Pebblebrook Hotel Trust
Form 10-Q
October 27, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number 001-34571

PEBBLEBROOK HOTEL TRUST

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**27-1055421**
(State of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
2 Bethesda Metro Center, Suite 1530 Bethesda, Maryland	**20814**
(Address of Principal Executive Offices)	**(Zip Code)**

(240) 507-1300

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at October 21, 2011**
Common shares of beneficial interest ($0.01 par value per share)	50,897,688

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Pebblebrook Hotel Trust

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Pebblebrook Hotel Trust

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Investment in hotel properties, net	$ 1,120,484	$ 599,714
Investment in unconsolidated entities	167,603	
Ground lease asset, net	10,557	10,721
Cash and cash equivalents	75,318	220,722
Restricted cash	8,730	4,485
Hotel receivables (net of allowance for doubtful accounts of $56 and $13, respectively)	14,925	3,924
Deferred financing costs, net	3,614	2,718
Prepaid expenses and other assets	16,197	13,231
Total assets	$ 1,417,428	$ 855,515
LIABILITIES AND SHAREHOLDERS EQUITY		
Senior credit facility	$	$
Mortgage debt	251,834	143,570
Accounts payable and accrued expenses	32,302	15,799
Advance deposits	5,200	2,482
Accrued interest	931	304
Distribution payable	8,736	4,908
Total liabilities	299,003	167,063
Commitments and contingencies (Note 10)		
Shareholders equity:		
Preferred shares of beneficial interest, stated at liquidation preference $25 per share, $.01 par value, 100,000,000 shares authorized; 9,000,000 and 0 shares issued and outstanding at September 30, 2011 and at December 31, 2010, respectively	225,000	
Common shares of beneficial interest, $.01 par value, 500,000,000 shares authorized; 50,771,380 issued and outstanding at September 30, 2011 and 39,814,760 issued and outstanding at December 31, 2010	508	398
Additional paid-in capital	917,842	698,100
Accumulated deficit and distributions	(27,603)	(11,586)
Total shareholders equity	1,115,747	686,912
Non-controlling interests	2,678	1,540
Total equity	1,118,425	688,452
Total liabilities and equity	$ 1,417,428	$ 855,515

The accompanying notes are an integral part of these financial statements.

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Pebblebrook Hotel Trust

Consolidated Statements of Operations

(In thousands, except share and per-share data)

(Unaudited)

	For the three months ended September 30, 2011	For the three months ended September 30, 2010	For the nine months ended September 30, 2011	For the nine months ended September 30, 2010
Revenues:				
Room	$ 56,437	$ 12,805	$ 127,597	$ 14,165
Food and beverage	25,627	7,816	63,580	8,586
Other operating	5,739	1,016	12,401	1,102
Total revenues	87,803	21,637	203,578	23,853
Expenses:				
Hotel operating expenses:				
Room	14,477	3,769	33,984	4,067
Food and beverage	18,736	5,615	45,423	6,020
Other direct	2,747	452	5,830	493
Other indirect	23,651	6,006	56,587	6,651
Total hotel operating expenses	59,611	15,842	141,824	17,231
Depreciation and amortization	9,037	2,032	21,426	2,260
Real estate taxes, personal property taxes and property insurance	3,860	836	8,941	909
Ground rent	589	11	1,350	11
General and administrative	3,527	1,729	8,253	5,371
Hotel acquisition costs	3,903	1,665	7,344	4,811
Total operating expenses	80,527	22,115	189,138	30,593
Operating income (loss)	7,276	(478)	14,440	(6,740)
Interest income	49	638	815	2,513
Interest expense	(3,775)	(471)	(10,077)	(471)
Other	38		85	
Equity in earnings of unconsolidated entities	2,169		2,169	
Income (loss) before income taxes	5,757	(311)	7,432	(4,698)
Income tax (expense) benefit	81	3	(339)	(23)
Net income (loss)	5,838	(308)	7,093	(4,721)
Net income (loss) attributable to non-controlling interests	114		199	
Net income (loss) attributable to the Company	5,724	(308)	6,894	(4,721)
Distributions to preferred shareholders	(2,899)		(5,907)	
Net income (loss) attributable to common shareholders	$ 2,825	$ (308)	$ 987	$ (4,721)
Net income (loss) per share attributable to common shareholders, basic and diluted	$ 0.05	$ (0.01)	$ 0.01	$ (0.19)
Weighted-average number of common shares, basic and diluted	50,771,355	34,073,090	46,962,639	24,915,173

The accompanying notes are an integral part of these financial statements.

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Pebblebrook Hotel Trust

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	For the nine months ended September 30, 2011	2010
Operating activities:		
Net income (loss)	$ 7,093	$ (4,721)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	21,426	2,260
Share-based compensation	1,972	1,506
Amortization of deferred financing costs	1,135	175
Amortization of ground lease	164	
Equity in earnings from unconsolidated entities	(2,169)	
Deferred income tax benefit		23
Other	142	
Changes in assets and liabilities:		
Restricted cash, net	(686)	
Hotel receivables	(10,024)	(3,453)
Prepaid expenses and other assets	(5,024)	(2,345)
Accounts payable and accrued expenses	13,359	7,941
Advance deposits	1,035	357
Net cash provided by operating activities	28,423	1,743
Investing activities:		
Acquisition of hotel properties	(467,135)	(331,650)
Improvements and additions to hotel properties	(26,348)	(350)
Contributions to unconsolidated entities	(165,434)	
Deposit on hotel property		(1,000)
Redemption of certificates of deposits		70,000
Purchase of corporate office equipment, computer software, and furniture	(145)	(464)
Restricted cash, net	(3,559)	(1,061)
Net cash used in investing activities	(662,621)	(264,525)
Financing activities:		
Gross proceeds from issuance of common shares	235,980	332,350
Gross proceeds from issuance of preferred shares	225,150	
Payment of offering costs common and preferred shares	(17,108)	(15,392)
Payment of deferred financing costs	(2,031)	(2,300)
Contributions from non-controlling interest	95	
Borrowings under senior credit facility	42,000	
Repayments under senior credit facility	(42,000)	
Proceeds from mortgage debt	67,000	
Repayments of mortgage debt	(736)	
Repurchase of shares	(140)	
Distributions common shares/units	(16,025)	
Distributions preferred shares	(3,391)	

Net cash provided by financing activities	488,794	314,658
Net change in cash and cash equivalents	(145,404)	51,876
Cash and cash equivalents, beginning of year	220,722	319,119
Cash and cash equivalents, end of period	$ 75,318	$ 370,995

The accompanying notes are an integral part of these financial statements.

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PEBBLEBROOK HOTEL TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Organization

Pebblebrook Hotel Trust (the Company) was formed as a Maryland real estate investment trust on October 2, 2009 to opportunistically acquire and invest in hotel properties located primarily in major United States cities, with an emphasis on major coastal markets.

As of September 30, 2011, the Company owned interests in 20 hotels, including 14 wholly-owned hotels, with a total of 3,812 guest rooms and a 49% joint venture interest in 6 hotels with 1,732 guest rooms. The hotels are located in the following markets: Atlanta (Buckhead), Georgia; Bethesda, Maryland; Boston, Massachusetts; Miami, Florida; Minneapolis, Minnesota; New York, New York; Philadelphia, Pennsylvania; San Diego, California; San Francisco, California; Santa Monica, California; Seattle, Washington; Stevenson, Washington, Washington, D.C.; and West Hollywood, California.

Substantially all of the Company s assets are held by, and all of the operations are conducted through, Pebblebrook Hotel, L.P., (the Operating Partnership). The Company is the sole general partner of the Operating Partnership. At September 30, 2011, the Company owned 98.2 percent of the common Operating Partnership units issued by the Operating Partnership. The remaining 1.8 percent of the common units issued by the Operating Partnership are owned by the other limited partners of the Operating Partnership. For the Company to qualify as a real estate investment trust (REIT) under the Internal Revenue Code, it cannot operate the hotels it owns. Therefore, its Operating Partnership and its subsidiaries lease the hotel properties to subsidiaries of Pebblebrook Hotel Lessee, Inc. (collectively, PHL), the Company s taxable REIT subsidiary (TRS), which in turn engages third-party eligible independent contractors to manage the hotels. PHL is consolidated into the Company s financial statements.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and in conformity with the rules and regulations of the Securities and Exchange Commission (SEC) applicable to interim financial information. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations of the SEC. These unaudited consolidated financial statements include all adjustments considered necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows for the periods presented. Interim results are not necessarily indicative of full-year performance, as a result of the impact of seasonal and other short-term variations and to the acquisitions of hotel assets. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

The consolidated financial statements include all of the accounts of the Company and its wholly-owned subsidiaries in accordance with U.S. GAAP. All intercompany balances and transactions have been eliminated in consolidation. Investments in entities that the Company does not control, but has the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method.

The Company s comprehensive income (loss) equals its net income (loss) attributable to common shareholders and the Company had no items classified as accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2011 and 2010.

Use of Estimates

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and revenues and expenses. These estimates are prepared using management s best judgment, after considering past, current and expected events and economic conditions. Actual results could differ from these estimates.

Investment in Hotel Properties

Upon acquisition of hotel properties, the Company allocates the purchase price based on the fair value of the acquired land, land improvements, building, furniture, fixtures and equipment, identifiable intangible assets or liabilities, other assets and assumed liabilities. Identifiable intangible assets or liabilities typically arise from contractual arrangement terms that are above or below market compared to an estimated market agreement at the acquisition date. Acquisition-date fair values of assets and assumed liabilities are determined based on replacement costs, appraised values, and estimated fair values using methods similar to those used by independent appraisers and that use appropriate discount and/or capitalization rates and available market information.

Acquisition costs are expensed as incurred.

Hotel renovations and replacements of assets that improve or extend the life of the asset are recorded at cost and depreciated over their estimated useful lives. Furniture, fixtures and equipment under capital leases are recorded at the present value of the minimum lease payments. Repair and maintenance costs are expensed as incurred.

Hotel properties are recorded at cost and depreciated using the straight-line method over an estimated useful life of 15 to 40 years for buildings, land improvements, and building improvements and one to 10 years for furniture, fixtures and equipment. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets. Intangible assets arising from contractual arrangements are typically amortized over the life of the contract. The Company is required to make subjective assessments as to the useful lives and classification of properties for purposes of determining the amount of depreciation expense to reflect each year with respect to the assets. These assessments may impact the Company s results of operations.

The Company reviews its investments in hotel properties for impairment whenever events or changes in circumstances indicate that the carrying value of the hotel properties may not be recoverable. Events or circumstances that may cause a review include, but are not limited to, when a hotel property experiences a current or projected loss from operations, when it becomes more likely than not that a hotel property will be sold before the end of its useful life, adverse changes in the demand for lodging at the properties due to declining national or local economic conditions and/or new hotel construction in markets where the hotels are located. When such conditions exist, the Company performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel exceed its carrying value. If the estimated undiscounted future cash flows are less than the carrying value of the asset, an adjustment to reduce the carrying value to the related hotel s estimated fair market value is recorded and an impairment loss recognized. In the evaluation of impairment of its hotel properties, the Company makes many assumptions and estimates including projected cash flows both from operations and eventual disposition, expected useful life and holding period, future required capital expenditures, and fair values, including consideration of capitalization rates, discount rates, and comparable selling prices. The Company will adjust its assumptions with respect to the remaining useful life of the hotel property when circumstances change or it is more likely than not that the hotel property will be sold prior to its previously expected useful life.

The Company will classify a hotel as held for sale when a binding agreement to purchase the property has been signed under which the buyer has committed a significant amount of nonrefundable cash, no significant financing contingencies exist, and the sale is expected to close within one year. If these criteria are met and if the fair value less costs to sell is lower than the carrying value of the hotel, the Company will record an impairment loss and will cease recording depreciation expense. The Company will classify the loss, together with the related operating results, as discontinued operations on the statements of operations and classify the assets and related liabilities as held for sale on the balance sheet.

Revenue Recognition

Revenue consists of amounts derived from hotel operations, including the sales of rooms, food and beverage, and other ancillary amenities. Revenue is recognized when rooms are occupied and services have been rendered. The Company collects sales, use, occupancy and similar taxes at its hotels which are presented on a net basis on the statement of operations.

Income Taxes

To qualify as a REIT for federal income tax purposes, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90 percent of its adjusted taxable income to its shareholders. As a REIT, the Company generally will not be subject to federal corporate income tax on that portion of its taxable income that is currently distributed to shareholders. The Company is subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income. In addition, PHL, which

leases the Company s hotels from the Operating Partnership, is subject to federal and state income taxes. The Company accounts 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 the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Valuation allowances are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing the net income (loss) attributable to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income (loss) attributable to common shareholders as adjusted for potentially dilutive securities, by the weighted average number of common shares outstanding plus potentially dilutive securities. Any anti-dilutive securities are excluded from the diluted per-share calculation.

Note 3. Acquisition of Hotel Properties

On February 16, 2011, the Company acquired the 252-room Argonaut Hotel located in San Francisco, California for $84.0 million. The acquisition was funded with $42.0 million of available cash and the assumption of a $42.0 million first mortgage loan. The hotel is subject to a long-term ground lease agreement with the United States Department of the Interior that expires in 2059. The hotel is required to pay the greater of a base rent of $1.2 million, as adjusted for consumer price index (CPI) increases, or a percentage of rooms revenues, food and beverage revenues, and other department revenues in excess of certain thresholds, as defined in the agreement. The fee, as a percentage of rooms revenues, ranges from 8% to 12% in the initial years and 12% to 14% in the later years. The fee as a percentage of food and beverage and other department revenues is 4% over the term of the lease. The terms of the ground lease were evaluated and they were determined to approximate current market terms. The Company retained Kimpton Hotels and Restaurants to manage the hotel.

On April 6, 2011, the Company acquired the 450-room Westin Gaslamp Quarter located in San Diego, California for $110.0 million. Prior to the acquisition, the hotel was undergoing a $25.0 million renovation project and, in addition to the purchase price, the Company reimbursed the seller approximately $8.6 million for the renovation costs incurred and paid by the seller through the date of closing. The remaining renovation costs will be paid by the Company. The Company retained Starwood Hotels and Resorts to manage the hotel.

On April 7, 2011, the Company acquired the 189-room Hotel Monaco Seattle located in Seattle, Washington for $51.2 million. The Company retained Kimpton Hotels and Restaurants to manage the hotel.

On May 3, 2011, the Company acquired the 237-room Mondrian Los Angeles located in Los Angeles, California for $137.0 million. The Company retained the Morgans Hotel Group to manage the hotel.

On May 26, 2011, the Company acquired the 148-room Viceroy Miami located in Miami, Florida for $36.5 million. The Company retained the Viceroy Hotel Group to manage the hotel and PHL received $3.0 million in key money from Viceroy Hotel Group to enter into the management agreement with Viceroy Hotel Group which is amortized as a reduction of management fee expense over the ten-year term of the management agreement.

On June 8, 2011, the Company acquired the 235-room W Boston located in Boston Massachusetts for $89.5 million. The Company retained Starwood Hotels and Resorts to manage the hotel.

The allocation of purchase price to the fair value of the acquired assets and liabilities is as follows (in thousands):

	Argonaut Hotel	Westin Gaslamp Quarter	Hotel Monaco Seattle	Mondrian Los Angeles	Viceroy Miami	W Boston	Total
Land	$	$ 25,537	$ 10,105	$ 20,306	$ 8,368	$ 19,453	$ 83,769
Buildings and improvements	79,492	86,113	38,888	110,283	24,246	63,893	402,915
Furniture, fixtures and equipment	4,247	6,826	2,073	6,091	3,723	5,887	28,847
In place lease assets	190						190
Inventory	71	78	84	75	163	267	738

Net working capital	193	(931)	(251)	74	(146)	(1,263)	(2,324)
Net assets acquired	$ 84,193	$ 117,623	$ 50,899	$ 136,829	$ 36,354	$ 88,237	$ 514,135

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The results of operations of the Argonaut Hotel, Westin Gaslamp Quarter, Hotel Monaco Seattle, Mondrian Los Angeles, Viceroy Miami,W Boston, and Denihan joint venture (defined in Note 5 below) are included in the consolidated statements of operations beginning on their acquisition dates. The following unaudited pro forma financial information presents the results of operations of the Company for the three and nine months ended September 30, 2011 and 2010 as if the hotels and joint venture acquired in 2010 and 2011 were acquired on January 1, 2010. The pro forma results below excluded acquisition costs of $3.9 million and $7.3 million for the three and nine months ended September 30, 2011, respectively and $1.7 million and $4.8 million for the three and nine months ended September 30, 2010, respectively. The unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of either the results of operations that would have actually occurred had these transactions occurred on January 1, 2010 or the future results of operations (in thousands, except per-share data).

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Total revenues	$ 87,803	$ 80,292	$ 245,806	$ 230,191
Operating income (loss)	11,179	8,112	23,238	18,304
Net income (loss) attributable to common shareholders	8,052	7,588	6,879	13,034
Net income (loss) per share attributable to common shareholders basic and diluted	$ 0.16	$ 0.15	$ 0.14	$ 0.26

Note 4. Investment in Hotel Properties

Investment in hotel properties as of September 30, 2011 and December 31, 2010 consisted of the following (in thousands):

	September 30, 2011	December 31, 2010
Land	$ 190,197	$ 106,428
Buildings and improvements	878,819	460,988
Furniture, fixtures and equipment	78,245	37,966
Investment in hotel properties	$ 1,147,261	$ 605,382
Less: Accumulated depreciation	(26,777)	(5,668)
Investment in hotel properties, net	$ 1,120,484	$ 599,714

Note 5. Investment in Unconsolidated Entities

On July 29, 2011, the Company acquired a 49% interest in a joint venture (the Denihan joint venture), which owns six properties in New York, New York, for $152.6 million. The transaction values the six hotels at approximately $908 million (subject to working capital and similar adjustments). The Company accounts for this investment using the equity method. As of September 30, 2011, the joint venture reported approximately $566.9 million in total assets and $627.4 million in total liabilities, including $595.3 million of non-recourse debt which matures in February of 2013. The Company is not a guarantor of any existing debt of the joint venture except for limited customary carve-outs related to fraud or misapplication of funds. The Company incurred approximately $4.6 million in acquisition costs, excluding costs paid by the joint venture, related to this investment.

At the time of the Company s investment, the estimated fair value of the hotel properties owned by the Denihan joint venture exceeded the carrying value. This basis difference between the Company s investment in unconsolidated entities and the Company s proportionate 49% interest in these depreciable assets held by the joint venture is amortized over the estimate life of the underlying assets and recognized as a component of equity in earnings of unconsolidated entities (referred to as the basis difference in the table below).

The summarized results of operations of the Company s investment in the Denihan joint venture from the acquisition date to September 30, 2011 are presented below (in thousands):

	Acquisition date to September 30, 2011
Revenues	$ 31,206
Total operating expenses	21,709
Operating income	9,497
Net income (loss)	4,708
Company s 49% interest of net income (loss)	2,307
Basis adjustment	(138)
Equity in earnings (losses) in unconsolidated entities	$ 2,169

Note 6. Debt

Senior Credit Facility

On June 3, 2011, the Company amended and restated in its entirety the credit agreement that it had entered into in July 2010. The Company s credit facility is now unsecured and its borrowing capacity is now $200.0 million, an increase of $50.0 million as compared to the prior credit facility s capacity. The credit facility matures on June 3, 2014, and the Company has a one-year extension option. The Company has the ability to increase the credit facility borrowings up to $400.0 million with lender approval. Borrowings on the credit facility bear interest at LIBOR plus 2.5% to 3.5%, depending on the Company s leverage ratio. Additionally, the Company is required to pay an unused commitment fee at an annual rate of 0.35% or 0.50% of the unused portion of the senior credit facility, depending on the amount of borrowings outstanding. The credit facility contains certain financial covenants including a maximum leverage ratio, a maximum debt service coverage ratio, a minimum fixed charge coverage ratio, and minimum net worth. The Company incurred approximately $1.3 million in fees in connection with this amendment which are amortized over the term of the credit facility. As of September 30, 2011 and December 31, 2010, the Company had no outstanding borrowings under the credit facility. As of September 30, 2011, the Company was in compliance with the credit facility debt covenants. For the three and nine months ended September 30, 2011, the Company incurred unused commitment fees of $0.2 million and $0.6 million, respectively. The Company incurred unused commitment fees of $0.2 million for the three and nine months ended September 30, 2010.

Mortgage Debt

Each of the Company s mortgage loans is secured by a first-mortgage lien on the underlying property. The mortgages are non-recourse to the Company except for fraud or misapplication of funds.

On January 6, 2011, the Company entered into a first-mortgage loan on the Skamania Lodge. The debt has a principal balance of $31.0 million, a term of five years, bears interest at 5.44% and requires monthly principal and interest payments of $174,898.

On January 21, 2011, the Company entered into a first-mortgage loan on the DoubleTree by Hilton Bethesda-Washington DC. The debt has a principal balance of $36.0 million, a term of five years, bears interest at 5.28% and requires interest-only payments for the first 12 months and, beginning in March 2012, will require monthly principal and interest payments of $199,407 through February 2016, the maturity date.

In conjunction with the Company s acquisition of the Argonaut Hotel, the Company assumed a $42.0 million interest-only first mortgage loan. The debt matures in March 2012 and has a fixed annual interest rate of 5.67%.

Mortgage debt as of September 30, 2011 and December 31, 2010 consisted of the following (in thousands):

			Balance Outstanding as of	
	Interest Rate	**Maturity Date**	**September 30, 2011**	**December 31, 2010**
Sofitel Philadelphia	Floating(1)	February 2012	$ 56,070	$ 56,070
Monaco Washington DC	5.68%	March 2012	35,000	35,000
Argonaut Hotel	5.67%	March 2012	42,000	
InterContinental Buckhead	4.88%	January 2016	51,998	52,500
Skamania Lodge	5.44%	February 2016	30,766	
DoubleTree by Hilton Bethesda-Washington DC	5.28%	February 2016	36,000	
			$ 251,834	$ 143,570

(1) Mortgage debt bears interest at LIBOR plus 1.3%. The interest rates as of September 30, 2011 and December 31, 2010 were 1.52% and 1.57%, respectively.

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The Company estimates the fair value of its fixed rate debt by discounting the future cash flows of each instrument at estimated market rates, taking into consideration general market conditions and maturity. The estimated fair value of the Company s debt as of September 30, 2011 and December 31, 2010 was $250.8 million and $143.9 million, respectively.

The Company was in compliance with all debt covenants as of September 30, 2011.

Note 7. Equity

Common Shares

The Company is authorized to issue up to 500,000,000 common shares of beneficial interest, $.01 par value per share (common shares). Each outstanding common share entitles the holder to one vote on all matters submitted to a vote of shareholders. Holders of the Company s common shares are entitled to receive dividends when authorized by the Company s board of trustees.

On April 6, 2011, the Company issued 10,925,000 common shares and raised $226.5 million, net of underwriting discounts and offering costs, in a follow-on offering of common shares.

On April 13, 2011, the Company filed a shelf registration statement on Form S-3 with the SEC. Under this shelf registration statement, the Company may issue common shares, preferred shares, debt securities, warrants and units from time to time.

Common Dividends

The Company paid or will pay the following dividends on common shares/units during the nine months ended September 30, 2011:

Dividend per Share/Unit	For the quarter ended	Record Date	Payable Date
$0.12	March 31, 2011	March 31, 2011	April 15, 2011
$0.12	June 30, 2011	June 30, 2011	July 15, 2011
$0.12	September 30, 2011	September 30, 2011	October 17, 2011

Preferred Shares

The Company is authorized to issue up to 100,000,000 preferred shares of beneficial interest, $.01 par value per share (preferred shares).

The Company had no preferred shares outstanding as of December 31, 2010. On March 11, 2011, the Company issued 5,000,000 shares of its 7.875% Series A Cumulative Redeemable Preferred Shares (Series A Preferred Shares) at a public offering price of $25.00 per share, for a total of approximately $120.9 million of net proceeds, after deducting the underwriting discount and other offering-related costs.

On July 14, 2011, the Company issued an additional 600,000 Series A Preferred Shares at a price of $25.25 per share for a total of approximately $15.1 million in net proceeds. Following this offering, the Company had 5,600,000 Series A Preferred Shares outstanding.

On September 14, 2011, the Company issued 3,400,000 shares of its 8.00% Series B Cumulative Redeemable Preferred Shares (Series B Preferred Shares) at a public offering price of $25.00 per share, for a total of approximately $82.3 million of net proceeds, after deducting the underwriting discount and other offering-related costs.

The Series A Preferred Shares and the Series B Preferred Shares (collectively, the Preferred Shares) rank senior to the common shares of beneficial interest and on parity with each other with respect to payment of distributions. The Preferred Shares are cumulative redeemable preferred shares. The outstanding Preferred Shares do not have any maturity date, and are not subject to mandatory redemption. The Company may not optionally redeem the Series A Preferred Shares or Series B Preferred Shares prior to March 11, 2016 and September 21, 2016, respectively, except in limited circumstances relating to the Company s continuing qualification as a REIT or as discussed below. After those dates, the Company may, at its option, redeem the Preferred Shares, in whole or from time to time in part, by payment of $25.00 per share, plus any accumulated, accrued and unpaid distributions through the date of redemption. Upon the occurrence of a change of control, as defined, the result of which the Company s common shares of beneficial interest and the common securities of the acquiring or surviving entity are not listed

on the New York Stock Exchange, the NYSE Amex or NASDAQ, or any successor exchanges, the Company may, at its option, redeem the Preferred Shares in whole or in part within 120 days after the change of control occurred, by paying $25.00 per share, plus any accrued and unpaid distributions through the date of redemption. If the Company does not exercise its right to redeem the Preferred Shares upon a change of control, the holders of Preferred Shares have the right to convert some or all of their shares into a number of the Company s common shares of beneficial interest based on a defined formula subject to a share cap. The share cap on each Series A Preferred Share is 2.3234 common shares and the share cap on each Series B Preferred Share is 3.4483 common shares.

Preferred Dividends

The Company paid or will pay the following dividends on preferred shares during the nine months ended September 30, 2011:

Security Type	**Dividend per Share/Unit**	**For the quarter ended**	**Record Date**	**Payable Date**
7.875% Series A	$ 0.19 [(1)]	March 31, 2011	March 31, 2011	April 15, 2011
7.875% Series A	$ 0.49	June 30, 2011	June 30, 2011	July 15, 2011
7.875% Series A	$ 0.49	September 30, 2011	September 30, 2011	October 17, 2011
8.00% Series B	$ 0.13 [(1)]	September 30, 2011	September 30, 2011	October 17, 2011

(1) Pro-rata payment for the partial quarter from the date of issuance.

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Non-controlling Interest of Common Units in Operating Partnership

Holders of Operating Partnership units have certain redemption rights that enable the unit holders to cause the Operating Partnership to redeem their units in exchange for, at the Company s option, cash per unit equal to the market price of the Company s common shares at the time of redemption or for the Company s common shares on a one-for-one basis. The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of share splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of our limited partners or our shareholders.

As of September 30, 2011 and December 31, 2010, the Operating Partnership had 929,099 and 0 long-term incentive partnership units (LTIP units), respectively, outstanding, all of which have reached parity with other common Operating Partnership units. As of September 30, 2011, 185,820 of these LTIP units have vested. Only vested LTIP units may be converted to common units of the Operating Partnership which in turn can be redeemed for an equal number of common shares in the Company. As of September 30, 2011, no LTIP units have been converted to common shares.

Note 8. Share-Based Compensation Plan

The Company maintains the 2009 Equity Incentive Plan to attract and retain independent trustees, executive officers and other key employees and service providers. The plan provides for the grant of options to purchase common shares, share awards, share appreciation rights, performance units and other equity-based awards. Share awards under this plan generally vest over three to five years. The Company pays dividends on unvested shares. All share awards are vested upon a change in control. As of September 30, 2011, there were 224,317 common shares available for issuance under the 2009 Equity Incentive Plan.

The following table provides a summary of restricted share activity as of September 30, 2011:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at January 1, 2011	78,440	$ 20.88
Granted	79,330	22.03
Vested	(22,709)	20.98
Forfeited	(2,232)	21.58
Unvested at September 30, 2011	132,829	$ 21.54

The fair value of each restricted share award is determined based on the closing price of the Company s common shares on the grant date. For the three and nine months ended September 30, 2011, the Company recognized approximately $0.3 million and $0.8 million, respectively, of share-based compensation expense related to these restricted shares in the consolidated statements of operations. For the three and nine months ended September 30, 2010, the Company recognized approximately $0.1 million and $0.3 million, respectively, of share-based compensation expense related to these restricted shares in the consolidated statements of operations. As of September 30, 2011, there was $2.2 million of total unrecognized share-based compensation expense related to unvested restricted shares. The unrecognized share-based compensation expense is expected to be recognized over the weighted-average remaining vesting period of 2.0 years.

Long-Term Incentive Partnership Units

LTIP units, which are also referred to as profits interest units, may be issued to eligible participants for the performance of services to or for the benefit of the Operating Partnership. LTIP units are a class of partnership unit in the Company s Operating Partnership and will receive, whether vested or not, the same per-unit profit distributions as the other outstanding units in the Operating Partnership, which equal per-share distributions on common shares. Prior to reaching parity with common units, LTIP units have a capital account balance of zero, do not receive an allocation of net income (loss) and do not have full parity with the common Operating Partnership units with respect to liquidating distributions. If such parity is reached, vested LTIP units may be converted, at any time, into an equal number of common Operating Partnership units and thereafter will possess all of the rights and interests of a common Operating Partnership unit, including the right to redeem the common Operating Partnership unit for a common share in the Company or cash, at the option of the Operating Partnership.

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As of September 30, 2011, the Company had 929,099 LTIP units outstanding, all of which have reached parity with common units. All of the LTIP units were held by officers of the Company as of September 30, 2011. These LTIP units vest ratably on each of the first five anniversaries of their date of grant. All LTIP units will vest upon a change in control. The LTIP units were valued using a Monte Carlo simulation method model. The LTIP unit grants were valued at $8.50 per LTIP unit. As of September 30, 2011, 185,820 units have vested.

The Company recognized $0.4 million and $1.2 million in share-based compensation expense related to the LTIP units for the three and nine months ended September 30, 2011 and 2010, respectively. As of September 30, 2011, there was $5.1 million of total unrecognized share-based compensation expense related to LTIP units. This unrecognized share-based compensation expense is expected to be recognized over the weighted- average remaining vesting period of 3.3 years. The aggregate expense related to the LTIP unit grants is presented as non-controlling interest in the Company s consolidated balance sheets.

Upon completion of the Company s equity offering of common shares on April 6, 2011, the Company determined that a revaluation event occurred, as defined in the Internal Revenue Code, and the LTIP units achieved full parity with the common Operating Partnership units with respect to liquidating distributions and all other purposes. These LTIP units are allocated their pro-rata share of the Company s net income (loss).

Note 9. Earnings per Common Share

The following is a reconciliation of basic and diluted earnings per common share (in thousands, except share and per-share data):

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Numerator:				
Net income (loss) attributable to common shareholders	$ 2,825	$ (308)	$ 987	$ (4,721)
Less: dividends paid on unvested restricted shares	(16)		(47)	
Less: dividends paid on LTIP units	(111)		(334)	
Undistributed earnings attributable to unvested restricted shares				
Net income (loss) attributable to common shareholders-basic and diluted	$ 2,698	$ (308)	$ 606	$ (4,721)
Denominator:				
Weighted-average number of common shares basic and diluted	50,771,355	34,073,090	46,962,639	24,915,173
Net income (loss) per share attributable to common shareholders basic and diluted	$ 0.05	$ (0.01)	$ 0.01	$ (0.19)

For the three and nine months ended September 30, 2011, 132,829 of unvested restricted shares and 929,099 of LTIP units were excluded from diluted weighted-average common shares, as their effect would have been anti-dilutive. For the three and nine months ended September 30, 2010, 82,407 unvested restricted shares were excluded from diluted weighted-average common shares, as their effect would have been anti-dilutive.

Note 10. Commitments and Contingencies

Management Agreements

The Company s hotel properties operate pursuant to separate management agreements for each property with various management companies. The initial terms of these management agreements range from five years to 20 years, not including renewals, and five years to 40 years, including renewals. Many of the Company s management agreements are terminable at will by the Company upon paying a termination fee and some are terminable by the Company upon sale of the property, with in some cases, the payment of termination fees. Most of the agreements also provide the Company the ability to terminate based on failure to achieve defined operating performance thresholds. Termination fees range from zero to up to six times the annual base management and incentive management fees, depending on the agreement and the reason for termination. Certain of the Company s management agreements are non-terminable except upon the manager s breach of a material representation or the manager s failure to meet performance thresholds as defined in the management agreement.

The management agreements require the payment of a base management fee generally between 2% and 4% of hotel revenues. Under certain management agreements, the management companies are also eligible to receive an incentive management fee if hotel operating income, cash flows or other performance measures, as defined in the agreements, exceeds certain performance thresholds. The incentive management fee is generally calculated as a percentage of hotel operating income after the Company has received a priority return on its investment in the hotel. Combined base and incentive management fees were $2.5 million and $5.8 million for the three and nine months ended September 30, 2011, respectively, and $0.6 million and $0.7 million, for the three and nine months ended September 30, 2010, respectively.

Reserve Funds

Certain of the Company s agreements with its hotel managers, franchisors and lenders have provisions for the Company to provide funds, typically 4.0% of hotel revenues, sufficient to cover the cost of (a) certain non-routine repairs and maintenance to the hotels and (b) replacements and renewals to the hotels furniture, fixtures and equipment.

Restricted Cash

At September 30, 2011 and December 31, 2010, the Company had $8.7 million and $4.5 million, respectively, in restricted cash, which consisted of reserves for replacement of furniture and fixtures or reserves to pay for real estate taxes or property insurance under certain hotel management agreements or lender requirements.

Ground Lease

The Monaco Washington DC is subject to a long-term ground lease agreement on the land underlying the hotel. The ground lease expires in 2059. The hotel is required to pay the greater of a base rent of $0.2 million or a percentage of gross hotel revenues and gross food and beverage revenues in excess of certain thresholds, as defined in the agreement. The lease contains certain restrictions on modifications that can be made to the structure due to its status as a national historic landmark.

The Company assumed a long-term ground lease agreement in connection with its acquisition of the Argonaut Hotel. The ground lease expires in 2059. The hotel is required to pay the greater of a base rent of $1.2 million or a percentage of rooms revenues, food and beverage revenues and other department revenues in excess of certain thresholds, as defined in the agreement. The lease contains certain restrictions on modifications that can be made to the structure due to its status as a national historic landmark.

Litigation

The nature of the operations of the hotels exposes the hotels, the Company and the Operating Partnership to the risk of claims and litigation in the normal course of their business. The Company may obtain insurance to cover certain potential material losses. The Company is not presently subject to any material litigation nor, to the Company s knowledge, is any material litigation threatened against the Company.

Note 11. Supplemental Information to Statements of Cash Flows

	For the nine months ended September 30,			
	2011		2010	
	(in thousands)			
Interest paid	$	8,279	$	
Income taxes paid	$	663	$	
Non-Cash Investing and Financing Activities:				
Distributions payable to common shares/units	$	6,219	$	
Distributions payable to preferred shares	$	2,516	$	
Issuance of common shares for board of trustees compensation	$	183	$	

Mortgage loan assumed in connection with acquisition	$	42,000	$
Deposit applied to purchase price of acquisition	$	5,000	$

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. Pebblebrook Hotel Trust is a Maryland real estate investment trust that conducts its operations so as to qualify as a REIT under the Code. Substantially all of the operations are conducted through Pebblebrook Hotel, L.P. (the Operating Partnership), a Delaware limited partnership of which Pebblebrook Hotel Trust is the sole general partner. In this report, we use the terms the Company, we or our to refer to Pebblebrook Hotel Trust and its subsidiaries, unless the context indicates otherwise.

Forward-Looking Statements

This report, together with other statements and information publicly disseminated by the Company, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and include this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words may, will, should, potential, could, predict, continue, believe, expect, intend, anticipate, forecast or similar expressions. Forward-looking statements in this report include, among others, statements about our business strategy, including our acquisition and development strategies, industry trends, estimated revenues and expenses, ability to realize deferred tax assets and expected liquidity needs and sources (including capital expenditures and the ability to obtain financing or raise capital). You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and which could materially affect actual results, performances or achievements. Factors that may cause actual results to differ materially from current expectations include, but are not limited to:

- the timing and availability of potential hotel acquisitions and our ability to identify and complete hotel acquisitions in accordance with our business strategy;
- risks associated with the hotel industry, including competition, increases in employment costs, energy costs and other operating costs, or decreases in demand caused by actual or threatened terrorist attacks, any type of flu or disease-related pandemic, or downturns in general and local economic conditions;
- the availability and terms of financing and capital and the general volatility of securities markets;
- our dependence on third-party managers of our hotels, including our inability to implement strategic business decisions directly;
- risks associated with the real estate industry, including environmental contamination and costs of complying with the Americans with Disabilities Act and similar laws;
- interest rate increases;
- our possible failure to qualify as a REIT and the risk of changes in laws affecting REITs;
- the possibility of uninsured losses;

- risks associated with redevelopment and repositioning projects, including delays and overruns; and

- the other factors discussed under the heading Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, as updated elsewhere in this report.

Accordingly, there is no assurance that our expectations will be realized. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

Pebblebrook Hotel Trust is an internally managed hotel investment company, organized in October 2009, to opportunistically acquire and invest in hotel properties located primarily in major U.S. cities, with an emphasis on the major coastal markets. As of September 30, 2011, the Company owned interests in 20 hotels, including 14 wholly owned hotels, with a total of 3,812 guest rooms and a 49% joint venture interest in 6 hotels with 1,732 guest rooms.

During the third quarter of 2011, we invested approximately $152.6 million for a 49% equity interest in a joint venture that owns six Manhattan hotel properties in New York, New York (the Manhattan Collection). We also raised $97.4 million from the follow-on equity offering of 600,000 Series A Preferred Shares and 3.4 million Series B Preferred Shares.

In addition to acquiring hotels and raising capital, we have been actively employing our asset management initiatives at our hotels. While we do not operate our hotel properties, both our asset management team and our executive management team monitor and work cooperatively with our hotel managers in all aspects of our hotels operations, including property positioning and repositioning, revenue management, operations analysis, physical design, renovation and capital improvements, guest experience and overall strategic direction. Through these efforts, we seek to improve property efficiencies, lower costs, maximize revenues, and enhance property operating margins which we expect will enhance returns to our shareholders. During the nine months ended September 30, 2011, we completed renovation projects at the Sir Francis Drake, The Grand Minneapolis and DoubleTree by Hilton Bethesda-Washington DC hotels. We expect to invest a total of approximately $55.0 million to $60.0 million, including amounts paid upon acquisition of the Westin Gaslamp Quarter, in 2011 on renovation and repositioning projects and other capital improvements.

The U.S. hotel industry has continued to exhibit positive fundamentals during the third quarter of 2011 despite an economic slowdown in the United States. While there continue to be concerns about a slow-moving national economy, stagnant unemployment and the increased global volatility and risk related to the European debt crisis, the financial condition of corporate America has improved over the past 12 to 24 months and companies have made significant headway in shoring up their balance sheets and improving their capital ratios.

The strength in corporate transient and group travel, specifically in the major urban markets, has continued to drive increases in occupancy and average daily rates. These positive fundamentals have driven the high year-over-year transaction volume year-to-date and are expected to continue through the balance of the year and into 2012. We continue to believe that we will see a long and healthy recovery in the hotel industry and believe our properties have significant opportunities to achieve significant growth in their long-term economic values.

Key Indicators of Financial Condition and Operating Performance

We measure hotel results of operations and the operating performance of our business by evaluating financial and nonfinancial metrics such as room revenue per available room (RevPAR); average daily rate (ADR); occupancy rate (occupancy); funds from operations (FFO); and earnings before interest, income taxes, depreciation and amortization (EBITDA). We evaluate individual hotel and company-wide performance with comparisons to budgets, prior periods and competing properties. ADR, occupancy and RevPAR may be impacted by macroeconomic factors as well as regional and local economies and events. See Non-GAAP Financial Matters for further discussion of FFO and EBITDA.

Results of Operations

Results of operations for the three and nine months ended September 30, 2011 include the operating activities of the 14 hotels we owned since their respective dates of acquisition. We owned five hotel properties, the DoubleTree by Hilton Bethesda-Washington DC, Sir Francis Drake, InterContinental Buckhead, Monaco Washington D.C., and The Grand Hotel Minneapolis, at September 30, 2010. Our net income attributable to common shareholders for the three months ended September 30, 2011 was $2.8 million compared with a net loss attributable to common shareholders of $0.3 million for the three months ended September 30, 2010. Our net income attributable to common shareholders for the nine months ended September 30, 2011 was $1.0 million compared with a net loss attributable to common shareholders of $4.7 million for the nine months ended September 30, 2010.

Comparison of three and nine months ended September 30, 2011 to three and nine months ended September 30, 2010

The results of operations for the three and nine months ended September 30, 2010 include the operating activity of the five hotels for the periods from acquisition of each hotel to September 30, 2010. The results of operations for the three and nine months ended September 30, 2011 include the operating activity for the eight hotels acquired in 2010 for the full periods and the operating activity for the six hotels acquired in 2011 for the periods from acquisition of each hotel to September 30, 2011.

Revenues Revenues for the three and nine months ended September 30, 2011 increased to $87.8 million and $203.6 million, respectively, due primarily to the additional nine hotels acquired since September 30, 2010. Revenues for the three and nine months ended September 30, 2010 were $21.6 million and $23.9 million, respectively.

Hotel operating expenses Hotel operating expenses for the three and nine months ended September 30, 2011 increased to $59.6 million and $141.8 million, respectively, due primarily to the additional nine hotels acquired since September 2010. Hotel operating expenses for the three and nine months ended September 30, 2010 were $15.8 million and $17.2 million, respectively.

Depreciation and amortization Depreciation and amortization expense for the three and nine months ended September 30, 2011 increased by approximately $7.0 million and $19.2 million, respectively, primarily as a result of the additional nine hotels we acquired since September 2010.

Real estate taxes, personal property taxes and property insurance Real estate taxes, personal property taxes and insurance for the three and nine months ended September 30, 2011 increased by approximately $3.0 million and $8.0 million, respectively, primarily as a result of the additional nine hotels we acquired since September 2010.

Ground rent Ground rent expense for the three and nine months ended September 30, 2011 increased by approximately $0.6 million and $1.3 million, respectively, resulting from the acquisitions of the Hotel Monaco DC and the Argonaut Hotel, both of which are subject to long-term ground lease arrangements.

Corporate general and administrative Corporate general and administrative expenses for the three and nine months ended September 30, 2011 increased by approximately $1.8 million and $2.9 million, respectively, primarily as a result of increased staffing and other costs related to growth in our portfolio since September 2010. Corporate general and administrative expenses consist of employee compensation costs, legal and professional fees, insurance and other expenses.

Hotel property acquisition costs Hotel property acquisition costs for the three and nine months ended September 30, 2011 increased by approximately $2.2 million and $2.5 million, respectively, primarily as a result of the acquisition costs related to our equity investment in the joint venture that owns the Manhattan Collection. Hotel property acquisition costs consist of legal fees, other professional fees, transfer taxes, and other direct costs associated with our acquisition of hotel investments. As a result, these costs are generally higher when properties are acquired or when we have significant ongoing acquisition activity.

Interest income Interest income for the three and nine months ended September 30, 2011 decreased from the prior periods by approximately $0.6 million and $1.7 million, respectively, as a result of cash being used to acquire hotel properties resulting in a lower average cash balance as well as a decrease in the interest rate on cash deposits.

Interest expense Interest expense for the three and nine months ended September 30, 2011 increased from the prior periods by approximately $3.3 million and $9.6 million, respectively, due to the Company arranging or assuming mortgage financings on certain properties acquired after September 30, 2010 while the Company had one mortgage debt outstanding as of September 30, 2010.

Equity in earnings of unconsolidated entities In July 2011, we purchased an equity interest in a joint venture and recognized $2.2 million for the three and nine months ended September 30, 2011.

Income tax expense Income tax expense for the nine months ended September 30, 2011 increased from the prior year by approximately $0.3 million as a result of an increase in net income of our taxable REIT subsidiary.

Non-controlling interests Non-controlling interests represent the allocation of income or loss of the Operating Partnership to the common units held by the LTIP unit holders. There was no allocation of income or loss to these unit holders in 2010 as these units did not reach parity with the common shares until April 2011.

Distributions to preferred shareholders Distributions to preferred shareholders for the three and nine months ended September 30, 2011 were approximately $2.9 million and $5.9 million, respectively. We had no preferred shares issued in 2010.

Non-GAAP Financial Measures

Non-GAAP financial measures are measures of our historical or future financial performance that are different from measures calculated and presented in accordance with U.S. GAAP. We report FFO and EBITDA, which are non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance.

We calculate FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (NAREIT), which defines FFO as net income (calculated in accordance with GAAP), excluding depreciation and amortization, gains (losses) from sales of real estate, the cumulative effect of changes in accounting principles and adjustments for unconsolidated partnerships and joint ventures. Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, most industry investors consider presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. By excluding the effect of depreciation and amortization and gains (losses) from sales of real estate, both of which are based on historical cost accounting and which may be of lesser significance in evaluating current performance, we believe that FFO provides investors a useful financial measure to evaluate our operating performance.

The following table reconciles net income (loss) attributable to common shareholders to FFO for the three and nine months ended September 30, 2011 and 2010 (in thousands except share and per share data):

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Net income (loss) attributable to common shareholders	$ 2,825	$ (308)	$ 987	$ (4,721)
Adjustments:				
Depreciation and amortization	8,999	2,005	21,325	2,210
Depreciation and amortization from unconsolidated entities	1,169		1,169	
Non-controlling interests	114		199	
FFO	**$ 13,107**	**$ 1,697**	**$ 23,680**	**$ (2,511)**

EBITDA is defined as earnings before interest, income taxes, depreciation and amortization. We believe that EBITDA provides investors a useful financial measure to evaluate our operating performance, excluding the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization).

The following table reconciles net income (loss) attributable to shareholders to EBITDA for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Net income (loss) attributable to common shareholders	$ 2,825	$ (308)	$ 987	$ (4,721)
Adjustments:				
Interest expense	3,775	471	10,077	471
Interest expense from unconsolidated entities	2,364		2,364	
Income tax expense (benefit)	(81)	(3)	339	23
Depreciation and amortization	9,037	2,032	21,426	2,260
Depreciation and amortization from unconsolidated entities	1,169		1,169	
Non-controlling interests	114		199	
Distributions to preferred shareholders	2,899		5,907	
EBITDA	**$ 22,102**	**$ 2,192**	**$ 42,468**	**$ (1,967)**

Neither FFO nor EBITDA represent cash generated from operating activities as determined by U.S. GAAP and neither should be considered as an alternative to U.S. GAAP net income (loss), as an indication of our financial performance, or to U.S. GAAP cash flow from operating activities, as a measure of liquidity. In addition, FFO and EBITDA are not indicative of funds available to fund cash needs, including the ability to make cash distributions.

Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances. All of our significant accounting policies, including certain critical accounting policies, are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010.

Liquidity and Capital Resources

We expect to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under our senior revolving credit facility. We expect our existing cash balances and cash provided by operations will be adequate to fund operating requirements, pay interest on any borrowings and fund dividends in accordance with the REIT requirements of the federal income tax laws.

We expect to meet our long-term liquidity requirements, such as hotel property acquisitions, property redevelopment, capital investments, and debt maturities, through the net proceeds from additional issuances of common shares, issuances of preferred shares, issuances of units of limited partnership interest in our operating partnership, secured and unsecured borrowings, and cash provided by operations. The success of our business strategy may depend in part on our ability to access additional capital through issuances of debt and equity securities, which is dependent on favorable market conditions.

Sources and Uses of Cash

Our principal sources of cash are cash from operations, borrowings under mortgage financings, draws on our credit facility and the proceeds from offerings of our equity securities. Our principal uses of cash are asset acquisitions, debt service, capital investments, operating costs, corporate expenses and dividends.

Cash provided by Operations. Our cash provided by operating activities was $28.4 million for the nine months ended September 30, 2011. Our cash from operations includes the operating activities of the 14 wholly owned hotels. Our cash provided by operating activities for the nine months ended September 30, 2010 was $1.7 million and relates principally to the five hotels we owned at September 30, 2010.

Cash used in Investing Activities. Our cash used in investing activities was $662.6 million and $264.5 million for the nine months ended September 30, 2011 and 2010, respectively. During the nine months ended September 30, 2011, we used $467.1 million to acquire six hotels, incurred capital investments of $26.3 million at our hotels, invested $165.4 million for an equity interest in a joint venture and had an increase in restricted cash of $3.6 million. During the nine months ended September 30, 2010, we used $331.7 million to acquire five hotels, placed a deposit of $1.0 million on one property under contract, had a $1.1 million increase in restricted cash and redeemed a net amount of $70.0 million in certificates of deposits.

Cash provided by Financing Activities. $488.8 million of cash was provided by financing activities for the nine months ended September 30, 2011, which consisted of $236.0 million of proceeds received from our public offering of approximately 10.9 million common shares and $225.2 million of proceeds received from our offering of preferred shares, both of which were offset by an aggregate of approximately $17.1 million in underwriting discounts and offering-related costs. We borrowed $42.0 million from our revolving credit facility and repaid that amount in September 2011. We also received $67.0 million of proceeds from the mortgage debt placed on the Skamania Lodge and DoubleTree hotels and paid $19.4 million in distributions during the period. For the nine months ended September 30, 2010, cash flows provided by financing activities were $317.0 million from our offering of common shares offset by $2.3 million in deferred financing costs.

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Capital Investments

We intend to maintain all of our hotels, and will maintain each hotel that we acquire in the future, in good repair and condition and in conformity with applicable laws and regulations and when applicable, in accordance with the franchisor s standards and the agreed-upon requirements in our management agreements. Routine capital investments will be administered by the hotel management companies. However, we maintain approval rights over the capital investments as part of the annual budget process and as otherwise required from time to time.

From time to time, certain of our hotel properties may undergo renovations as a result of our decision to upgrade portions of the hotels, such as guestrooms, meeting space and restaurants, in order to better compete with other hotels in our markets. In addition, after we acquire a hotel property, we are often required by the franchisor or brand manager, if there is one, to complete a property improvement plan (PIP) in order to bring the hotel property up to the franchisor s or brand s standards. Generally we expect to fund the renovations and improvements with cash and cash equivalents, borrowings under our credit facility, or proceeds from new mortgage debt or equity offerings.

For the nine months ended September 30, 2011, we invested $26.3 million in capital investments to reposition and improve the properties we own. We expect to invest approximately $20.0 million in capital investments through the remainder of 2011.

Contractual Obligations and Off-Balance Sheet Arrangements

The table below summarizes our contractual obligations as of September 30, 2011 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

		Payments due by period			
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Mortgage loans (1)	$ 279,944	$ 143,134	$ 15,657	$ 121,153	$
Ground leases (2)	66,468	1,380	2,760	2,760	59,568
Purchase commitments (3)	6,				