.0%	26.3%	24.4%	27.3%	100.0%
2013 Comparable Portfolio ⁽¹⁾	\$215,661	\$257,506	\$251,275	\$241,644	\$966,086
2013 Revenues as a percentage of total	22.3%	26.7%	26.0%	25.0%	100.0%

(1) Includes all of the hotels in which we have interests as of December 31, 2013, except the Boston Park Plaza due to the hotel adding 12 rooms in September 2012, and an additional 100 rooms in January 2013. Also includes the following prior ownership results: the Hilton New Orleans St. Charles and the Hyatt Regency San Francisco for all of 2011 and 2012, and during the periods in 2013 before our acquisitions of the hotels; the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile for all of 2011, and during the periods in 2012 before our acquisitions of the hotels; and the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront during the periods in 2011 before our acquisitions of the hotels.

INFLATION

Inflation may affect our expenses, including, without limitation, by increasing such costs as labor, food, taxes, property and casualty insurance and utilities.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities.

We evaluate our estimates on an ongoing basis. We base our estimates on historical experience, information that is currently available to us and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect the most significant judgments and estimates used in the preparation of our consolidated financial statements.

» ***Impairment of long-lived assets and goodwill.*** We periodically review each property and any related goodwill for possible impairment. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. We perform a Level 3 analysis of fair value, using a discounted cash flow analysis to estimate the fair value of our properties taking into account each property’s expected cash flow from operations, holding period and proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. Our judgment is required in determining the discount rate applied to estimated cash flows, growth rate of the properties, operating income of the properties, the need for capital expenditures, as well as specific market and economic conditions.

We account for goodwill in accordance with the Intangibles—Goodwill and Other Topic of the FASB ASC, which states that goodwill has an indefinite useful life that should not be amortized but should be reviewed annually for impairment, or more frequently if events or changes in circumstances indicate that goodwill might be impaired, as well as the Fair Value Measurements and Disclosures Topic of the FASB ASC for financial and nonfinancial assets and liabilities, which establishes a framework for measuring fair value and expands disclosures about fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The review of any potential goodwill impairment requires estimates of fair value for our properties that have goodwill arising from unallocated acquisition costs. These estimates of fair value are prepared using Level 3 measurements.

» ***Acquisition related assets and liabilities.*** Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment, intangible assets and capital lease obligations that are assumed as part of the acquisition of a leasehold interest. During 2011, 2012 and 2013, we used all available information to make these fair value determinations, and engaged an independent valuation specialist to assist in the fair value determination of the long-lived assets acquired in our purchases of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture, the outside 50.0% equity interests in the BuyEfficient joint venture, the JW Marriott New Orleans, the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco. Due to the inherent subjectivity in determining the estimated fair value of long-lived assets, we believe that the recording of acquired assets and liabilities is a critical accounting policy.

» *Depreciation and amortization expense.* Depreciation expense is based on the estimated useful life of our assets. The life of the assets is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish our hotels, as well as specific market and economic conditions. Hotel properties and other investments are depreciated using the straight-line method over estimated useful lives primarily ranging from five to 35 years for buildings and improvements and three to 12 years for furniture, fixtures and equipment. While we believe our estimates are reasonable, a change in the estimated lives could affect depreciation expense and net income or the gain or loss on the sale of any of our hotels. We have not changed the estimated useful lives of any of our assets during the periods discussed.

NEW ACCOUNTING STANDARDS AND ACCOUNTING CHANGES

In December 2011, the FASB issued Accounting Standards Update No. 2011-10, “*Property, Plant and Equipment: Derecognition of in Substance Real Estate—a Scope Clarification*” (“ASU No. 2011-10”). Under the amendments in ASU No. 2011-10, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s non-recourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related non-recourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary’s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The adoption of ASU No. 2011-10 in the first quarter of 2013 did not have any effect on our financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

To the extent that we incur debt with variable interest rates, our future income, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. We have no derivative financial instruments held for trading purposes. We use derivative financial instruments to manage, or hedge, interest rate risks.

As of December 31, 2013, 70.7% of our debt obligations are fixed in nature, which largely mitigates the effect of changes in interest rates on our cash interest payments. If market rates of interest on our variable rate debt increase or decrease by 100 basis points, interest expense would increase or decrease, respectively, our future earnings and cash flows by approximately \$4.4 million based on the variable rates at December 31, 2013. This increase or decrease in interest expense would increase or decrease, respectively, our future earnings by \$3.8 million, after adjusting for the non-controlling interest in the Hilton San Diego Bayfront based on the variable rates at December 31, 2013. However, increases and decreases in LIBOR rates are sometimes correlated with increases and decreases in lodging operations, which may mean that any increases in our interest expense due to higher variable rates may coincide with increases in our revenue due to higher lodging demand.

CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) have concluded that as of the end of the period covered by this Annual Report our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the SEC and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework (1992 Framework). Based on its evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2013.

Ernst & Young LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report and, as part of its audit, has issued its report, included herein at page 60, on the effectiveness of our internal control over financial reporting.

(c) Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Sunstone Hotel Investors, Inc.

We have audited Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) (the COSO criteria). Sunstone Hotel Investors, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sunstone Hotel Investors, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sunstone Hotel Investors, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2013 of Sunstone Hotel Investors, Inc. and our report dated February 25, 2014 expressed an unqualified opinion thereon.

Irvine, California
February 25, 2014

Ernst + Young LLP

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Sunstone Hotel Investors, Inc.

We have audited the accompanying consolidated balance sheets of Sunstone Hotel Investors, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sunstone Hotel Investors, Inc. at December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) and our report dated February 25, 2014 expressed an unqualified opinion thereon.

Irvine, California
February 25, 2014

Ernst + Young LLP

CONSOLIDATED BALANCE SHEETS

	December 31, 2013	December 31, 2012
<i>(In thousands, except share data)</i>		
ASSETS		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 104,363	\$ 157,217
Restricted cash	89,306	78,394
Accounts receivable, net	29,941	27,498
Inventories	1,464	1,377
Prepaid expenses	12,612	10,739
Assets held for sale, net	—	132,335
Total current assets	237,686	407,560
Investment in hotel properties, net	3,231,382	2,681,877
Deferred financing fees, net	9,219	11,931
Goodwill	9,405	9,405
Other assets, net	21,106	25,902
Total assets	<u>\$3,508,798</u>	<u>\$3,136,675</u>
LIABILITIES AND EQUITY		
<i>Current liabilities:</i>		
Accounts payable and accrued expenses	\$ 25,116	\$ 22,646
Accrued payroll and employee benefits	29,933	26,738
Dividends payable	11,443	7,437
Other current liabilities	30,288	30,963
Current portion of notes payable	23,289	76,723
Notes payable of assets held for sale	—	27,270
Liabilities of assets held for sale	—	8,228
Total current liabilities	120,069	200,005
Notes payable, less current portion	1,380,786	1,286,666
Capital lease obligations, less current portion	15,586	15,621
Other liabilities	39,958	15,070
Total liabilities	1,556,399	1,517,362
Commitments and contingencies <i>(Note 14)</i>		
Preferred stock, Series C Cumulative Convertible Redeemable Preferred Stock, \$0.01 par value, 4,102,564 shares authorized, zero shares issued and outstanding at December 31, 2013 and 4,102,564 shares issued and outstanding at December 31, 2012, liquidation preference of \$24.375 per share	—	100,000
<i>Equity:</i>		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized.		
8.0% Series A Cumulative Redeemable Preferred Stock, zero shares issued and outstanding at December 31, 2013 and 7,050,000 shares issued and outstanding at December 31, 2012, stated at liquidation preference of \$25.00 per share	—	176,250
8.0% Series D Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at December 31, 2013 and 2012, stated at liquidation preference of \$25.00 per share	115,000	115,000
Common stock, \$0.01 par value, 500,000,000 shares authorized, 180,858,699 shares issued and outstanding at December 31, 2013 and 135,237,438 shares issued and outstanding at December 31, 2012	1,809	1,352
Additional paid in capital	2,068,721	1,493,397
Retained earnings	224,364	158,376
Cumulative dividends	(511,444)	(475,144)
Accumulated other comprehensive loss	—	(5,335)
Total stockholders' equity	1,898,450	1,463,896
Non-controlling interest in consolidated joint ventures	53,949	55,417
Total equity	<u>1,952,399</u>	<u>1,519,313</u>
Total liabilities and equity	<u>\$3,508,798</u>	<u>\$3,136,675</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
<i>(In thousands, except per share data)</i>			
REVENUES			
Room	\$653,955	\$576,146	\$501,183
Food and beverage	213,346	200,810	175,103
Other operating	56,523	52,128	45,508
Total revenues	923,824	829,084	721,794
OPERATING EXPENSES			
Room	170,361	147,932	128,225
Food and beverage	147,713	139,106	126,139
Other operating	16,819	16,162	14,004
Advertising and promotion	47,306	42,474	37,226
Repairs and maintenance	35,884	32,042	29,067
Utilities	27,006	25,596	25,537
Franchise costs	32,932	30,067	25,595
Property tax, ground lease and insurance	79,004	66,830	58,010
Property general and administrative	103,454	94,642	85,293
Corporate overhead	26,671	24,316	25,453
Depreciation and amortization	137,476	130,907	113,708
Impairment loss	—	—	10,862
Total operating expenses	824,626	750,074	679,119
Operating income	99,198	79,010	42,675
Equity in earnings of unconsolidated joint ventures	—	—	21
Interest and other income	2,821	297	3,115
Interest expense	(72,239)	(76,821)	(74,195)
Loss on extinguishment of debt	(44)	(191)	—
Gain on remeasurement of equity interests	—	—	69,230
Income before income taxes and discontinued operations	29,736	2,295	40,846
Income tax provision	(8,145)	(1,148)	—
Income from continuing operations	21,591	1,147	40,846
Income from discontinued operations	48,410	48,410	40,453
NET INCOME	70,001	49,557	81,299
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)
Distributions to non-controlling interest	(32)	(31)	(30)
Dividends paid on unvested restricted stock compensation	(201)	—	—
Preferred stock dividends and redemption charges	(19,013)	(29,748)	(27,321)
Undistributed income allocated to unvested restricted stock compensation	(235)	(203)	(636)
INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 46,507	\$ 17,814	\$ 53,000
Basic and diluted per share amounts:			
Income (loss) from continuing operations available (attributable) to common stockholders	\$ (0.01)	\$ (0.24)	\$ 0.11
Income from discontinued operations	0.30	0.38	0.34
Basic and diluted income available to common stockholders per common share	\$ 0.29	\$ 0.14	\$ 0.45
Basic and diluted weighted average common shares outstanding	161,784	127,027	117,206

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
<i>(In thousands)</i>			
Net income	\$ 70,001	\$ 49,557	\$ 81,299
Pension liability adjustment	—	(419)	(1,779)
Reclassification to income from discontinued operations	5,335	—	—
Comprehensive income	75,336	49,138	79,520
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)
Distributions to non-controlling interest	(32)	(31)	(30)
Dividends paid on unvested restricted stock compensation	(201)	—	—
Preferred stock dividends and redemption charges	(19,013)	(29,748)	(27,321)
Undistributed comprehensive income allocated to unvested restricted stock compensation	(235)	(203)	(636)
Comprehensive income available to common stockholders	\$ 51,842	\$ 17,395	\$ 51,221

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF EQUITY

	Preferred Stock						Additional Paid in Capital	Retained Earnings	Cumulative Dividends	Accumulated Other Compre- hensive Loss	Non- Controlling Interest in Consolidated Joint Ventures	Total
	Series A		Series D		Common Stock							
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount						
(In thousands, except per share data)												
Balance at December 31, 2010	7,050,000	\$ 176,250	—	\$ —	116,950,504	\$1,170	\$1,313,498	\$ 29,593	\$(418,075)	\$(3,137)	\$ —	\$1,099,299
Net proceeds from sale of preferred stock	—	—	4,600,000	115,000	—	—	(4,052)	—	—	—	—	110,948
Vesting of restricted common stock	—	—	—	—	314,586	3	3,120	—	—	—	—	3,123
Non-controlling interest assumed at acquisition	—	—	—	—	—	—	—	—	—	—	61,067	61,067
Distributions to non-controlling interests	—	—	—	—	—	—	—	—	—	—	(1,342)	(1,342)
Series A preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(14,100)	—	—	(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share	—	—	—	—	—	—	—	—	(6,448)	—	—	(6,448)
Series D preferred dividends and dividends payable at \$1.472222 per share	—	—	—	—	—	—	—	—	(6,773)	—	—	(6,773)
Net income	—	—	—	—	—	—	—	80,987	—	—	312	81,299
Pension liability adjustment	—	—	—	—	—	—	—	—	—	(1,779)	—	(1,779)
Balance at December 31, 2011	7,050,000	176,250	4,600,000	115,000	117,265,090	1,173	1,312,566	110,580	(445,396)	(4,916)	60,037	1,325,294
Net proceeds from sale of common stock	—	—	—	—	12,143,273	121	126,058	—	—	—	—	126,179
Issuance of common stock in connection with hotel acquisitions, net	—	—	—	—	5,454,164	55	51,008	—	—	—	—	51,063
Vesting of restricted common stock	—	—	—	—	374,911	3	3,765	—	—	—	—	3,768
Distributions to non-controlling interests	—	—	—	—	—	—	—	—	—	—	(6,381)	(6,381)
Series A preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(14,100)	—	—	(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share	—	—	—	—	—	—	—	—	(6,448)	—	—	(6,448)
Series D preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(9,200)	—	—	(9,200)
Net income	—	—	—	—	—	—	—	47,796	—	—	1,761	49,557
Pension liability adjustment	—	—	—	—	—	—	—	—	—	(419)	—	(419)
Balance at December 31, 2012	7,050,000	176,250	4,600,000	115,000	135,237,438	1,352	1,493,397	158,376	(475,144)	(5,335)	55,417	1,519,313
Net proceeds from sale of common stock	—	—	—	—	45,300,000	453	565,307	—	—	—	—	565,760
Vesting of restricted common stock	—	—	—	—	321,261	4	5,247	—	—	—	—	5,251
Redemptions of Series A and Series C preferred stock	(7,050,000)	(176,250)	—	—	—	—	4,770	—	(4,770)	—	—	(176,250)
Distributions to non-controlling interests	—	—	—	—	—	—	—	—	—	—	(5,481)	(5,481)
Common stock dividends and dividends payable at \$0.10 per share	—	—	—	—	—	—	—	—	(17,287)	—	—	(17,287)
Series A preferred dividends at \$0.50 per share through redemption date	—	—	—	—	—	—	—	—	(2,350)	—	—	(2,350)
Series C preferred dividends at \$0.786 per share through redemption date	—	—	—	—	—	—	—	—	(2,693)	—	—	(2,693)
Series D preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(9,200)	—	—	(9,200)
Net income	—	—	—	—	—	—	—	65,988	—	—	4,013	70,001
Pension liability reclassification	—	—	—	—	—	—	—	—	—	5,335	—	5,335
Balance at December 31, 2013	—	\$ —	4,600,000	\$115,000	180,858,699	\$1,809	\$2,068,721	\$224,364	\$(511,444)	\$ —	\$53,949	\$1,952,399

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
<i>(In thousands)</i>			
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 70,001	\$ 49,557	\$ 81,299
Adjustments to reconcile net income to net cash provided by operating activities:			
Bad debt expense	294	410	630
Gain on sales of hotel properties and other assets, net	(51,632)	(38,274)	(14,995)
(Gain) loss on extinguishment of debt	3,159	191	(18,145)
Gain on remeasurement of equity interests	—	—	(69,230)
(Gain) loss on derivatives, net	(525)	406	2,655
Depreciation	131,793	128,206	118,834
Amortization of franchise fees and other intangibles	10,115	20,198	15,069
Amortization and write-off of deferred financing fees	2,957	3,952	3,305
Amortization of loan discounts	3	1,058	1,062
Amortization of deferred stock compensation	4,858	3,466	2,745
Impairment loss	—	—	12,357
Equity in earnings of unconsolidated joint ventures	—	—	(21)
Changes in operating assets and liabilities:			
Restricted cash	(11,688)	(249)	13,322
Accounts receivable	1,740	4,587	(4,123)
Inventories	1,524	(271)	(316)
Prepaid expenses and other assets	2,724	(7,906)	2,558
Accounts payable and other liabilities	7,001	2,279	5,422
Accrued payroll and employee benefits	(1,637)	2,983	2,020
Discontinued operations	432	903	730
Net cash provided by operating activities	171,119	171,496	155,178
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of hotel properties and other assets	195,628	46,367	44,576
Restricted cash—replacement reserve	1,272	(10,743)	(8,143)
Proceeds received from sale of note receivable	—	—	79,194
Acquisitions of hotel properties and other assets	(450,544)	(120,003)	(263,264)
Renovations and additions to hotel properties and other assets	(117,694)	(109,321)	(100,400)
Payments for interest rate derivatives	(12)	—	(1,082)
Net cash used in investing activities	(371,350)	(193,700)	(249,119)

(continued)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
<i>(In thousands)</i>			
CASH FLOWS FROM FINANCING ACTIVITIES			
Redemptions of preferred stock	\$(276,250)	\$ —	\$ —
Proceeds from preferred stock offering	—	—	115,000
Payment of preferred stock offering costs	—	—	(4,052)
Proceeds from common stock offerings	566,451	126,533	—
Payment of common stock offering costs	(691)	(451)	—
Proceeds from notes payable and credit facility	35,750	15,000	460,000
Payments on notes payable and credit facility	(141,527)	(73,328)	(568,308)
Payments for costs related to extinguishment of notes payable	(3,108)	(70)	—
Payments of deferred financing costs	(243)	(1,332)	(9,049)
Dividends paid	(27,524)	(29,748)	(25,021)
Distributions to non-controlling interests	(5,481)	(6,381)	(1,342)
Net cash provided by (used in) financing activities	147,377	30,223	(32,772)
Net (decrease) increase in cash and cash equivalents	(52,854)	8,019	(126,713)
Cash and cash equivalents, beginning of year	157,217	149,198	275,911
Cash and cash equivalents, end of year	\$ 104,363	\$ 157,217	\$ 149,198
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid for interest	\$ 71,563	\$ 78,234	\$ 76,015
Cash paid for income taxes	\$ 7,143	\$ 1,023	\$ —
NONCASH INVESTING ACTIVITY			
Accounts payable related to renovations and additions to hotel properties and other real estate	\$ 7,842	\$ 5,897	\$ 8,304
Amortization of deferred stock compensation—construction activities	\$ 393	\$ 302	\$ 376
Amortization of deferred stock compensation—unconsolidated joint venture	\$ —	\$ —	\$ 2
NONCASH FINANCING ACTIVITY			
Issuance of note receivable	\$ —	\$ —	\$ 90,000
Issuance of common stock in connection with acquisition of hotel property	\$ —	\$ 51,160	\$ —
Assignment of debt in connection with dispositions of hotel properties	\$ —	\$(122,622)	\$ (11,532)
Assumption of debt in connection with acquisitions of hotel properties	\$ 119,190	\$ —	\$ 545,952
Dividends payable	\$ 11,443	\$ 7,437	\$ 7,437

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Sunstone Hotel Investors, Inc. (the “Company”) was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company, through its 100% controlling interest in Sunstone Hotel Partnership, LLC (the “Operating Partnership”), of which the Company is the sole managing member, and the subsidiaries of the Operating Partnership, including Sunstone Hotel TRS Lessee, Inc. (the “TRS Lessee”) and its subsidiaries, is currently engaged in acquiring, owning, asset managing and renovating hotel properties. The Company may also sell certain hotel properties from time to time. The Company operates as a real estate investment trust (“REIT”) for federal income tax purposes.

As a REIT, certain tax laws limit the amount of “non-qualifying” income the Company can earn, including income derived directly from the operation of hotels. As a result, the Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company’s hotels. As of December 31, 2013, the Company had interests in 29 hotels (the “29 hotels”) held for investment, and the Company’s third-party managers included the following:

	Number of Hotels
Subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”)	10
Interstate Hotels & Resorts, Inc.	6
Highgate Hotels L.P. and an affiliate	4
Davidson Hotels & Resorts	2
Hilton Worldwide	2
Hyatt Corporation	2
Crestline Hotels & Resorts	1
Dimension Development Company	1
Fairmont Hotels & Resorts (U.S.)	1
Total hotels held for investment	29

In addition, the Company owns BuyEfficient, LLC (“BuyEfficient”), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements as of December 31, 2013 and 2012, and for the years ended December 31, 2013, 2012 and 2011, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company consolidates subsidiaries when it has the ability to direct the activities that most significantly impact the economic performance of the entity. The Company also evaluates its subsidiaries to determine if they should be considered variable interest entities (“VIEs”). Typically, the entity that has the power to direct the activities that most significantly impact economic performance would consolidate the VIE. The Company considers an entity a VIE if equity investors own an interest therein that does not have the characteristics of a controlling financial interest or if such investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. In accordance with the Consolidation Topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), the Company reviewed its subsidiaries to determine if (i) they should be considered VIEs, and (ii) whether the Company should change its consolidation determination based on changes in the characteristics of these entities. Based on its review, the Company determined that all of its subsidiaries were properly consolidated as of December 31, 2013 and 2012, and for the years ended December 31, 2013, 2012 and 2011.

Non-controlling interests at both December 31, 2013 and 2012 represent the outside equity interests in various consolidated affiliates of the Company.

The Company has evaluated subsequent events through the date of issuance of these financial statements.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Reporting Periods

The results the Company reports in its consolidated statements of operations are based on results reported to the Company by its hotel managers. Prior to 2013, Marriott used a fiscal year ending on the Friday closest to December 31 and reported twelve weeks of operations each for the first three quarters of the year, and sixteen or seventeen weeks of operations for the fourth quarter of the year. Beginning in 2013, Marriott switched its reporting to a standard monthly calendar; however, Marriott's 2013 calendar contains an additional three days, December 29, 2012 through December 31, 2012. The Company and its other hotel managers use a standard monthly calendar to report their financial information. The Company has elected to adopt quarterly close periods of March 31, June 30 and September 30, and an annual year end of December 31. As a result, the Company's 2013, 2012 and 2011 results of operations for the Marriott-managed hotels are reported using the following reporting periods:

	2013	2012	Number of Days in 2013 Versus 2012 ⁽¹⁾		Number of Days in 2013 Versus 2011
First quarter	December 29–March 31	December 31–March 23	8 days	January 1–March 25	9 days
Second quarter	April 1–June 30	March 24–June 15	7 days	March 26–June 17	7 days
Third quarter	July 1–September 30	June 16–September 7	8 days	June 18–September 9	8 days
Fourth quarter	October 1–December 31	September 8–December 28	(20 days)	September 10–December 30	(20 days)
Full year	December 29, 2012–December 31, 2013	December 31, 2011–December 28, 2012	3 days	January 1, 2011–December 30, 2011	4 days

(1) Number of days in 2013 versus 2012 does not include the leap day, February 29, 2012, as this extra day was not caused by the Marriott calendar conversion.

The Company estimates that Marriott's fiscal calendar had the following effects on the Company's total revenue and net income based on the average daily revenues and income generated by its Marriott hotels during the years ended December 31, 2013, 2012 and 2011 as follows (in thousands):

	2013 ⁽¹⁾	2012 ⁽¹⁾	2011 ⁽¹⁾
Total revenue	\$2,300	\$(1,251)	\$(1,048)
Net income	\$ 672	\$ (328)	\$ (273)

(1) Increases (decreases) to total revenue and net income based on the Marriott fiscal calendars for 2013 (368 days), 2012 (364 days) and 2011 (364 days) versus a standard 365 day year.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and in various bank accounts plus all short-term investments with an original maturity of three months or less.

The Company maintains cash and cash equivalents and certain other financial instruments with various financial institutions. These financial institutions are located throughout the country and the Company's policy is designed to limit exposure to any one institution. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company's investment strategy. At December 31, 2013 and 2012, the Company had amounts in banks that were in excess of federally insured amounts.

Restricted Cash

Restricted cash is comprised of reserve accounts for debt service, interest reserves, capital replacements, ground leases, and property taxes. These restricted funds are subject to supervision and disbursement approval by certain of the Company's lenders and/or hotel managers.

Accounts Receivable

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes, among other things, receivables from customers who utilize purchase volume rebates through BuyEfficient, as well as tenants who lease space in the Company's hotels. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company's accounts receivable includes an allowance for doubtful accounts of \$0.2 million at both December 31, 2013 and 2012.

Inventories

Inventories, consisting primarily of food and beverages at the hotels, are stated at the lower of cost or market, with cost determined on a method that approximates first-in, first-out basis.

Acquisitions of Hotel Properties and Other Entities

Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment, intangible assets and any capital lease obligations that are assumed as part of the acquisition of a leasehold interest. During 2013, 2012 and 2011, the Company used all available information to make these fair value determinations, and engaged independent valuation specialists to assist in the fair value determination of the long-lived assets acquired and the liabilities assumed in the Company's purchases of the Hilton New Orleans St. Charles, the Boston Park Plaza, the Hyatt Regency San Francisco, the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture, the outside 50.0% equity interests in the BuyEfficient joint venture, the JW Marriott New Orleans and the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. Due to the inherent subjectivity in determining the estimated fair value of long-lived assets, the Company believes that the recording of acquired assets and liabilities is a critical accounting policy.

Investments in Hotel Properties and Other Assets

Hotel properties and other investments are depreciated using the straight-line method over estimated useful lives primarily ranging from five to 35 years for buildings and improvements and three to 12 years for furniture, fixtures and equipment. Intangible assets are amortized using the straight-line method over their estimated useful life or over the length of the related agreement, whichever is shorter.

The Company's investment in hotel properties, net also includes initial franchise fees which are recorded at cost and amortized using the straight-line method over the lives of the franchise agreements ranging from 14 to 27 years. All other franchise fees that are based on the Company's results of operations are expensed as incurred.

The Company follows the requirements of the Property, Plant and Equipment Topic of the FASB ASC, which requires impairment losses to be recorded on long-lived assets to be held and used by the Company when indicators of impairment are present and the future undiscounted net cash flows expected to be generated by those assets are less than the assets' carrying amount. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment is recognized. The impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. In computing fair value, the Company uses a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets, taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. In both 2013 and 2012, the Company did not identify any properties or other assets with indicators of impairment. In 2011, the Company did not recognize any impairments on its hotel properties, but did recognize a \$1.5 million impairment on its commercial laundry facility located in Salt Lake City, Utah based on proceeds received from its sale in July 2011. Based on the Company's review, management believes that there were no other impairments on its long-lived assets, and that the carrying values of its hotel properties and other assets are recoverable at December 31, 2013.

Fair value represents the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than a forced or liquidation sale. The estimation process involved in determining if assets have been impaired and in the determination of fair value is inherently uncertain because it requires estimates of current market yields as well as future events and conditions. Such future events and conditions include economic and market conditions, as well as the availability of suitable financing. The realization of the Company's investment in hotel properties and other real estate is dependent upon future uncertain events and conditions and, accordingly, the actual timing and amounts realized by the Company may be materially different from their estimated fair values.

Assets Held for Sale

The Company considers a hotel or other asset held for sale if it is probable that the sale will be completed within twelve months, among other requirements. A sale is determined to be probable once the buyer completes its due diligence of the asset, there is an executed purchase and sale agreement between the Company and the buyer, and the Company has received a substantial non-refundable deposit. Depreciation ceases when a property is held for sale. Should an impairment loss be required for assets held for sale, the related assets are adjusted to their estimated fair values, less costs to sell. Once a hotel or other asset is designated as held for sale, the hotel or other asset is included in discontinued operations, and operating results are removed from income from continuing operations and reported as discontinued operations. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations. As of December 31, 2013, the Company had no hotels or other assets held for sale. As of December 31, 2012, the Company classified four hotels and a commercial laundry facility as held for sale due to their sale in January 2013.

Deferred Financing Fees

Deferred financing fees consist of loan fees and other financing costs related to the Company's outstanding indebtedness and credit facility commitments, and are amortized to interest expense over the terms of the related debt or commitment. Upon repayment or refinancing of the underlying debt, any related unamortized deferred financing fee is charged to interest expense. Upon any loan modification, any related unamortized deferred financing fee is amortized over the remaining terms of the modified loan.

During 2013, the Company paid deferred financing fees of \$0.2 million related to the assumption of a mortgage in connection with the acquisition of the Boston Park Plaza and the purchase of an interest rate cap derivative agreement on the Hilton San Diego Bayfront mortgage. During 2012, the Company incurred and paid deferred financing fees of \$1.3 million related to an amendment of its credit facility. During 2011, approximately \$9.0 million of deferred financing fees were incurred and paid related to the Company's assumptions of debt on the Doubletree Guest Suites Times Square and the JW Marriott New Orleans in connection with the acquisitions of these hotels, the issuance of a note payable to the Company's Hilton San Diego Bayfront joint venture, the refinancing of debt secured by the Doubletree Guest Suites Times Square, as well as costs related to the Company's credit facility.

During 2012, the Company wrote-off \$0.2 million in deferred financing fees related to its sales of the Marriott Del Mar, the Doubletree Guest Suites Minneapolis, the Hilton Del Mar and the Marriott Troy, along with its repayment of the non-recourse mortgage secured by the Renaissance Long Beach. During 2011, the Company wrote-off \$0.1 million in deferred financing fees related to its sale of the Valley River Inn, along with its refinancing of debt secured by the Doubletree Guest Suites Times Square.

Total amortization and write-off of deferred financing fees for 2013, 2012 and 2011 was as follows (in thousands):

	2013	2012	2011
Continuing operations:			
Amortization of deferred financing fees	\$2,955	\$3,690	\$3,138
Write-off of deferred financing fees	—	3	21
Total deferred financing fees—continuing operations	2,955	3,693	3,159
Discontinued operations:			
Amortization of deferred financing fees	2	74	104
Write-off of deferred financing fees	—	185	42
Total deferred financing fees—discontinued operations	2	259	146
Total amortization and write-off of deferred financing fees	\$2,957	\$3,952	\$3,305

Goodwill and BuyEfficient Intangibles

The Company follows the requirements of the Intangibles—Goodwill and Other Topic of the FASB ASC, which states that goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests. As a result, the carrying value of goodwill allocated to hotel properties and other assets is reviewed at least annually for impairment. In addition, when facts and circumstances suggest that the Company's goodwill may be impaired, an interim evaluation of goodwill is prepared. Such review entails comparing the carrying value of the individual hotel property or other asset (the reporting unit) including the allocated goodwill to the fair value determined for that reporting unit (see Fair Value of Financial Instruments for detail on the Company's valuation methodology). If the aggregate carrying value of the reporting unit exceeds the fair value, the goodwill of the reporting unit is impaired to the extent of the difference between the fair value and the aggregate carrying value, not to exceed the carrying amount of the allocated goodwill. The Company's annual impairment evaluation is performed each year as of December 31.

During 2011, the Company recorded goodwill of \$8.4 million related to its purchase of the outside equity interest in its BuyEfficient joint venture.

Based on its annual impairment evaluations for both 2013 and 2012, the Company determined that no adjustments to its goodwill were required.

The Company's other assets, net includes BuyEfficient's intangibles related to certain trademarks, customer and supplier relationships and intellectual property related to internally developed software. These intangibles are amortized using the straight-line method over their useful lives ranging between seven to 20 years.

Property and Equipment

Property and equipment is stated on the cost basis and includes computer equipment and other corporate office equipment and furniture. Property and equipment is depreciated on a straight-line basis over the estimated useful lives ranging from three to 12 years. The Company includes property and equipment, net of related accumulated depreciation, in its other assets, net on the accompanying consolidated balance sheets.

Fair Value of Financial Instruments

As of December 31, 2013 and 2012, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

The Company follows the requirements of the Fair Value Measurements and Disclosures Topic of the FASB ASC, which establishes a framework for measuring fair value and disclosing fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

As discussed in Note 6, during 2011, the Company entered into interest rate protection agreements to manage, or hedge, interest rate risks in conjunction with its acquisitions of the outside equity interests in the Doubletree Guest Suites Times Square, the JW Marriott New Orleans, a majority interest in the entity that owns the Hilton San Diego Bayfront and the refinancing of the debt secured by the Doubletree Guest Suites Times Square. The Company records interest rate protection agreements on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in the consolidated statements of operations as they are not designated as hedges. In accordance with the Fair Value Measurements and Disclosure Topic of the FASB ASC, the Company estimates the fair value of its interest rate protection agreements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. The Company has valued the derivative interest rate cap agreements related to the Doubletree Guest Suites Times Square and the Hilton San Diego Bayfront using Level 2 measurements as an asset of \$16,000 and \$48,000 as of December 31, 2013 and 2012, respectively. The interest rate cap agreements are included in other assets, net, in the accompanying consolidated balance sheets. The Company has valued the derivative interest rate swap agreement related to the JW Marriott New Orleans using Level 2 measurements as a liability of \$1.1 million and \$1.6 million as of December 31, 2013 and 2012, respectively. The interest rate swap agreement is included in other liabilities in the accompanying consolidated balance sheets.

On an annual basis and periodically when indicators of impairment exist, the Company analyzes the carrying values of its hotel properties and other assets using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. The Company did not identify any properties or other assets with indicators of impairment during either 2013 or 2012. In 2011, the Company recognized a \$1.5 million impairment on its commercial laundry facility located in Salt Lake City, Utah based on proceeds received from its sale in July 2011. Also in 2011, the Company recognized a \$10.9 million impairment on the \$90.0 million mortgage-secured purchase money loan received from the buyer of the Royal Palm Miami Beach (the "Royal Palm note") due to its sale in October 2011.

On an annual basis and periodically when indicators of impairment exist, the Company also analyzes the carrying value of its goodwill using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its reporting units. The Company did not identify any properties with indicators of goodwill impairment in 2013, 2012 or 2011.

As of December 31, 2013 and 2012, 70.7% and 69.6%, respectively, of the Company's outstanding debt included in continuing operations had fixed interest rates, including the effect of an interest rate swap agreement. The Company's carrying value of its debt secured by properties not classified as discontinued operations totaled \$1.4 billion as of both December 31, 2013 and 2012. Using Level 3 measurements, including the Company's weighted average cost of capital ranging from 5.0% to 5.5% the Company estimates that the fair market value of its debt included in continuing operations totaled \$1.4 billion and \$1.3 billion as of December 31, 2013 and 2012, respectively.

The following table presents the Company's assets measured at fair value on a recurring and non-recurring basis at December 31, 2013 and 2012 (in thousands):

	Total	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
DECEMBER 31, 2013:				
Interest rate cap derivative agreements	\$ 16	\$—	\$ 16	\$—
Life insurance policy ⁽¹⁾	1,385	—	1,385	—
Total assets at December 31, 2013	<u>\$1,401</u>	<u>\$—</u>	<u>\$1,401</u>	<u>\$—</u>
DECEMBER 31, 2012:				
Interest rate cap derivative agreements	\$ 48	\$—	\$ 48	\$—
Life insurance policy ⁽¹⁾	1,494	—	1,494	—
Total assets at December 31, 2012	<u>\$1,542</u>	<u>\$—</u>	<u>\$1,542</u>	<u>\$—</u>

(1) Includes the split life insurance policy for the Company's former Chairman and Chief Executive Officer, Robert A. Alter, which the Company has valued using Level 2 measurements. These amounts are included in other assets, net on the accompanying consolidated balance sheets, and will be used to reimburse the Company for payments made to Mr. Alter associated with a retirement benefit agreement.

The following table presents the Company's liabilities measured at fair value on a recurring and non-recurring basis at December 31, 2013 and 2012 (in thousands):

	Total	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
DECEMBER 31, 2013:				
Interest rate swap derivative agreement	\$1,066	\$—	\$1,066	\$—
Retirement benefit agreement ⁽¹⁾	1,385	—	1,385	—
Total liabilities at December 31, 2013	<u>\$2,451</u>	<u>\$—</u>	<u>\$2,451</u>	<u>\$—</u>
DECEMBER 31, 2012:				
Interest rate swap derivative agreement	\$1,636	\$—	\$1,636	\$—
Retirement benefit agreement ⁽¹⁾	1,494	—	1,494	—
Total liabilities at December 31, 2012	<u>\$3,130</u>	<u>\$—</u>	<u>\$3,130</u>	<u>\$—</u>

(1) Includes the retirement benefit agreement for the Company's former Chairman and Chief Executive Officer, Robert A. Alter, which the Company has valued using Level 2 measurements. The agreement calls for the balance of the retirement benefit agreement to be paid out to Mr. Alter in 10 annual installments, beginning in 2011. As such, the Company paid Mr. Alter a total of \$0.6 million through December 31, 2013, which was reimbursed to the Company using funds from the split life insurance policy. These amounts are included in accrued payroll and employee benefits in the accompanying consolidated balance sheets.

The following table presents the gains and impairment charges included in earnings as a result of applying Level 3 measurements for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	2013	2012	2011
Gains:			
Investment in unconsolidated joint ventures ⁽¹⁾	<u>\$—</u>	<u>\$—</u>	<u>\$ 69,230</u>
Impairment charges:			
Other assets, net ⁽²⁾	<u>—</u>	<u>—</u>	<u>(10,862)</u>
Assets held for sale, net ⁽³⁾	<u>—</u>	<u>—</u>	<u>(1,495)</u>
Total impairment charges	<u>—</u>	<u>—</u>	<u>(12,357)</u>
Total Level 3 measurement charges included in earnings ⁽⁴⁾	<u>\$—</u>	<u>\$—</u>	<u>\$ 56,873</u>

(1) Includes the gains recorded by the Company on the remeasurements of the Company's equity interests in its Doubletree Guest Suites Times Square and BuyEfficient joint ventures.

(2) Includes the impairment loss recorded by the Company on the Royal Palm note due to the note's sale in October 2011.

(3) Includes the \$1.5 million impairment loss recorded on a commercial laundry facility in Salt Lake City, Utah which the Company sold in July 2011.

(4) There were no transfers into or out of Level 3 of the fair value hierarchy during either of the years ended December 31, 2013, 2012 or 2011.

Revenue Recognition

Room revenue and food and beverage revenue are recognized as earned, which is generally defined as the date upon which a guest occupies a room and/or utilizes the hotel's services. Additionally, some of the Company's hotel rooms are booked through independent internet travel intermediaries. Revenue for these rooms is booked at the price the Company sold the room to the independent internet travel intermediary less any discount or commission paid.

Other operating revenue consists of revenue derived from incidental hotel services such as telephone, transportation, parking, spa, entertainment and other guest services, along with sublease revenues relating to the restaurants and retail shops. Other operating revenue also includes revenue generated by BuyEfficient. Revenues from incidental hotel services and BuyEfficient are recognized in the period the related services are provided or the revenue is earned.

Advertising and Promotion Costs

Advertising and promotion costs are expensed when incurred. Advertising and promotion costs represent the expense for advertising and reservation systems under the terms of the hotel franchise and brand management agreements and general and administrative expenses that are directly attributable to advertising and promotions.

Stock Based Compensation

Compensation expense related to awards of restricted shares and performance shares are measured at fair value on the date of grant and amortized over the relevant requisite service period or derived service period.

Income Taxes

The Company has elected to be treated as a REIT pursuant to the Internal Revenue Code, as amended (the “Code”). Management believes that the Company has qualified and intends to continue to qualify as a REIT. Therefore, the Company is permitted to deduct distributions paid to its stockholders, eliminating the federal taxation of income represented by such distributions at the company level. REITs are subject to a number of organizational and operational requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) on taxable income at regular corporate tax rates.

With respect to taxable subsidiaries, the Company accounts for income taxes in accordance with the Income Taxes Topic of the FASB ASC. Accordingly, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse.

The Income Taxes Topic of the FASB ASC addresses how uncertain tax positions should be recognized, measured, presented, and disclosed in the financial statements. The guidance requires the accounting and disclosure of tax positions taken or expected to be taken in the course of preparing the Company’s tax returns to determine whether the tax positions are “more-likely-than-not” to be sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense in the current year. The Company’s management is required to analyze all open tax years, as defined by the statute of limitations, for all major jurisdictions, which includes federal and certain states.

Non-Controlling Interests

The Company’s financial statements include entities in which the Company has a controlling financial interest. Non-controlling interest is the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. Such non-controlling interests are reported on the consolidated balance sheets within equity, separately from the Company’s equity. On the consolidated statements of operations, revenues, expenses and net income or loss from less-than-wholly-owned subsidiaries are reported at the consolidated amounts, including both the amounts attributable to the Company and non-controlling interests. Income or loss is allocated to non-controlling interests based on their weighted average ownership percentage for the applicable period. The consolidated statements of equity include beginning balances, activity for the period and ending balances for each component of shareholders’ equity, non-controlling interests and total equity.

At December 31, 2013, 2012 and 2011, the non-controlling interest reported in the Company’s financial statements includes Hilton Worldwide’s 25.0% ownership in the Hilton San Diego Bayfront. In addition, the Company is the sole common stockholder of the captive REIT that owns the Doubletree Guest Suites Times Square; however, there are also preferred investors in the captive REIT whose preferred dividends less administrative fees during 2013, 2012 and 2011 are represented as distributions to non-controlling interests on the Company’s statements of operations.

Dividends

In August 2013, the Company’s board of directors reinstated a quarterly dividend payable to the Company’s common stockholders. In addition, the Company currently pays quarterly dividends to the preferred stockholders of its 8.0% Series D Cumulative Redeemable Preferred Stock (“Series D preferred stock”) as declared by the Company’s board of directors. Prior to their redemption dates in March 2013 and May 2013, respectively, the Company also paid quarterly dividends to the preferred stockholders of its 8.0% Series A Cumulative Redeemable Preferred Stock (“Series A preferred stock”) and its Series C Cumulative Convertible Redeemable Preferred Stock (“Series C preferred stock”) as declared by the Board of Directors. The Company’s ability to pay dividends is dependent on the receipt of distributions from the Operating Partnership.

Earnings Per Share

The Company applies the two-class method when computing its earnings per share as required by the Earnings Per Share Topic of the FASB ASC, which requires the net income per share for each class of stock (common stock and convertible preferred stock) to be calculated assuming all of the Company’s net income is distributed as dividends to each class of stock based on their contractual rights. To the extent the Company has undistributed earnings in any calendar quarter, the Company will follow the two-class method of computing earnings per share.

The Company follows the requirements of the Earnings Per Share Topic of the FASB ASC, which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. During 2013, distributed earnings representing nonforfeitable dividends of \$0.2 million were allocated to the participating securities. There were no distributed earnings representing nonforfeitable dividends allocated to the participating securities during either 2012 or 2011. Undistributed earnings representing nonforfeitable dividends of \$0.2 million, \$0.2 million and \$0.6 million were allocated to the participating securities for 2013, 2012 and 2011, respectively.

In accordance with the Earnings Per Share Topic of the FASB ASC, basic earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period, plus potential common shares considered outstanding during the period, as long as the inclusion of such awards is not anti-dilutive. Potential common shares consist of unvested restricted stock awards and the incremental common shares issuable upon the exercise of stock options, using the more dilutive of either the two-class method or the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per common share (in thousands, except per share data):

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Numerator:			
Net income	\$ 70,001	\$ 49,557	\$ 81,299
Income from consolidated joint venture attributable to non-controlling interest	(4,013)	(1,761)	(312)
Distributions to non-controlling interest	(32)	(31)	(30)
Dividends paid on unvested restricted stock compensation	(201)	—	—
Preferred stock dividends and redemption charges	(19,013)	(29,748)	(27,321)
Undistributed income allocated to unvested restricted stock compensation	(235)	(203)	(636)
Numerator for basic and diluted earnings available to common stockholders	<u>\$ 46,507</u>	<u>\$ 17,814</u>	<u>\$ 53,000</u>
Denominator:			
Weighted average basic and diluted common shares outstanding	<u>161,784</u>	<u>127,027</u>	<u>117,206</u>
Basic and diluted earnings available to common stockholders per common share	<u>\$ 0.29</u>	<u>\$ 0.14</u>	<u>\$ 0.45</u>

The Company's unvested restricted shares associated with its long-term incentive plan and shares associated with common stock options have been excluded from the above calculation of earnings per share for the years ended December 31, 2013, 2012 and 2011, as their inclusion would have been anti-dilutive. Prior to their redemption in May 2013, the shares of the Company's Series C preferred stock issuable upon conversion were excluded from the above calculation of earnings per share for the years ended December 31, 2013, 2012 and 2011, as their inclusion would have been anti-dilutive.

Segment Reporting

The Company reports its consolidated financial statements in accordance with the Segment Reporting Topic of the FASB ASC. Currently, the Company operates in one segment, operations held for investment.

Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update No. 2011-10, "*Property, Plant and Equipment: Derecognition of in Substance Real Estate—a Scope Clarification*" ("ASU No. 2011-10"). Under the amendments in ASU No. 2011-10, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's non-recourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related non-recourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The adoption of ASU No. 2011-10 in the first quarter of 2013 did not have any effect on the Company's financial statements.

3. INVESTMENT IN HOTEL PROPERTIES

Investment in hotel properties, net consisted of the following (in thousands):

	December 31,	
	2013	2012
Land	\$ 439,304	\$ 260,939
Buildings and improvements	2,977,458	2,541,024
Furniture, fixtures and equipment	414,192	329,770
Intangibles	171,889	167,467
Franchise fees	1,346	1,261
Construction in process	34,643	48,388
	<u>4,038,832</u>	<u>3,348,849</u>
Accumulated depreciation and amortization	<u>(807,450)</u>	<u>(666,972)</u>
	<u>\$3,231,382</u>	<u>\$2,681,877</u>

Acquisitions—2013

In May 2013, the Company purchased the 250-room Hilton New Orleans St. Charles for a net purchase price of \$59.1 million, including \$0.2 million of proration credits and unrestricted cash received from the seller. The acquisition was funded with \$53.2 million of proceeds generated by the Company's January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota (see Note 4), as well as with proceeds received from the Company's February 2013 issuance of common stock. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties and hotel working capital assets and liabilities. The Company incurred acquisition-related costs of \$0.4 million during 2013, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Hilton New Orleans St. Charles have been included in the Company's consolidated statements of operations from the acquisition date of May 1, 2013 through the year ended December 31, 2013.

In July 2013, the Company purchased the 1,053-room Boston Park Plaza for a net purchase price of \$248.0 million, including \$2.0 million of proration credits, unrestricted and restricted cash and other adjustments received from the seller. The acquisition was funded with \$92.3 million of proceeds generated by the Company's January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota (see Note 4), the assumption of a \$119.2 million non-recourse loan secured by the hotel, as well as with proceeds received from the Company's February 2013 issuance of common stock and with cash on hand. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, hotel working capital assets, notes payable and hotel working capital liabilities. The Company incurred acquisition-related costs of \$0.9 million during 2013, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Boston Park Plaza have been included in the Company's consolidated statements of operations from the acquisition date of July 2, 2013 through the year ended December 31, 2013.

In December 2013, the Company purchased the 802-room Hyatt Regency San Francisco for a net purchase price of \$262.5 million, including \$5.5 million of purchase price adjustments comprised of restricted cash and other adjustments received from the seller. The acquisition was funded with proceeds generated by the Company's November 2013 issuance of common stock. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price and other adjustments allocated to investment in hotel properties, prepaid expenses and other current liabilities. The Company incurred acquisition-related costs of \$0.5 million during 2013, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Hyatt Regency San Francisco have been included in the Company's consolidated statements of operations from the acquisition date of December 2, 2013 through the year ended December 31, 2013.

The fair values of the assets acquired and liabilities assumed at the dates of acquisition for the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco were allocated based on an independent third-party analysis. The following table summarizes the fair values of assets acquired, liabilities assumed and adjustments recorded in these acquisitions (in thousands):

ASSETS:	
Investment in hotel properties	\$570,420
Accounts receivable	3,024
Inventory	160
Prepaid expenses	1,126
Total assets acquired	<u>574,730</u>
LIABILITIES:	
Accounts payable	295
Accrued payroll and employee benefits	2,777
Other current liabilities	1,924
Note payable	<u>119,190</u>
Total liabilities assumed	<u>124,186</u>
Total cash paid for acquisitions	<u><u>\$450,544</u></u>

Investment in hotel properties was allocated to land (\$178.4 million), buildings and improvements (\$355.6 million), furniture, fixtures and equipment (\$31.9 million), intangibles (\$4.4 million) related to advanced bookings and tenant lease agreements, and franchise fees (\$0.1 million) related to a franchise agreement. Details of the intangibles and the franchise agreement are as follows (in thousands):

	Value at Acquisition	Expected Life
Advanced bookings	\$ 6,414	49 to 60 months
Above/(below) market lease agreements, net	(3,635)	12 to 215 months
In-place lease agreements	1,643	12 to 169 months
Franchise agreement	85	15 years
Total intangibles and franchise fees related to 2013 acquisitions	4,507	
Accumulated amortization	(607)	
Net balance of intangibles at December 31, 2013	<u>\$ 3,900</u>	

During 2013, the Company recorded amortization expense related to its Hilton New Orleans St. Charles, Boston Park Plaza and Hyatt Regency San Francisco intangibles as follows (in thousands):

	2013
Advanced bookings	\$ 632
Above/(below) market lease agreements, net	(134)
In-place lease agreements	105
Franchise agreement	4
	<u>\$ 607</u>

Acquisitions—2012

In June 2012, the Company purchased the leasehold interest in the 417-room Wyndham Chicago for a contractual purchase price of \$88.425 million. The Company funded the acquisition with \$29.7 million of cash on hand (including \$0.3 million of proration credits) and the issuance of 5,454,164 shares of the Company's common stock, the "Wyndham stock consideration." The Wyndham stock consideration was determined by dividing \$58.425 million by the product of (1) the closing price of \$10.40 on the NYSE of the Company's common stock on May 2, 2012 and (2) 1.03. In connection with this acquisition, the Company entered into a registration rights agreement requiring the Company to register the Wyndham stock consideration. The Company prepared the registration statement on Form S-3, which was filed with the SEC as required on June 4, 2012. Based on the \$9.38 closing price of the Company's common stock on the NYSE on June 4, 2012, the date the acquisition closed, the total purchase price of the Wyndham Chicago hotel for accounting purposes was \$81.16 million, excluding proration adjustments and closing costs. Immediately upon acquisition, the Company rebranded the hotel the Hyatt Chicago Magnificent Mile. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, hotel working capital assets and liabilities, obligations under capital lease and the Company's common stock. During 2012, the Company incurred acquisition-related costs of \$1.3 million, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Hyatt Chicago Magnificent Mile have been included in the Company's consolidated statements of operations from the acquisition date of June 4, 2012 through the year ended December 31, 2013.

In July 2012, the Company purchased the 357-room Hilton Garden Inn Chicago Downtown/Magnificent Mile for a net purchase price of \$90.3 million, including \$1.45 million of proration credits. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties and hotel working capital assets and liabilities. The Company incurred acquisition-related costs of \$0.7 million and \$0.2 million during 2012 and 2011, respectively, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Hilton Garden Inn Chicago Downtown/Magnificent Mile have been included in the Company's consolidated statements of operations from the acquisition date of July 19, 2012 through the year ended December 31, 2013.

Acquisitions—2011

In January 2011, the Company purchased the outside 62.0% equity interests in its Doubletree Guest Suites Times Square joint venture for \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel located in New York City, New York. The purchase price included \$13.0 million of unrestricted cash held on the partnership's balance sheet. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets and liabilities. The Company incurred acquisition-related costs of \$2.5 million during 2011, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Doubletree Guest Suites Times Square have been included in the Company's consolidated statements of operations from the acquisition date of January 14, 2011 through the year ended December 31, 2013. Preferred dividends earned by investors from an entity that owns the Doubletree Guest Suites Times Square, less administrative fees, totaled \$32,000 for the year ended December 31, 2013, \$31,000 for the year ended December 31, 2012, and \$30,000 for the year ended December 31, 2011, and are included in distributions to non-controlling interest on the Company's consolidated statements of operations.

In February 2011, the Company purchased the 494-room JW Marriott New Orleans located in New Orleans, Louisiana for approximately \$51.6 million in cash and the assumption of a \$42.2 million floating-rate, non-recourse senior mortgage. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets. The Company incurred acquisition-related costs of \$0.4 million during 2011, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the JW Marriott New Orleans have been included in the Company's consolidated statements of operations from the acquisition date of February 15, 2011 through the year ended December 31, 2013.

In April 2011, the Company paid \$182.8 million to acquire a 75.0% majority interest in the joint venture that owns the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California, which implied a gross value of approximately \$475.0 million. The purchase price included \$3.7 million of unrestricted cash held on the joint venture's balance sheet. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets and liabilities. The Company incurred acquisition-related costs of \$0.5 million during 2011, which are included in corporate overhead on the Company's consolidated statements of operations. The results of operations for the Hilton San Diego Bayfront have been included in the Company's consolidated statements of operations from the acquisition date of April 15, 2011 through the year ended December 31, 2013. The remaining 25.0% interest in the joint venture continues to be owned by Hilton Worldwide, and is included in non-controlling interest in consolidated joint ventures on the Company's consolidated balance sheets and in income from consolidated joint venture attributable to non-controlling interest in the Company's consolidated statements of operations.

Acquired properties are included in the Company's results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the Company's results as if the acquisitions of the Hilton New Orleans St. Charles in May 2013, the Boston Park Plaza in July 2013, the Hyatt Regency San Francisco in December 2013, the Hyatt Chicago Magnificent Mile in June 2012, the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012, the Doubletree Guest Suites Times Square in January 2011, the JW Marriott New Orleans in February 2011 and the Hilton San Diego Bayfront in April 2011 had occurred on January 1, 2011. In the Company's opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made (in thousands, except per share data):

	2013	2012	2011
Revenues	\$1,043,203	\$1,004,300	\$1,062,319
Income available (loss attributable) to common stockholders from continuing operations	\$ 7,509	\$ (23,741)	\$ 23,221
Income (loss) per diluted share available (attributable) to common stockholders from continuing operations	\$ 0.05	\$ (0.19)	\$ 0.20

For the year ended December 31, 2013, the Company included \$51.0 million of revenues, and net income of \$2.8 million in its consolidated statements of operations related to the Company's 2013 acquisitions. For the year ended December 31, 2012, the Company included \$27.7 million of revenues, and a net loss of \$1.1 million in its consolidated statements of operations related to the Company's 2012 acquisitions. For the year ended December 31, 2011, the Company included \$169.1 million of revenues, and a net loss of \$0.5 million in its consolidated statements of operations related to the Company's 2011 acquisitions.

Intangible Assets

As of December 31, 2013 and 2012, intangible assets included in the Company's investment in hotel properties, net consisted of the following (in thousands):

	2013	2012
Advanced bookings ⁽¹⁾	\$ 35,154	\$ 28,740
Easement agreement ⁽²⁾	9,727	9,727
Ground/air lease agreements ⁽³⁾	121,850	121,850
In-place lease agreements ⁽⁴⁾	6,223	4,580
Above/(below) market lease agreements, net ⁽⁵⁾	(3,915)	(280)
Below market management agreement ⁽⁶⁾	2,850	2,850
	171,889	167,467
Accumulated amortization	(44,426)	(34,978)
	\$127,463	\$132,489

Amortization expense on these intangible assets for the years ended December 31, 2013, 2012 and 2011 consisted of the following (in thousands):

	2013	2012	2011
Advanced bookings ⁽¹⁾	\$4,560	\$14,824	\$ 9,988
Ground/air lease agreements ⁽³⁾	4,113	4,113	3,978
In-place lease agreements ⁽⁴⁾	454	348	299
Above/(below) market lease agreements, net ⁽⁵⁾	(148)	(6)	—
Below market management agreement ⁽⁶⁾	469	212	—
	<u>\$9,448</u>	<u>\$19,491</u>	<u>\$14,265</u>

(1) Advanced bookings consist of advance deposits related to the purchases of the Boston Park Plaza, the Doubletree Guest Suites Times Square, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, the Hyatt Regency San Francisco, and the JW Marriott New Orleans. The contractual advance hotel bookings were recorded at a discounted present value based on estimated collectability, and are amortized using the straight-line method based over the periods the amounts are expected to be collected. The contractual advance hotel bookings for the Doubletree Guest Suites Times Square, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, and the JW Marriott New Orleans are fully amortized as of December 31, 2013. The contractual advance hotel bookings for the Boston Park Plaza and the Hyatt Regency San Francisco will be fully amortized by June 30, 2018.

(2) The Easement agreement at the Hilton Times Square was valued at fair value at the date of acquisition. The Hilton Times Square easement agreement has an indefinite useful life, and, therefore, is not amortized. This non-amortizable intangible asset is reviewed annually for impairment and more frequently if events or circumstances indicate that the asset may be impaired. If a non-amortizable intangible asset is subsequently determined to have a finite useful life, the intangible asset will be written down to the lower of its fair value or carrying amount and then amortized prospectively, based on the remaining useful life of the intangible asset.

(3) Ground/air lease agreements at the Doubletree Guest Suites Times Square, the Hilton Times Square and the JW Marriott New Orleans were valued at fair value at the dates of acquisition. The agreements are amortized using the straight-line method over the remaining non-cancelable terms of the related agreements, which range from between approximately 23 and 77 years as of December 31, 2013.

(4) In-place lease agreements at the Boston Park Plaza, the Doubletree Guest Suites Times Square, the Hilton New Orleans St. Charles, the Hilton San Diego Bayfront and the Hyatt Regency San Francisco, were valued at fair value at the dates of acquisition. The agreements are amortized using the straight-line method over the remaining non-cancelable terms of the related agreements, which range from between approximately seven months and 14 years as of December 31, 2013.

(5) The above/(below) market lease agreements, net consist of unfavorable tenant lease liabilities at the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile and the Hyatt Regency San Francisco, and favorable tenant lease assets at the Hilton New Orleans St. Charles and the Hyatt Regency San Francisco. These agreements were valued at fair value at the dates of acquisition, and are amortized using the straight-line method over the remaining non-cancelable terms of the related agreements, which range from between approximately seven months and 18 years as of December 31, 2013.

(6) The below market management agreement at the Hilton Garden Inn Chicago Downtown/Magnificent Mile was valued at fair value at the acquisition date. The agreement is comprised of two components, one for the management of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, and the other for the potential management of a future hotel. The agreement is amortized using the straight-line method over the remaining non-cancelable terms of the two components, approximately 4 and 9 years each as of December 31, 2013.

For the next five years, amortization expense for the intangible assets noted above is expected to be as follows, (in thousands):

2014	\$6,344
2015	\$6,167
2016	\$6,110
2017	\$5,884
2018	\$4,994

4. DISCONTINUED OPERATIONS

In January 2013, the Company sold a four-hotel, 1,222-room portfolio (the “Rochester Hotels”) and a commercial laundry facility (together with the Rochester Hotels, the “Rochester Portfolio”) in Rochester, Minnesota, to an unaffiliated third party, for net proceeds of \$195.6 million, of which \$145.7 million was deposited with an accommodator in order to facilitate tax-deferred exchanges. The Rochester Hotels include the 660-room Kahler Grand, the 271-room Kahler Inn & Suites, the 202-room Marriott Rochester and the 89-room Residence Inn by Marriott Rochester. The Company recognized a net gain on the sale of \$51.6 million. The Company retained a \$25.0 million preferred equity investment (the “Preferred Equity Investment”) in the Rochester Hotels that yields an 11% dividend, resulting in a deferred gain on the sale of \$25.0 million. The \$25.0 million gain will be deferred until the Preferred Equity Investment is redeemed. The Preferred Equity Investment is recorded at face value on the Company’s consolidated balance sheet net of the deferred gain, resulting in a net book value of zero on the Company’s consolidated balance sheet as of December 31, 2013. During 2013, the Company recognized \$2.6 million in dividends on the Preferred Equity Investment, which is included in interest and other income on the Company’s consolidated statements of operations. The Company also provided a \$3.7 million working cash advance to the buyer, resulting in a deferred gain on the sale of \$3.7 million. The \$3.7 million gain will be deferred until the Company is repaid from the Rochester Portfolio’s available cash flow. The working cash advance is recorded at face value on the Company’s consolidated balance sheet net of the deferred gain, resulting in a net book value of zero on the Company’s consolidated balance sheet as of December 31, 2013. In addition, the Company retained a liability not to exceed \$14.0 million related to the Rochester Portfolio’s pension plan, which could be triggered in certain circumstances, including termination of the pension plan. The \$14.0 million pension plan liability is included in other liabilities on the Company’s consolidated balance sheet as of December 31, 2013. The recognition of the \$14.0 million pension plan liability reduced the Company’s gain on the sale of the Rochester Portfolio. The \$14.0 million gain will be recognized, if at all, when and to the extent the Company is released from any potential liability related to the Rochester Portfolio’s pension plan. Concurrent with the Rochester Portfolio sale, the Company extinguished the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of \$29.8 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of \$3.1 million which is included in discontinued operations on the Company’s consolidated statements of operations. The Company reclassified the Rochester Portfolio’s results of operations for January 2013 and the years ended December 31, 2012 and 2011, to discontinued operations on its consolidated statements of operations.

Prior to the sale of the Rochester Portfolio, pension liability adjustments related to the Rochester Portfolio's defined benefit retirement plan were recorded as other comprehensive loss. The following table details the activity in accumulated other comprehensive loss in January 2013 due to the sale of the Rochester Portfolio (in thousands):

	One Month Ended January 31, 2013	Affected Line in the Company's Statements of Operations and Comprehensive Income
Beginning balance of accumulated other comprehensive loss	\$(5,335)	
Sale of Rochester Portfolio—pension liability adjustment	5,335	Income from discontinued operations
Ending balance of accumulated other comprehensive loss	\$ —	

During 2012, the Company sold four hotels and an office building adjacent to one of the sold hotels. In August 2012, the Company sold the Marriott Del Mar located in San Diego, California for net proceeds of \$17.7 million, including the assumption of the existing mortgage secured by the hotel which totaled \$47.1 million on the date of sale, and recognized a gain on the sale of \$25.5 million. In addition, the Company wrote off \$48,000 in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the hotel. The Company reclassified the hotel's results of operations for the first eight months of 2012, as well as for the year ended December 31, 2011 to discontinued operations on its consolidated statements of operations.

In September 2012, the Company sold a portfolio of assets that included the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy (located in Minneapolis, Minnesota, San Diego, California, and Troy, Michigan, respectively) and an office building adjacent to the Marriott Troy for net proceeds of \$28.6 million, including the assumptions of three separate mortgages secured by the hotels totaling \$75.6 million, as well as a \$2.2 million liability for deferred management fees payable to the Marriott Troy's third-party manager. The Company recognized a net gain on the sale of \$12.7 million. In addition, the Company wrote off \$0.1 million in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the three hotels. The Company reclassified the results of operations for the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and the office building to discontinued operations for the first nine months of 2012, as well as for the year ended December 31, 2011 on its consolidated statements of operations.

During 2011, the Company sold two hotels and a commercial laundry facility. In April 2011, the Company sold the Royal Palm Miami Beach hotel for net proceeds of \$129.8 million, including \$39.8 million in cash and the \$90.0 million Royal Palm note, and recognized a gain on the sale of \$14.0 million. The Company reclassified the hotel's results of operations for the first four months of 2011 to discontinued operations on its consolidated statements of operations. The Company retained an earn-out right on the Royal Palm hotel which will enable it to receive future payments of up to \$20.0 million in the event the hotel achieves certain return hurdles. In March 2012, the Company recorded additional gain of \$0.2 million on the sale of the Royal Palm Miami Beach for property tax refunds and reimbursements for certain transaction related invoices, which is included in discontinued operations on the Company's consolidated statements of operations.

In July 2011, the Company sold its commercial laundry facility located in Salt Lake City, Utah for net proceeds of \$0.1 million, and recognized a loss on the sale of \$0.1 million. In anticipation of this sale, the Company recorded an impairment loss of \$1.5 million to discontinued operations in June 2011. The Company reclassified the laundry's results of operations for the first seven months of 2011 to discontinued operations on its consolidated statements of operations.

In October 2011, the Company sold the Valley River Inn located in Eugene, Oregon for net proceeds of \$16.1 million, including the assumption of the existing mortgage secured by the hotel which totaled \$11.5 million on the date of sale, and recognized a gain on the sale of \$0.9 million. The Company reclassified the hotel's results of operations for the first 10 months of 2011 to discontinued operations on its consolidated statements of operations.

The following sets forth the discontinued operations for the years ended December 31, 2013, 2012 and 2011 for the four hotels and the commercial laundry facility sold in 2013, the four hotels and the office building sold in 2012, and the two hotel properties and the commercial laundry facility sold in 2011, which all met the "held for sale" and "discontinued operations" criteria in accordance with the Property, Plant and Equipment Topic of the FASB ASC (in thousands):

	2013	2012	2011
Operating revenues	\$ 3,690	\$100,861	\$130,997
Operating expenses	(3,686)	(71,089)	(96,581)
Interest expense	(99)	(6,490)	(9,337)
Depreciation and amortization expense	—	(13,164)	(16,188)
Impairment loss	—	—	(1,495)
Gain (loss) on extinguishment of debt	(3,115)	—	18,145
Gain on sale of hotels and other assets, net	51,620	38,292	14,912
Income from discontinued operations	<u>\$48,410</u>	<u>\$ 48,410</u>	<u>\$ 40,453</u>

5. INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES

In December 2006, the Company entered into a joint venture agreement to obtain a 38.0% interest in the Doubletree Guest Suites Times Square located in New York City, New York. The Company accounted for its ownership interest in the hotel using the equity method, and its accounting policies were consistent with those of the unconsolidated joint venture. In January 2011, the Company purchased the outside 62.0% equity interests in its Doubletree Guest Suites Times Square joint venture, and, as a result, became the sole owner of the entity that owns the hotel. In conjunction with this purchase, the Company recognized a gain of \$30.1 million on the remeasurement of the Company's equity interest in this joint venture to its fair market value, and a gain of \$30.4 million on the remeasurement of the Company's investment in a \$30.0 million, 8.5% mezzanine loan secured by the hotel which it purchased in April 2010 to its fair market value. Subsequent to this acquisition, the Company has consolidated the results of operations of the Doubletree Guest Suites Times Square with its continuing operations, and the mezzanine loan was eliminated in consolidation on the Company's balance sheet until the mezzanine loan was satisfied in conjunction with the Company's refinancing of the debt secured by the Doubletree Guest Suites Times Square in October 2011.

In December 2007, the Company entered into a joint venture agreement with Strategic Hotels & Resorts ("Strategic") to own and operate BuyEfficient. Under the terms of the agreement, Strategic acquired a 50.0% interest in BuyEfficient from the Company. The Company accounted for its ownership interest in BuyEfficient using the equity method, and its accounting policies were consistent with those of the unconsolidated joint venture. In January 2011, the Company repurchased Strategic's 50.0% share in BuyEfficient. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to intangibles (which are included in other assets, net on the Company's consolidated balance sheets as of December 31, 2013 and 2012), goodwill and other working capital assets and liabilities. In conjunction with this purchase, the Company recognized a gain of \$8.7 million on the remeasurement of the Company's equity interest in this joint venture to its fair market value. Subsequent to this acquisition, the Company is the sole owner of BuyEfficient, and has consolidated BuyEfficient's results of operations with its continuing operations.

6. INTEREST RATE DERIVATIVE AGREEMENTS

At December 31, 2013 and 2012, the Company held two interest rate cap agreements and one interest rate swap agreement to manage its exposure to the interest rate risks related to its floating rate debt. The first interest rate cap agreement is on the Hilton San Diego Bayfront mortgage, which mortgage bears an interest rate of 3-month LIBOR plus 325 basis points. The initial interest rate cap agreement, whose strike rate was 3.75%, matured in April 2013. In April 2013, the Company purchased a new interest rate cap agreement on the Hilton San Diego Bayfront mortgage for a cost of \$12,000, which extended the maturity date from April 2013 to April 2015. The new interest rate cap agreement on the Hilton San Diego Bayfront continues to cap the 3-month LIBOR rate at 3.75%. The notional amount of the related debt capped totaled \$117.0 million and \$120.0 million at December 31, 2013 and 2012, respectively. The second interest rate cap agreement is on the Doubletree Guest Suites Times Square mortgage, which mortgage bears an interest rate of 3-month LIBOR plus 325 basis points. The Doubletree Guest Suites Times Square cap agreement caps the 3-month LIBOR rate at 4.0% until October 2015. The notional amount of the related debt capped totaled \$179.6 million and \$180.0 million at December 31, 2013 and 2012, respectively.

The interest rate swap agreement is on the JW Marriott New Orleans mortgage. The interest rate swap agreement caps the LIBOR interest rate on the underlying debt at a total interest rate of 5.45%, and the maturity date is in September 2015. The notional amount of the related debt totaled \$39.8 million and \$40.7 million as of December 31, 2013 and 2012, respectively.

None of the interest rate derivative agreements qualify for effective hedge accounting treatment. Accordingly, changes in the fair value of the Company's interest rate derivative agreements resulted in a net gain of \$0.5 million for the year ended December 31, 2013, and net losses of \$0.4 million and \$2.7 million for the years ended December 31, 2012 and 2011, respectively, which have been reflected as a decrease in interest expense for 2013, and as increases in interest expense for 2012 and 2011. As of December 31, 2013 and 2012, the fair values of the interest rate cap agreements totaled an asset of \$16,000 and \$48,000, respectively. The interest rate cap agreements are included in other assets, net on the Company's consolidated balance sheets. The fair value of the interest rate swap agreement was a liability of \$1.1 million and \$1.6 million as of December 31, 2013 and 2012, respectively, and is included in other liabilities on the Company's consolidated balance sheets.

7. OTHER ASSETS

Other assets, net consisted of the following (in thousands):

	December 31,	
	2013	2012
Property and equipment, net	\$ 2,478	\$ 2,529
Land held for development	188	188
Intangibles, net	7,277	7,877
Interest rate cap derivative agreements	16	48
Cash trap receivables	4,443	8,208
Other receivables	3,942	4,130
Other	2,762	2,922
	<u>\$21,106</u>	<u>\$25,902</u>

As of December 31, 2013 and 2012, property and equipment, net consisted of the following (in thousands):

	2013	2012
Cost basis	\$10,933	\$10,153
Accumulated depreciation	(8,455)	(7,624)
Property and equipment, net	<u>\$ 2,478</u>	<u>\$ 2,529</u>

The Company's other assets, net as of December 31, 2013 and 2012, include BuyEfficient's intangible assets totaling \$7.3 million and \$7.9 million, respectively, net of accumulated amortization related to certain trademarks, customer and supplier relationships and intellectual property related to internally developed software. These intangibles are amortized using the straight-line method over their useful lives ranging between seven and 20 years. Accumulated amortization totaled \$1.8 million and \$1.2 million at December 31, 2013 and 2012, respectively. Amortization expense totaled \$0.6 million for the years ended December 31, 2013, 2012 and 2011. For the next five years, amortization expense for the BuyEfficient intangible assets is expected to be as follows, (in thousands):

2014	\$600
2015	\$600
2016	\$600
2017	\$600
2018	\$351

In conjunction with the Company's 2012 sales of the Marriott Del Mar, the Hilton Del Mar and the Marriott Troy, the mortgages secured by these hotels were assumed by the buyers of the hotels. These mortgages contain "cash trap" provisions that were triggered in prior years due to the decline in the performance of the three hotels. Once triggered, substantially all of the excess cash flow from operations generated by the three hotels was deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lenders. Cash was distributed to the Company only after certain items were paid, including deposits into leasing and maintenance reserve accounts and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and leasing expenses. During 2013, a total of \$3.8 million was returned to the Company related to the mortgages secured by the Marriott Del Mar and the Marriott Troy. As of December 31, 2013, the remaining \$4.4 million remained trapped by the lender associated with the mortgage secured by the Hilton Del Mar. In February 2014, the lender released the cash, and the entire \$4.4 million was returned to the Company.

8. NOTES PAYABLE

Notes payable consisted of the following at December 31 (in thousands):

	2013	2012
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.4% to 6.6%; maturing at dates ranging from May 2015 through May 2021. The notes are collateralized by first deeds of trust on 14 hotel properties at December 31, 2013, and 13 hotel properties at December 31, 2012.	\$ 993,164	\$ 890,668
Note payable requiring payments of interest and principal, bearing a blended rate of 3-month LIBOR plus 325 basis points; maturing in April 2016. The note is collateralized by a first deed of trust on one hotel property.	231,451	234,724
Note payable requiring payments of interest only through October 2013, and interest and principal thereafter, with a blended interest rate of 3-month LIBOR plus 325 basis points; maturing in October 2018. The note is collateralized by a first deed of trust on one hotel property.	179,460	180,000
Senior Notes, with a fixed interest rate of 4.60%, maturing in July 2027. Repurchased and redeemed in January 2013. The notes were guaranteed by the Company and certain of its subsidiaries.	—	58,000
	<u>1,404,075</u>	<u>1,363,392</u>
Less: discount on Senior Notes	—	(3)
	<u>1,404,075</u>	<u>1,363,389</u>
Less: current portion	<u>(23,289)</u>	<u>(76,723)</u>
	<u>\$1,380,786</u>	<u>\$1,286,666</u>

In January 2013, the Company repurchased \$42.0 million of the Senior Notes, and redeemed the remaining \$16.0 million of the Senior Notes. The Company funded the total \$58.0 million in Senior Note repurchases and redemptions with available cash, leaving no future amounts outstanding related to the Senior Notes.

Concurrent with the Rochester Portfolio sale in January 2013, the Company extinguished the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of \$29.8 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of \$3.1 million which is included in discontinued operations.

In conjunction with the Company's acquisition of the Boston Park Plaza in July 2013, the Company assumed a \$119.2 million non-recourse mortgage secured by the hotel. The mortgage bears interest at a fixed rate of 4.4%, and matures in February 2018.

In February 2012, the Company used its existing cash to repurchase \$4.5 million in aggregate principal amount of the Senior Notes for \$4.57 million. After the repurchase, such Senior Notes were cancelled. The Company wrote off \$47,000 in deferred financing fees and \$0.1 million of the Senior Notes discount, and recognized a loss of \$0.2 million on this early extinguishment of debt.

In April 2012, the Company used existing cash to repay the remaining balance on its \$32.2 million non-recourse mortgage secured by the Renaissance Long Beach, which was scheduled to mature in July 2012. The Company wrote off \$3,000 in deferred financing fees in connection with the repayment of this debt.

In August 2012, the buyer of the Marriott Del Mar assumed the \$47.1 million existing mortgage secured by the hotel, and the Company wrote off \$48,000 in related deferred financing fees.

In September 2012, the buyer of the portfolio that included the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and an office building adjacent to the Marriott Troy assumed \$75.6 million in existing mortgages secured by the three hotels in the portfolio, and the Company wrote off \$0.1 million in related deferred financing fees.

In September 2012, the Company amended and restated its \$150.0 million senior unsecured revolving credit facility, which was scheduled to mature in November 2013. The pricing on the amended revolving credit facility was reduced and the 1% LIBOR floor was eliminated. The maturity of the credit facility was extended by two years to November 2015 with an option to extend to November 2016. The amended credit facility's interest rate is based on a pricing grid with a range of 175 to 350 basis points, which represents a reduction from the previous grid that ranged from 325 to 425 basis points over LIBOR depending on the Company's leverage ratio. The credit facility also includes an accordion option that allows the Company to request additional lender commitments up to a total of \$350.0 million. The Company paid \$1.3 million in deferred financing fees in conjunction with this amendment, which will be amortized over the term of the amended credit facility.

Total interest incurred and expensed on the notes payable is as follows (in thousands):

	2013	2012	2011
Interest expense	\$69,806	\$71,664	\$67,319
(Gain) loss on derivatives, net	(525)	406	2,655
Accretion of Senior Notes	3	1,058	1,062
Amortization of deferred financing fees	2,955	3,690	3,138
Write-off of deferred financing fees	—	3	21
	<u>\$72,239</u>	<u>\$76,821</u>	<u>\$74,195</u>

Aggregate future principal maturities and amortization of notes payable at December 31, 2013, are as follows (in thousands):

2014	\$ 23,289
2015	160,275
2016	425,723
2017	252,472
2018	285,675
Thereafter	256,641
Total	<u>\$1,404,075</u>

9. OTHER CURRENT LIABILITIES AND OTHER LIABILITIES

Other Current Liabilities

Other current liabilities consisted of the following (in thousands):

	December 31,	
	2013	2012
Property, sales, and use taxes payable	\$14,482	\$13,254
Income tax payable	—	125
Accrued interest	3,078	4,901
Advance deposits	8,259	6,938
Management fees payable	1,077	2,346
Other	3,392	3,399
	<u>\$30,288</u>	<u>\$30,963</u>

Other Liabilities

Other liabilities consisted of the following (in thousands):

	December 31,	
	2013	2012
Deferred gain on sale of asset	\$14,000	\$ —
Interest rate swap derivative agreement	1,066	1,636
Accrued income tax	1,491	—
Deferred revenue	6,918	1,089
Deferred rent	12,270	9,459
Deferred incentive management fees	1,714	—
Other	2,499	2,886
	<u>\$39,958</u>	<u>\$15,070</u>

In conjunction with the Rochester Portfolio sale, the Company retained a \$14.0 million liability related to the Rochester Portfolio's pension plan, which could be triggered in certain circumstances, including termination of the pension plan. Accordingly, the Company has deferred \$14.0 million of gain on the sale of the Rochester Portfolio, which \$14.0 million in gain will be recognized, if at all, when and to the extent the Company is released from any potential liability related to the Rochester Portfolio's pension plan.

The Company's other liabilities include accrued income tax of \$1.5 million. Based on the Company's ongoing evaluations of its uncertain tax positions related to the years ended December 31, 2013 and 2012, the Company adjusted for an unrecognized tax benefit of \$1.5 million during 2013, which is included in the Company's consolidated statement of operations.

In June 2013, the Company received a \$6.5 million incentive from Hyatt Franchising L.L.C. for rebranding the Company's Hyatt Chicago Magnificent Mile from a Wyndham to a Hyatt. The Company is amortizing this incentive on a straightline basis over the remaining 25-year term of its franchise agreement with Hyatt. The Company includes the \$0.3 million portion of the incentive to be recognized during 2014 in accounts payable and accrued expenses, and includes the long-term portion of \$6.1 million in other liabilities in its consolidated balance sheet for the year ended December 31, 2013.

The Company's other liabilities also include deferred incentive management fees of \$1.7 million related to one of its hotels. Per the Company's management agreement with the hotel's third-party manager, payment of the incentive management fees will be deferred until such time as the hotel's adjusted cash flow, as defined in the management agreement, surpasses a certain threshold.

10. INCOME TAXES

The Company has elected to be taxed as a REIT under the Code. As a REIT, the Company generally will not be subject to corporate level federal income taxes on net income it distributes to its stockholders. The Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. The Company may also be subject to federal and/or state income taxes when using net operating loss carryforwards to offset current taxable income. During 2013 and 2012, the Company's use of net operating loss carryforwards resulted in federal and state income tax expense of \$1.9 million and \$1.1 million, respectively.

The Company leases its hotels to the TRS Lessee and its subsidiaries, which are subject to federal and state income taxes. The Company accounts for income taxes in accordance with the provisions of the Income Taxes Topic of the FASB ASC, which requires the Company to account for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between GAAP carrying amounts and their respective tax bases.

During the first quarter of 2013, the Internal Revenue Service ("IRS") issued a notice of proposed adjustment to the Company, challenging certain aspects of the Company's leases with its TRS Lessee and its subsidiaries. Though the Company believes its leases comply with all applicable IRS requirements, the Company determined that the costs associated with defending its position were greater than the benefits that might result therefrom. As such, the Company accrued \$4.7 million in March 2013 related to the IRS's audit of tax years 2008, 2009 and 2010, including \$0.6 million in accrued interest, all of which is included in income tax provision on the Company's consolidated statement of operations. The Company recorded additional income tax expense of \$1.5 million during 2013 based on the ongoing evaluations of its uncertain tax positions related to the year ended December 31, 2012, and as a result of its recent resolution of outstanding issues with the IRS. No amounts were accrued under the Income Taxes Topic of the FASB ASC as of December 31, 2012, as the Company believed it had no uncertain tax positions that warranted accrual. During 2013, the Company recorded additional tax expense of \$1.9 million related to estimated 2013 federal alternative minimum tax resulting from its use of net operating loss carryforwards, as well as state income tax where the Company's use of net operating loss carryforwards was either limited or unavailable. During 2012, the Company's federal alternative minimum tax resulting from its use of net operating loss carryforwards combined with the Company's state income tax expense where the use of net operating loss carryforwards was either limited or unavailable to total \$1.1 million of income tax expense. The Company recognizes penalties and interest related to unrecognized tax benefits in income tax expense. During 2013, the Company recognized \$0.6 million in interest expense related to its tax provisions. The Company recognized no penalties or interest related to its tax provisions for either 2012 or 2011.

The income tax provision for the Company is included in the consolidated financial statements as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012	Year Ended December 31, 2011
Current:			
Federal	\$ 6,371	\$ 850	\$ —
State	1,774	298	—
Total current income tax provision	<u>\$ 8,145</u>	<u>\$ 1,148</u>	<u>\$ —</u>
Deferred:			
Federal	\$ (9,488)	\$ 1,031	\$ 345
State	(2,426)	278	96
	<u>(11,914)</u>	<u>1,309</u>	<u>441</u>
Valuation allowance	11,914	(1,309)	(441)
Total deferred income tax provision	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

The tax effects of temporary differences giving rise to the deferred tax assets (liabilities) are as follows (in thousands):

	December 31,	
	2013	2012
NOL carryover	\$ 31,258	\$ 40,330
Other reserves	3,270	2,919
State taxes and other	(4,909)	(1,534)
Deferred tax asset before valuation allowance	<u>29,619</u>	<u>41,715</u>
Depreciation	133	(49)
Deferred tax liability before valuation allowance	<u>133</u>	<u>(49)</u>
Deferred tax assets, net	29,752	41,666
Valuation allowance	<u>(29,752)</u>	<u>(41,666)</u>
	<u>\$ —</u>	<u>\$ —</u>

The Company has provided a valuation allowance against its net deferred tax asset at December 31, 2013 and 2012. The valuation allowance is due to the uncertainty of realizing the Company's historical operating losses. Accordingly, no provision or benefit for income taxes related to the Company is reflected in the accompanying consolidated statements of operations.

At December 31, 2013 and 2012, the net operating loss carryforwards for federal income tax purposes totaled approximately \$80.3 million and \$102.6 million, respectively. These losses, which begin to expire in 2024, are available to offset future income through 2032.

Characterization of Distributions

For income tax purposes, distributions paid consist of ordinary income, capital gains, return of capital or a combination thereof. For the years ended December 31, 2013, 2012 and 2011, distributions paid per share were characterized as follows (unaudited):

	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Common Stock:						
Ordinary income	\$0.100	100.000%	\$ —	—%	\$ —	—%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$0.100	100.000%	\$ —	—%	\$ —	—%
Preferred Stock—Series A						
Ordinary income	\$0.330	100.000%	\$2.000	100.000%	\$2.500	100.000%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$0.330	100.000%	\$2.000	100.000%	\$2.500	100.000%
Preferred Stock—Series C						
Ordinary income	\$0.656	100.000%	\$1.572	100.000%	\$1.965	100.000%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$0.656	100.000%	\$1.572	100.000%	\$1.965	100.000%
Preferred Stock—Series D						
Ordinary income	\$2.000	100.000%	\$2.000	100.000%	\$1.472	100.000%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$2.000	100.000%	\$2.000	100.000%	\$1.472	100.000%

11. SERIES C CUMULATIVE CONVERTIBLE REDEEMABLE PREFERRED STOCK

In May 2013, the Company redeemed all 4,102,564 shares of its Series C preferred stock for an aggregate redemption price of \$101.1 million, including \$1.1 million in accrued dividends. In accordance with the FASB's Emerging Issues Task Force Topic D-42, an additional redemption charge of \$0.1 million was recognized related to the original issuance costs of the Series C preferred stock, which were previously included in additional paid in capital. The Company redeemed the Series C preferred shares using cash received from its February 2013 common stock offering. After the redemption date, the Company has no outstanding shares of Series C preferred stock, and all rights of the holders of such shares were terminated.

12. STOCKHOLDERS' EQUITY

Series A Cumulative Redeemable Preferred Stock

In March 2013, the Company redeemed all 7,050,000 shares of its Series A preferred stock for an aggregate redemption price of \$178.6 million, including \$2.3 million in accrued dividends. In accordance with the FASB's Emerging Issues Task Force Topic D-42, an additional redemption charge of \$4.6 million was recognized related to the original issuance costs of the Series A preferred stock, which were previously included in additional paid in capital. The Company redeemed the Series A preferred shares using cash received from its February 2013 common stock offering. After the redemption date, the Company has no outstanding shares of Series A preferred stock, and all rights of the holders of such shares were terminated. Because the redemption of the Series A preferred stock is a redemption in full, trading of the Series A preferred stock on the New York Stock Exchange ceased after the redemption date.

Series D Cumulative Redeemable Preferred Stock

In April 2011, the Company sold an aggregate of 4,600,000 shares, including the full exercise of the underwriters' over-allotment option, of Series D preferred stock with a liquidation preference of \$25.00 per share for net proceeds of \$110.9 million. The proceeds were used to partially fund the Company's acquisition of the Hilton San Diego Bayfront. On or after April 6, 2016, the Series D preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change in control of the Company, (i) the Company may, at its option, redeem the Series D preferred stock in whole or in part and within 120 days after the first date on which such change of control occurred, by paying \$25.00 per share, plus any accrued and unpaid dividends up to, but not including, the redemption date, and (ii) holders of Series D preferred stock will have the right (unless, prior to the change of control conversion date, the Company has provided or provides notice of its election to redeem the Series D preferred stock) to convert some or all of their shares of Series D preferred stock into shares of the Company's common stock. Holders of Series D preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series D preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series D preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company's board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series D preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. The Series D preferred stock has no maturity date and the Company is not required to redeem the Series D preferred stock at any time, unless the Company decides, at its option, to exercise its redemption right or, under circumstances where the holders of Series D preferred stock decide to convert the Series D preferred stock. If the Company does not exercise its right to redeem the Series D preferred stock upon a change of control, holders of the Series D preferred stock have the right to convert some or all of their shares into a number of the Company's common shares based on a defined formula subject to a cap of 22,571,280 common shares.

Common Stock

In February 2013, the Company issued 25,300,000 shares of its common stock, including the underwriters' over-allotment of 3,300,000 shares, for net proceeds of approximately \$294.9 million. The Company used \$279.7 million of these proceeds to redeem all of its Series A preferred stock in March 2013, and its Series C preferred stock in May 2013, including accrued interest, and used portions of the remaining proceeds towards the acquisitions of the Hilton New Orleans St. Charles and the Boston Park Plaza.

In November 2013, the Company issued 20,000,000 shares of its common stock for net proceeds of \$270.9 million. The Company used the net proceeds from this offering to purchase the Hyatt Regency San Francisco, and will use the remaining proceeds for potential future acquisitions, capital investment in the Company's portfolio and other general corporate purposes, including working capital.

In June 2012, the Company issued 5,454,164 shares of its common stock to the seller of the Wyndham Chicago (which the Company rebranded the Hyatt Chicago Magnificent Mile) in connection with the Company's acquisition of the hotel. The Company incurred offering costs of \$0.1 million related to this transaction.

In June 2012, the Company issued 12,143,273 shares of its common stock for net proceeds of approximately \$126.2 million. The Company used a portion of these proceeds to fund the purchase of the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012, and used the remaining proceeds for capital investment in the Company's portfolio, including the renovation of the Hyatt Chicago Magnificent Mile, and other general corporate purposes, including working capital.

Dividends

The Company declared dividends per share on its Series A preferred stock, Series D preferred stock and common stock during 2013, 2012 and 2011 as follows:

	2013	2012	2011
Series A preferred stock	\$0.500	\$2.000	\$2.000
Series D preferred stock	2.000	2.000	1.472
Common stock—cash	0.100	—	—
	<u>\$2.600</u>	<u>\$4.000</u>	<u>\$3.472</u>

Operating Partnership Units

As of December 31, 2013, the Operating Partnership had 180,858,699 units outstanding, all of which are held by the Company.

13. LONG-TERM INCENTIVE PLAN

Stock Grants

The Company's Long-Term Incentive Plan ("LTIP") provides for the granting to directors, officers and eligible employees incentive or nonqualified share options, restricted shares, deferred shares, share purchase rights and share appreciation rights in tandem with options, or any combination thereof. The Company has reserved 6,050,000 common shares for issuance under the LTIP, and 1,211,566 shares remain available for future issuance as of December 31, 2013.

Restricted shares granted pursuant to the Company's LTIP generally vest over periods from three to five years from the date of grant. In August 2011, the Company granted both time-based and performance-based shares to Kenneth E. Cruse upon Mr. Cruse's appointment as the Company's Chief Executive Officer. The time-based shares, representing 60.0% of the total shares granted, will vest on a pro-rata basis commencing on the third anniversary of the grant date, and will vest in equal amounts on each of the third, fourth and fifth anniversary of the grant date. The remaining 40.0% of the total shares granted to Mr. Cruse are subject to performance- or market-based, cliff vesting on the fifth anniversary of the grant date, depending on the satisfaction of the following measures: the Company's total stockholder return ("TSR"); the Company's TSR relative to companies in the NAREIT Equity Index; and the ratio of the Company's total net debt to the Company's adjusted EBITDA.

Compensation expense related to awards of restricted shares and performance shares are measured at fair value on the date of grant and amortized over the relevant requisite service period or derived service period.

The Company's compensation expense and forfeitures related to restricted shares and performance awards for the years ended December 31, 2013, 2012 and 2011 were as follows (in thousands):

	2013	2012	2011
Compensation expense, including forfeitures	<u>\$7,189</u>	<u>\$5,139</u>	<u>\$4,135</u>

The Company's total compensation expense differs from the vesting of restricted common stock amount presented in the Company's consolidated statements of equity due to the Company withholding and using a portion of its restricted shares granted pursuant to its LTIP for purposes of remitting statutory minimum withholding and payroll taxes in connection with the release of restricted common shares to plan participants ("net-settle"). In addition, the Company capitalizes all restricted shares granted to certain of those employees who work on the design and construction of its hotels. The Company's total compensation expense in relation to its vesting of restricted common stock presented in the Company's consolidated statements of equity for the years ended December 31, 2013, 2012 and 2011 is as follows (in thousands):

	2013	2012	2011
Total compensation expense, including forfeitures	\$ 7,189	\$ 5,139	\$ 4,135
Net-settle adjustment	(2,331)	(1,673)	(1,390)
Amortization related to shares issued to design and construction employees	393	302	376
Amortization related to shares issued to unconsolidated joint venture	—	—	2
Vesting of restricted stock presented on statement of equity	<u>\$ 5,251</u>	<u>\$ 3,768</u>	<u>\$ 3,123</u>

The following is a summary of non-vested stock grant activity:

	2013		2012		2011	
	Shares	Weighted Average Price	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at beginning of year	1,539,992	\$ 9.11	1,407,152	\$8.55	668,934	\$7.70
Granted	975,711	11.82	647,171	9.51	1,260,845	9.10
Vested	(497,199)	9.89	(513,095)	8.08	(428,935)	8.85
Forfeited	(9,092)	10.89	(1,236)	9.38	(93,692)	8.43
Outstanding at end of year	<u>2,009,412</u>	10.23	<u>1,539,992</u>	9.11	<u>1,407,152</u>	8.55

At December 31, 2013, there were no deferred shares, share purchase rights, or share appreciation rights issued or outstanding under the LTIP.

Stock Options

In April 2008, the Compensation Committee of the Company's board of directors approved a grant of 200,000 non-qualified stock options (the "Options") to Robert A. Alter, the Company's former Executive Chairman and Chief Executive Officer. The Options fully vested in April 2009, and will expire in April 2018. The exercise price of the Options is \$17.71 per share.

14. COMMITMENTS AND CONTINGENCIES

Management Agreements

Management agreements with the Company's third-party hotel managers require the Company to pay between 2% and 3.5% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. Total basic management fees incurred by the Company during the years ended December 31, 2013, 2012 and 2011 were included in the Company's consolidated statements of operations as follows (in thousands):

	2013	2012	2011
Continuing operations—property general and administrative expense, and corporate overhead expense	\$25,218	\$22,807	\$19,549
Discontinued operations	65	2,061	2,643
	<u>\$25,283</u>	<u>\$24,868</u>	<u>\$22,192</u>

In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers. Total incentive management fees incurred by the Company during the years ended December 31, 2013, 2012 and 2011 were included in the Company's consolidated statements of operations as follows (in thousands):

	2013	2012	2011
Continuing operations—property general and administrative expense	\$3,025	\$2,738	\$2,916
Discontinued operations	—	587	675
	<u>\$3,025</u>	<u>\$3,325</u>	<u>\$3,591</u>

License and Franchise Agreements

The Company has entered into license and franchise agreements related to certain of its hotel properties. The license and franchise agreements require the Company to, among other things, pay monthly fees that are calculated based on specified percentages of certain revenues. The license and franchise agreements generally contain specific standards for, and restrictions and limitations on, the operation and maintenance of the hotels which are established by the franchisors to maintain uniformity in the system created by each such franchisor. Such standards generally regulate the appearance of the hotel, quality and type of goods and services offered, signage and protection of trademarks. Compliance with such standards may from time to time require the Company to make significant expenditures for capital improvements.

Total license and franchise fees incurred by the Company during the years ended December 31, 2013, 2012 and 2011 were included in the Company's consolidated statements of operations as follows (in thousands):

	2013	2012	2011
Continuing operations—franchise costs	\$32,932	\$30,067	\$25,595
Discontinued operations	73	2,996	3,520
	<u>\$33,005</u>	<u>\$33,063</u>	<u>\$29,115</u>

Total license and franchise costs included royalties of \$10.8 million, \$10.6 million and \$8.8 million incurred by the Company during the years ended December 31, 2013, 2012 and 2011, respectively. The remaining costs included advertising, reservation and priority club assessments.

Renovation and Construction Commitments

At December 31, 2013, the Company had various contracts outstanding with third parties in connection with the renovation of certain of its hotel properties aimed at maintaining the appearance and quality of its hotels. The remaining commitments under these contracts at December 31, 2013 totaled \$43.5 million.

Capital Leases

The Hyatt Chicago Magnificent Mile is subject to a building lease which expires in December 2097 (see Note 3). The Company evaluated the terms of the lease agreement and determined the lease to be a capital lease pursuant to the Leases Topic of the FASB ASC. Upon acquisition of the hotel in June 2012, the Company recorded a capital asset related to its leasehold interest of \$58.8 million to buildings and improvements, and a capital lease obligation of \$15.6 million. In addition to minimum rent, the capital lease is subject to percentage rent equal to 4.0% of the hotel's gross room revenues over a certain threshold.

The Company leases certain printers and copiers which leases have been determined to be capital leases pursuant to the Leases Topic of the FASB ASC. All of the leases expire in December 2014.

Assets under capital lease were included in investment in hotel properties, net on the Company's consolidated balance sheets as follows (in thousands):

	December 31,	
	2013	2012
Buildings and improvements	\$58,799	\$58,799
Furniture, fixtures and equipment	104	104
	<u>58,903</u>	<u>58,903</u>
Accumulated depreciation	<u>(2,356)</u>	<u>(871)</u>
	<u>\$56,547</u>	<u>\$58,032</u>

Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2013 are as follows (in thousands):

2014	\$ 1,437
2015	1,411
2016	1,403
2017	1,403
2018	1,403
Thereafter	<u>110,817</u>
Total minimum lease payments ⁽¹⁾	117,874
Less: Amount representing interest ⁽²⁾	<u>(102,253)</u>
Present value of net minimum lease payments ⁽³⁾	<u>\$ 15,621</u>

(1) Minimum lease payments do not include percentage rent which may be paid under the Hyatt Chicago Magnificent Mile building lease on the basis of 4.0% of the hotel's gross room revenues over a certain threshold. The Company recorded zero and \$3,000 in percentage rent during 2013 and 2012, respectively.

(2) Interest includes the amount necessary to reduce net minimum lease payments to present value calculated at the Company's incremental borrowing rate at lease inception.

(3) The present value of net minimum lease payments are reflected in the Company's consolidated balance sheet as of December 31, 2013 as a current obligation of \$35,000, which is included in accounts payable and accrued expenses, and as a long-term obligation of \$15.6 million, which is included in capital lease obligations, less current portion.

Ground, Building and Air Leases

During 2013, 2012 and 2011, certain of the Company's 29 hotels were obligated to unaffiliated third parties under the terms of ground, building and air leases as follows:

	2013	2012	2011
Number of hotels with ground, building and/or air leases	10	10	9
Number of ground leases	9	9	9
Number of building leases	1	1	—
Number of air leases	3	3	3
Total number of ground, building and air leases	13	13	12

At December 31, 2013, the ground, building and air leases mature in dates ranging from 2037 through 2097, excluding renewal options. One of the air leases requires a payment of \$1.00 annually, which the Company has paid in full for the life of the lease. Total rent expense incurred pursuant to ground, building and air lease agreements for the years ended December 31, 2013, 2012 and 2011 was included in the Company's consolidated statements of operations as follows (in thousands):

	2013	2012	2011
Continuing operations—property tax, ground lease and insurance	\$17,359	\$16,950	\$14,787
Discontinued operations	—	14	52
	<u>\$17,359</u>	<u>\$16,964</u>	<u>\$14,839</u>

At December 31, 2013, the Company was obligated to an unaffiliated party under the terms of a sublease on the corporate facility, which matures in 2018. Rent expense incurred pursuant to leases on the corporate facility totaled \$0.4 million for both of the years ended December 31, 2013 and 2012, and \$0.3 million for the year ended December 31, 2011, and was included in corporate overhead expense.

Future minimum payments under the terms of the 13 ground, building and air leases, as well as the sublease on the corporate facility, in effect at December 31, 2013 are as follows (in thousands):

2014	\$ 10,476
2015	10,536
2016	10,597
2017	13,620
2018	13,548
Thereafter	<u>504,774</u>
Total	<u>\$563,551</u>

Employment Agreements

As of December 31, 2013, the Company has employment agreements with certain executive employees, which expire in August 2016. The terms of the agreements stipulate payments of base salaries and bonuses.

Approximate minimum future obligations under employment agreements are as follows as of December 31, 2013 (in thousands):

2014	\$1,435
2015	1,435
2016	<u>837</u>
	<u>\$3,707</u>

Collective Bargaining Agreements

The Company is subject to exposure to collective bargaining agreements at certain hotels operated by its management companies. At December 31, 2013, approximately 30.2% of workers employed by the Company's third-party managers were covered by such collective bargaining agreements.

401(k) Savings and Retirement Plan

The Company's employees may participate, subject to eligibility, in the Company's 401(k) Savings and Retirement Plan (the "401(k) Plan"). Employees are eligible to participate in the 401(k) Plan after attaining 21 years of age and after the first of the month following the performance of six months of service. Three percent of eligible employee annual base earnings are contributed by the Company as a Safe Harbor elective contribution. Safe Harbor contributions made by the Company totaled \$0.2 million for each of the years ended December 31, 2013, 2012 and 2011, and were included in corporate overhead expense.

The Company is also responsible for funding various retirement plans at certain hotels operated by its management companies. Property general and administrative expense on the Company's consolidated statements of operations includes matching contributions into these various retirement plans of \$1.1 million, \$0.9 million and \$0.3 million for the years ended December 31, 2013, 2012 and 2011, respectively. Discontinued operations on the Company's consolidated statements of operations includes matching contributions into these retirement plans of \$3,000 for the year ended December 31, 2013, and \$0.1 million for both the years ended December 31, 2012 and 2011.

Concentration of Risk

The concentration of the Company's hotels in California, New York, Illinois, Massachusetts and the greater Washington DC area exposes the Company's business to economic conditions, competition and real and personal property tax rates unique to these locales. As of December 31, 2013, the Company's 29 hotels were concentrated in California, New York, Illinois, Massachusetts and the greater Washington DC area as follows:

	California	New York	Illinois	Massachusetts	Greater Washington DC Area
Number of hotels	9	3	3	3	3
Percentage of total rooms	32%	9%	8%	14%	13%
Percentage of total revenue for the year ended December 31, 2013	34%	13%	7%	14%	13%

Other

The Company has provided customary unsecured environmental indemnities to certain lenders. The Company has performed due diligence on the potential environmental risks, including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate the Company to reimburse the indemnified parties for damages related to certain environmental matters. There is no term or damage limitation on these indemnities; however, if an environmental matter arises, the Company could have recourse against other previous owners or a claim against its environmental insurance policies.

At December 31, 2013, the Company had \$0.8 million of outstanding irrevocable letters of credit to guaranty the Company's financial obligations related to workers' compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon these letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through December 31, 2013.

15. QUARTERLY OPERATING RESULTS (UNAUDITED)

The consolidated quarterly results for the years ended December 31, 2013 and 2012, of the Company are as follows (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
REVENUES—CONTINUING OPERATIONS				
2013	\$194,921	\$234,638	\$250,370	\$243,895
2012	\$178,234	\$212,842	\$205,041	\$232,967
OPERATING INCOME—CONTINUING OPERATIONS				
2013	\$ 3,568	\$ 36,622	\$ 34,368	\$ 24,640
2012	\$ 5,151	\$ 28,614	\$ 16,248	\$ 28,997
NET INCOME (LOSS)				
2013	\$ 28,926	\$ 20,009	\$ 15,817	\$ 5,249
2012	\$ (12,968)	\$ 11,855	\$ 39,556	\$ 11,114
INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS				
PER SHARE—BASIC AND DILUTED				
2013	\$ 0.12	\$ 0.09	\$ 0.07	\$ 0.01
2012	\$ (0.18)	\$ 0.03	\$ 0.23	\$ 0.03

Income available (loss attributable) to common stockholders per share is computed independently for each of the quarters presented and therefore may not sum to the annual amount for the year.

16. SUBSEQUENT EVENTS

In January 2014, the Company was notified of its successful appeal of the real estate valuation for the Hilton San Diego Bayfront with the San Diego County Assessor's office. Based on current property tax rates, the Company expects to receive a refund of approximately \$4.0 million related to current and prior year real estate taxes.

In February 2014, the Company entered into separate Equity Distribution Agreements (the "Agreements") with Wells Fargo Securities, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Managers"). Under the terms of the Agreements, the Company may issue and sell from time to time through or to the Managers, as sales agents and/or principals, shares of the Company's common stock having an aggregate offering amount of up to \$150.0 million.

STOCK INFORMATION

Our common stock is traded on the NYSE under the symbol “SHO.” On February 14, 2014, the last reported price per share of common stock on the NYSE was \$13.40. The table below sets forth the high and low closing price per share of our common stock as reported on the NYSE and the cash dividends per share of common stock we declared with respect to each period.

	High	Low	Dividends Declared
2012:			
First Quarter	\$10.00	\$ 8.06	\$0.00
Second Quarter	\$10.99	\$ 9.27	\$0.00
Third Quarter	\$11.70	\$ 9.68	\$0.00
Fourth Quarter	\$10.97	\$ 9.34	\$0.00
2013:			
First Quarter	\$12.31	\$11.02	\$0.00
Second Quarter	\$13.09	\$11.14	\$0.00
Third Quarter	\$13.49	\$11.87	\$0.05
Fourth Quarter	\$14.06	\$12.50	\$0.05

Subject to certain limitations, we intend to make dividends on our stock in amounts equivalent to 100% of our annual taxable income. The level of any future dividends will be determined by our Board of Directors after considering taxable income projections, expected capital requirements, risks affecting our business and in context of our leverage-reduction initiatives. As a result, any future common stock dividends may be comprised of cash only, or a combination of cash and stock, consistent with Internal Revenue Service guidelines.

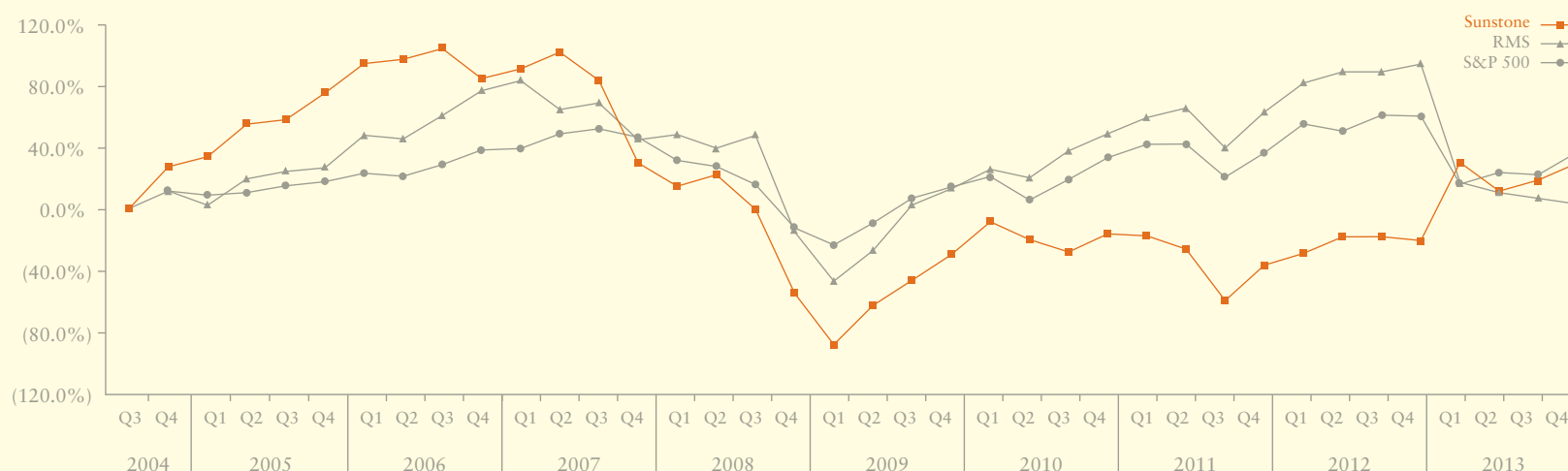
As of February 14, 2014, we had approximately 24 holders of record of our common stock. However, because many of the shares of our common stock are held by brokers and other institutions on behalf of stockholders, we believe there are substantially more beneficial holders of our common stock than record holders. In order to comply with certain requirements related to our qualification as a REIT, our charter limits the number of common shares that may be owned by any single person or affiliated group to 9.8% of the outstanding common shares, subject to the ability of our board to waive this limitation under certain conditions.

HISTORICAL PERFORMANCE COMPARISON⁽¹⁾

October 21, 2004–December 31, 2013

Sunstone Hotel Investors, Inc., Morgan Stanley REIT Index, Standard & Poor's 500 Composite Stock Index

Source: FactSet Research Systems as of 12/31/13



(1) This graph provides a comparison of cumulative total stockholder returns for the period from October 21, 2004, the date of our initial public offering, through December 31, 2013, among Sunstone Hotel Investors, Inc. (“Sunstone”), the Standard & Poor’s 500 Composite Stock Index (“S&P 500”) and the Morgan Stanley REIT Index (“RMS”).

The total return values were calculated assuming a \$100 investment on October 21, 2004 with reinvestment of all dividends in (i) our common stock, (ii) the S&P 500 and (iii) the RMS, respectively. The total return values do not include any dividends declared, but not paid, during the period.

CORPORATE INFORMATION

BOARD OF DIRECTORS

John V. Arabia
Director & President
Sunstone Hotel Investors, Inc.

Andrew M. Batinovich
President & Chief Executive Officer
Glenborough, LLC

Z. Jamie Behar
Managing Director, Real Estate and
Alternative Investments
General Motors Investment
Management Corporation

Kenneth E. Cruse
Director & Chief Executive Officer
Sunstone Hotel Investors, Inc.

Keith M. Locker
Non-Executive Chairman
Sunstone Hotel Investors, Inc.
President
Inlet Capital, LLC

Thomas A. Lewis, Jr.
Vice Chairman, Board of Directors
Realty Income Corporation

Douglas M. Pasquale
Director

Keith P. Russell
President
Russell Financial, Inc.

Lewis N. Wolff
Chairman & Chief Executive Officer
Wolff Urban Management, Inc.

EXECUTIVE OFFICERS

Kenneth E. Cruse
Chief Executive Officer

John V. Arabia
President

Marc A. Hoffman
Executive Vice President & Chief Operating Officer

Bryan A. Giglia
Senior Vice President & Chief Financial Officer

Robert C. Springer
Senior Vice President & Chief Investment Officer

Lindsay Monge
Senior Vice President & Chief Administrative Officer

David R. Sloan
Senior Vice President & General Counsel

W. Guy Lindsey
Senior Vice President—Design & Construction

ANNUAL MEETING OF STOCKHOLDERS

The Annual Meeting will be held at
11:30 A.M. on May 1, 2014 at:
Hilton San Diego Bayfront
1 Park Boulevard
San Diego, CA 92101

TRANSFER AGENT

American Stock Transfer & Trust Co.
59 Maiden Lane
New York, NY 10038
(800) 937-5449

STOCK LISTING

Common Stock of the Company is traded on the New York Stock Exchange under the symbol “SHO”.

Series D Preferred Stock is traded on the New York Stock Exchange under the symbol “SHO PR D”.

INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS

Ernst & Young LLP

FORM 10-K AND OTHER MATERIALS

A copy of the Company’s Annual Report on Form 10-K as filed with the Securities and Exchange Commission is available free of charge to its stockholders. Such requests should be made to:

INVESTOR RELATIONS

Sunstone Hotel Investors, Inc.
120 Vantis, Suite 350
Aliso Viejo, CA 92656
(949) 330-4000
investorrelations@sunstonehotels.com
www.sunstonehotels.com

CEO AND CFO CERTIFICATIONS

In 2013, the Company’s Chief Executive Officer (CEO) provided to the New York Stock Exchange the annual CEO certification regarding the Company’s compliance with the New York Stock Exchange’s corporate governance listing standards. In addition, all required certifications by the Company’s CEO and Chief Financial Officer (CFO) regarding the quality of the Company’s public disclosures in its fiscal 2013 reports were filed with the U.S. Securities and Exchange Commission.

This is a Greener Annual Report. Sunstone Hotel Investors, Inc. is committed to reducing its impact on the environment. The production of this annual report saved the following resources: *(estimates were made using the Neenab Environmental Calculator)*



MIX
Paper from
responsible sources
FSC® C019076



19 TREES
preserved for
the future



6M BTUs
of energy not
consumed



1,742 LBS
of emissions
prevented



8,390 GAL
wastewater
flow saved



509 LBS
solid waste
not generated



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