

HERSHA HOSPITALITY TRUST  
Form 10-Q  
May 10, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2006

OR

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

For the transition period from to

**Commission file number: 001-14765**

**HERSHA HOSPITALITY TRUST**

(Exact Name of Registrant as Specified in Its Charter)

**Maryland**

(State or Other Jurisdiction of Incorporation or Organization)

**251811499**

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

**148 Sheraton Drive, Box A**

**New Cumberland, Pennsylvania**

(Address of Registrant's Principal Executive Offices)

**17070**

(Zip Code)

Registrant's telephone number, including area code: **(717) 770-2405**

Indicate by check mark whether the registrant (i) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (ii) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated

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filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of March 31, 2006, the number of Class A common shares of beneficial interest outstanding was 20,379,463, and the number of Series A preferred shares of beneficial interest outstanding was 2,400,000.

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**Hersha Hospitality Trust**  
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**PART I**  
**FINANCIAL INFORMATION**  
**Financial Statements.**

**Item 1.**

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS AS OF**  
**MARCH 31, 2006 [UNAUDITED] AND DECEMBER 31, 2005**  
**[IN THOUSANDS, EXCEPT SHARE AMOUNTS]**

	(UNAUDITED) March 31, 2005	December 31, 2005
<b>Assets:</b>		
Investment in Hotel Properties, net of Accumulated Depreciation	\$ 423,931	\$ 317,980
Investment in Joint Ventures	52,040	55,981
Development Loan Receivables from Related Parties	14,100	32,450
Cash and cash equivalents	4,679	8,780
Escrow Deposits	9,593	7,329
Notes Receivable	1,938	1,886
Hotel Accounts Receivable	4,226	2,211
Deferred Costs, net of Accumulated Amortization of \$1,269 and \$1,437	4,705	4,131
Due from Related Parties	1,276	2,799
Interest Rate Derivative	144	23
Intangible Assets, net of Accumulated Amortization of \$513 and \$478	5,313	4,681
Other Assets	6,670	13,697
Hotel Assets Held for Sale	20,549	3,407
<b>Total Assets</b>	<b>\$ 549,164</b>	<b>\$ 455,355</b>
<b>Liabilities and Shareholders' Equity:</b>		
Line of Credit	\$ 37,243	\$ -
Mortgages and Notes Payable	303,108	256,146
Capital Lease Payable	873	-
Accounts Payable and Accrued Expenses	8,712	6,969
Advance Deposits	385	130
Dividends and Distributions Payable	5,270	5,151
Due to Related Parties	3,902	4,655
Debt and Capital Lease Payable Related to Hotel Assets Held for Sale	10,730	375
<b>Total Liabilities</b>	<b>\$ 370,223</b>	<b>\$ 273,426</b>

The Accompanying Notes are an Integral Part of These Consolidated Financial Statements.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS AS OF**  
**MARCH 31, 2006 [UNAUDITED] AND DECEMBER 31, 2005**  
**[IN THOUSANDS, EXCEPT SHARE AMOUNTS]**

	<b>(UNAUDITED)</b>	
	<b>March 31,</b>	<b>December 31,</b>
	<b>2005</b>	<b>2005</b>
<b>Minority Interests:</b>		
Common Units	\$ 25,761	\$ 15,147
Interest in Consolidated Joint Ventures	2,860	2,079
<b>Total Minority Interest</b>	<b>28,621</b>	<b>17,226</b>
<b>Shareholder's Equity:</b>		
Preferred Shares - 8% Series A, \$.01 Par Value, 10,000,000 Shares Authorized, 2,400,000 Shares Issued and Outstanding at March 31, 2006 and December 31, 2005 (Aggregate Liquidation Preference \$60,000 at March 31, 2006 and December 31, 2005, Respectively)	24	24
Common Shares - Class A, \$0.1 Par Value, 50,000,000 Shares Authorized, 20,308,463 and 20,302,752 Shares Issued and Outstanding at March 31, 2006 and December 31, 2005, Respectively	203	203
Common Shares - Class B, \$0.1 Par Value, 50,000,000 Shares Authorized, None Issued and Outstanding	-	-
Accumulated Other Comprehensive Income	444	327
Additional Paid-in Capital	187,480	193,228
Distributions in Excess of Net Earnings	(37,831)	(29,079)
<b>Total Shareholder's Equity</b>	<b>150,320</b>	<b>164,703</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 549,164</b>	<b>\$ 455,355</b>

The Accompanying Notes are an Integral Part of These Consolidated Financial Statements.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE**  
**THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

	March 31, 2006	March 31, 2005
<b>Revenue:</b>		
Hotel Operating Revenues	\$ 23,901	\$ 11,021
<b>Expenses:</b>		
Hotel Operating Expenses	15,958	8,092
Land Lease	162	108
Real Estate and Personal Property Taxes and Property Insurance	1,487	775
General and Administrative	1,164	977
Unrealized (Gain) on Derivatives	(4)	(4)
Depreciation and Amortization	3,796	1,655
<b>Total Operating Expenses</b>	<b>22,563</b>	<b>11,603</b>
<b>Operating Income (Loss)</b>	<b>1,338</b>	<b>(582)</b>
Interest Income	158	37
Interest Income - Secured Loans Related Party	421	1,000
Interest Income - Secured Loans	7	-
Other Revenue	194	27
Interest Expense	5,622	1,630
Debt Extinguishment	255	-
<b>Loss before income (loss) from Unconsolidated Joint Venture Investments, Distributions to Preferred Unitholders, Minority Interests and Discontinued Operations</b>	<b>(3,759)</b>	<b>(1,148)</b>
<b>Income (Loss) from Unconsolidated Joint Venture Investments</b>	<b>(1,110)</b>	<b>49</b>
<b>Loss before Distribution to Preferred Unitholders, Minority Interests and Discontinued Operations</b>	<b>(4,869)</b>	<b>(1,099)</b>
<b>Loss Allocated to Minority Interests in Continuing Operations</b>	<b>(1,015)</b>	<b>(242)</b>
<b>Loss from Continuing Operations</b>	<b>(3,854)</b>	<b>(857)</b>
<b>Discontinued Operations (Note 12):</b>		
<b>Loss from Discontinued Operations</b>	<b>(30)</b>	<b>(117)</b>
<b>Net Loss</b>	<b>(3,884)</b>	<b>(974)</b>
Preferred Distributions	1,200	-
<b>Net Loss applicable to Common Shareholders</b>	<b>\$ (5,084)</b>	<b>\$ (974)</b>
<b>Basic and diluted earnings per share</b>		
<b>Loss from continuing operations applicable to common shareholders</b>	<b>\$ (0.25)</b>	<b>\$ (0.04)</b>
<b>Discontinued Operations</b>	<b>-</b>	<b>(0.01)</b>
<b>Net Loss applicable to common shareholders</b>	<b>\$ (0.25)</b>	<b>\$ (0.05)</b>

**Weighted Average Common Shares Outstanding**

Basic	20,308,225	20,291,234
Diluted	20,379,225	20,291,234

The Accompanying Notes are an Integral Part of These Consolidated Financial Statements.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

	March 31, 2006	March 31, 2005
<b>Operating activities:</b>		
Net Loss	\$ (3,884)	\$ (974)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	4,015	1,958
Amortization	248	143
Debt extinguishment	223	-
Income allocated to minority interests	(1,020)	(258)
Equity in loss (income) of unconsolidated joint ventures	1,110	(49)
Distributions from unconsolidated joint ventures	1,135	-
Gain recognized on change in fair value of derivative instrument	(4)	-
Stock based compensation expense	43	-
Change in assets and liabilities:		
(Increase) decrease in:		
Hotel accounts receivable	(1,921)	(408)
Escrow and lease deposits	121	(322)
Other assets	545	(449)
Due from related party	1,523	(970)
Increase in:		
Advance deposits	255	115
Due to related party	(753)	737
Accounts payable and accrued expenses	1,679	763
<b>Net cash provided by operating activities</b>	<b>3,315</b>	<b>286</b>
<b>Investing activities:</b>		
Purchase of hotel property assets	(90,294)	(9,446)
Capital expenditures	(1,565)	(625)
Escrow deposits	-	(1,000)
Deposits on hotel acquisitions	(2,515)	-
Purchase of franchise fees	-	(44)
Investments in notes receivable and interest bearing deposits	-	(134)
Repayment of notes receivable and interest bearing deposits	5	-
Investment in development loans to related parties	(1,100)	(3,300)
Repayment of development loans to related parties	19,450	4,550
Distributions from unconsolidated joint venture	3,153	393
Advances and capital contributions to unconsolidated joint ventures	(719)	-
<b>Net used in investing activities</b>	<b>(73,585)</b>	<b>(9,606)</b>

The Accompanying Notes are an Integral Part of These Consolidated Financial Statements.



**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

	March 31, 2006	March 31, 2005
<b>Financing activities:</b>		
Proceeds from borrowings under line of credit	57,052	12,318
Repayment of borrowings under line of credit	(19,809)	(12,945)
Principal repayment of mortgages and notes payable	(755)	(490)
Proceeds from mortgages and notes payable	35,500	-
Cash paid for deferred financing costs	(448)	
Stock issuance costs	-	(30)
Distributions to consolidated joint venture interest	-	(84)
Contributions to consolidated joint venture interest	-	198
Dividends paid on common shares	(3,661)	(3,652)
Dividends paid on preferred shares	(1,200)	-
Distributions paid on partnership units	(510)	(512)
<b>Net cash provided by (used in) financing activities</b>	<b>66,169</b>	<b>(5,197)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(4,101)</b>	<b>(14,517)</b>
<b>Cash and cash equivalents - beginning of year</b>	<b>8,780</b>	<b>20,614</b>
<b>Cash and cash equivalents - end of quarter</b>	<b>\$ 4,679</b>	<b>\$ 6,097</b>

The Accompanying Notes are an Integral Part of These Consolidated Financial Statements.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE**  
**THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Hersha Hospitality Trust (“we” or the “Company”) was formed in May 1998 as a self-administered, Maryland real estate investment trust (“REIT”) for Federal income tax purposes.

The Company owns a controlling general partnership interest in Hersha Hospitality Limited Partnership (the “Partnership”), which owns a 99% limited partnership interest in various subsidiary partnerships. Hersha Hospitality, LLC (“HLLC”), a Virginia limited liability company, owns a 1% general partnership interest in the subsidiary partnerships and the Partnership is the sole member of HLLC.

On January 16, 2003, the Partnership formed a wholly owned taxable REIT subsidiary, 44 New England Management Company (“44 New England” or “TRS Lessee”), to lease certain of the Company’s hotels.

On October 21, 2003, we completed a public offering of 9,775,000 common shares at \$8.50 per share. Proceeds to the Company, net of underwriting discounts and commissions, structuring fees and expenses, were approximately \$77,262. Immediately upon closing the offering, the Company contributed all of the net proceeds of the offering to the Partnership. Of the net offering proceeds, approximately \$10,400 was used to fund limited partner redemptions and approximately \$24,000 was used to repay indebtedness. The remaining net proceeds were used principally to fund acquisitions and for general corporate purposes.

On September 24, 2004, we completed a public offering of 3,500,000 common shares at \$9.37 per share. On September 30, 2004, the underwriter exercised its over-allotment option with respect to that offering, and we issued an additional 400,000 common shares at \$9.37 per share. Proceeds to the Company, net of underwriting discounts and commissions and expenses, were approximately \$36,317. Immediately upon closing the offering, the Company contributed all of the net proceeds of the offering to the Partnership in exchange for additional Partnership interests. Of the net offering proceeds, approximately \$5,000 was used to repay indebtedness. The remaining net proceeds have been principally allocated to fund secured development loans, acquisitions and for general corporate purposes.

On August 5, 2005, the Company completed a public offering of 2,400,000 of its 8.00% Series A Cumulative Redeemable Preferred Shares of Beneficial Interest, liquidation preference \$25.00 per share. Net proceeds of the offering, less expenses and underwriters commissions, were approximately \$57,750. Proceeds from the offering were used to finance the acquisition of the Company’s interests in Mystic Partners, LLC and SB Partners, LLC. The remaining net proceeds have been principally allocated to fund secured development loans and for general corporate purposes.

Subsequent to the close of the quarter ended March 31, 2006, on April 28, 2006, we completed a public offering of 6,520,000 common shares at \$9.00 per share. On May 9, 2006, the underwriter exercised its over-allotment option with respect to that offering, and we issued an additional 977,500 common shares at \$9.00 per share. Proceeds to the Company, net of underwriting discounts and commissions and expenses, were approximately \$63,400. Immediately upon closing the offering, the Company contributed all of the net proceeds of the offering to the Partnership in exchange for additional Partnership interests. Of the net offering proceeds, approximately \$30,000 was used to repay indebtedness and approximately \$19,500 was used to fund property acquisitions.

As of March 31, 2006, the Company, through the Partnership and subsidiary partnerships, owned thirty-seven limited and full service hotels. All of the owned hotel facilities are leased to the Company’s taxable REIT subsidiary (“TRS”), 44

New England.

In addition to the wholly owned hotel properties, as of March 31, 2006, the Company owned joint venture interests in eighteen properties. The properties owned by the joint ventures are leased to a TRS owned by the joint venture or to an entity owned by the joint venture partners and 44 New England. The following table lists the properties owned by these joint ventures:

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**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE**  
**THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

<b>Joint Venture</b>	<b>Ownership</b>	<b>Property</b>	<b>Location</b>	<b>Lessee</b>
Inn America Hospitality at Ewing, LLC	50.0%	Courtyard	Ewing/Princeton, NJ	Hersha Inn America TRS Inc.
HT CNL Metro Hotels, LP	33.3%	Hampton Inn	Chelsea/Manhattan, NY	Hersha/CNL TRS Inc
PRA Glastonbury, LLC	40.0%	Hilton Garden Inn	Glastonbury, CT	Hersha PRA TRS, Inc
Mystic Partners, LLC	66.7%	Marriott	Mystic, CT	Mystic Partners Leaseco, LLC
	8.8%	Hilton	Hartford, CT	Mystic Partners Leaseco, LLC
	66.7%	Courtyard	Norwich, CT	Mystic Partners Leaseco, LLC
	66.7%	Courtyard	Warwick, RI	Mystic Partners Leaseco, LLC
	66.7%	Residence Inn	Danbury, CT	Mystic Partners Leaseco, LLC
	66.7%	Residence Inn	Mystic, CT	Mystic Partners Leaseco, LLC
	44.7%	Residence Inn	Southington, CT	Mystic Partners Leaseco, LLC
	66.7%	Springhill Suites	Waterford, CT	Mystic Partners Leaseco, LLC
	15.0%	Marriott	Hartford, CT	Mystic Partners Leaseco, LLC
Hiren Boston, LLC	50.0%	Courtyard	South Boston, MA	South Bay Boston, LLC
SB Partners, LLC	50.0%	Holiday Inn Express	South Boston, MA	South Bay Sandeep, LLC
Logan Hospitality Associates, LLC	55.0%	Four Points - Sheraton	Revere/Boston, MA	Revere Hotel Group, LLC
LTD Associates One, LLC	75.0%	Springhill Suites	Williamsburg, VA	HT LTD Williamsburg One LLC
LTD Associates Two, LLC	75.0%	Residence Inn	Williamsburg, VA	HT LTD Williamsburg Two LLC
Affordable Hospitality Associates, LP	80.0%	Hampton Inn	Philadelphia, PA	Philly One TRS, LLC

Hersha Inn America TRS Inc; Hersha/CNL TRS Inc.; Hersha PRA TRS, Inc; South Bay Sandeep, LLC; and Revere Hotel Group, LLC, are each a TRS wholly-owned by their respective joint ventures. Mystic Partners, LLC owns an interest in nine hotel properties. Each of the nine properties owned by Mystic Partners, LLC is leased to a separate

entity that is consolidated in Mystic Partners Leaseco, LLC which is owned by 44 New England and our joint venture partner in Mystic Partners, LLC. South Bay Boston, LLC; HT LTD Williamsburg LLC; HT LTD Williamsburg Two LTD LLC and Philly One TRS, LLC lease properties from each respective joint venture and are owned by 44 New England and our joint venture partner in each venture.

44 New England and the joint venture TRS lessees lease the hotel properties pursuant to separate percentage lease agreements (the "Percentage Leases") that provide for percentage rents based on the revenues of the hotels. HHMLP serves as the manager for all of the owned assets and joint venture assets, except for the properties owned by Mystic Partners, LLC; Hiren Boston, LLC; SB Partners, LLC; LTD Associates One, LLC; and LTD Associates Two, LLC. These properties are managed by parties related to our partners in those joint ventures. HHMLP is owned in part by four of the Company's executive officers, two of its trustees and other third party investors.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE**  
**THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Principles of Consolidation and Presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include all of our accounts as well as accounts of the Partnership, subsidiary partnerships and our wholly owned TRS Lessee. All significant inter-company amounts have been eliminated.

Consolidated properties are either wholly owned or owned less than 100% by the Partnership and are controlled by the Company as general partner of the Partnership. Properties owned in joint ventures are also consolidated if the determination is made that we are the primary beneficiary in a variable interest entity or we maintain control of the asset through our voting interest in the entity. Control could also be demonstrated by the ability of the general partner to manage day-to-day operations, refinance debt and sell the assets of the partnerships without the consent of the limited partners and the inability of the limited partners to replace the general partner.

The Financial Accounting Standards Board issued FASB Interpretation No. 46, ("FIN 46") "Consolidation of Variable Interest Entities (VIE's), an interpretation of Accounting Research Bulletin No. 51 (ARB No. 51)," in January 2003 and a further interpretation of FIN 46 in December 2003 ("FIN 46-R" and FIN 46, collectively "FIN 46"). FIN 46 addresses how a business enterprise should evaluate whether it has a controlling financial interest in any variable interest entity ("VIE") through means other than voting rights, and accordingly, should include the VIE in its consolidated financial statements. We have adopted FIN 46 effective as of March 31, 2004.

Our investments and contractual relationships with the following entities have been evaluated to determine whether they meet the guidelines of consolidation in accordance with FIN 46: HHMLP; Logan Hospitality Associates, LLC; HT CNL Metro Hotels, LP; PRA Glastonbury, LLC; Inn America Hospitality at Ewing, LLC; Mystic Partners, LLC; Mystic Partners Leaseco, LLC; Hiren Boston, LLC; South Bay Boston, LLC, SB Partners, LLC; LTD Associates One, LLC; HT LTD Williamsburg LLC; LTD Associates Two, LLC; HT LTD Williamsburg Two LLC; Hersha Statutory Trust I; Hersha Statutory Trust II; HPS Seaport LLC & BCM, LLC; Affordable Hospitality Associates, LP; Philly One TRS, LLC; and 44 Windsor Locks Hospitality, LLC.

Our examination consisted of reviewing the sufficiency of equity at risk, controlling financial interests, voting rights, and the obligation to absorb expected losses and expected gains, including residual returns. Based on our examination, each of the following entities were determined to be a VIE: Mystic Partners, LLC; Mystic Partners Leaseco, LLC; South Bay Boston, LLC; HT LTD Williamsburg LLC; HT LTD Williamsburg Two LTD LLC; Philly One TRS, LLC; Hersha Statutory Trust I; and Hersha Statutory Trust II.

We have consolidated the operations of the Logan Hospitality Associates, LLC; LTD Associates One, LLC; LTD Associates Two, LLC; and Affordable Hospitality Associates, LP joint ventures because each entity is a voting interest entity and the Company owns a majority voting interest in the venture.

Our investments in HT/CNL Metro Hotels, LP; PRA Glastonbury, LLC; Inn America Hospitality at Ewing, LLC; Hiren Boston, LLC; and SB Partners, LLC represent non-controlling ownership interests in the ventures. All of these entities are voting interest entities. These investments are accounted for using the equity method of accounting. These investments are recorded initially at cost and subsequently adjusted for net equity in income (loss), which is allocated in accordance with the provisions of the applicable partnership or joint venture agreements.

We hold an investment in development loan receivables with HPS Seaport LLC & BCM, LLC and 44 Windsor Locks Hospitality, LLC. We have determined that each borrower has sufficient equity at risk, a controlling financial interest and an obligation to absorb expected losses and expected gains, including residual returns of the entity. These entities are voting interest entities and because we have no voting interest they are not consolidated.

Mystic Partners, LLC is a VIE entity, however because we are not the primary beneficiary it is not consolidated by the Company. Also, Mystic Partners Leaseco, LLC; South Bay Boston, LLC; HT LTD Williamsburg LLC; HT LTD Williamsburg Two LTD LLC; and Philly One TRS, LLC lease hotel properties from our joint venture interests and are variable interest entities. These entities are consolidated by the lessors, the primary beneficiaries of each entity.

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE**  
**THREE MONTHS ENDED MARCH 31, 2006 AND 2005 [UNAUDITED]**  
**[IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS]**

**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

During the second quarter of 2005, we formed Hersha Statutory Trust I and Hersha Statutory Trust II, Delaware statutory trusts (collectively, the "Hersha Statutory Trusts"), to collectively issue \$50,000 of trust preferred securities in private placements. We acquired, for \$1,548, residual interests (common securities) in the Hersha Statutory Trusts. Preferred equity securities of \$25,000 issued by Hersha Statutory Trust I will mature on June 30, 2035, and the remaining \$25,000 preferred equity securities issued by Hersha Statutory Trust II will mature on July 30, 2035, at par. The preferred equity securities issued by Hersha Statutory Trust I and Hersha Statutory Trust II may be redeemed by the trusts beginning on June 30, 2010 and July 30, 2010, respectively. The holders of both the preferred equity and common securities will receive quarterly distributions from the Hersha Statutory Trusts, at a fixed rate of 7.34% per annum through June 30, 2010 for Hersha Statutory Trust I and 7.173% per annum through July 30, 2010 for Hersha Statutory Trust II. Subsequent to June 30, 2010, for Hersha Statutory Trust I and July 30, 2010 for Hersha Statutory Trust II, holders of the trusts preferred equity and common securities will receive quarterly distributions at a variable rate of LIBOR plus 3.0% per annum. The Hersha Statutory Trusts used the proceeds from the issuance of the preferred and common securities to acquire \$51,548 of junior subordinated notes from HHLP pursuant to indenture agreements. The note acquired by Hersha Statutory Trust I will mature on June 30, 2035, but may be redeemed at our option, in whole or in part, beginning on June 30, 2010 in accordance with the provisions of the indenture agreement. The note acquired by Hersha Statutory Trust II will mature on July 30, 2035, but may be redeemed at our option, in whole or in part, beginning on July 30, 2010 in accordance with the provisions of the indenture agreement. The note acquired by Hersha Statutory Trust I bears interest at a fixed rate of 7.34% per annum through June 30, 2010 and the note acquired by Hersha Statutory Trust II bears interest at a fixed rate of 7.173% per annum through July 30, 2010. Subsequent to June 30, 2010 for Hersha Statutory Trust I and July 30, 2010 for Hersha Statutory Trust II, holders the notes bear interest at a variable rate of LIBOR plus 3.0% per annum.

The Hersha Statutory Trusts are VIEs under FIN 46, because the equity holders at risk hold no substantial decision-making rights. Because HHLP is not the primary beneficiary in the Hersha Statutory Trusts, the accounts of the trusts are not consolidated with and into HHLP. HHLP's investment in the Hersha Statutory Trusts is accounted for using the equity method of accounting and is presented on our consolidated balance sheet in other assets.

The proceeds received by HHLP in exchange for the notes were used to fund acquisitions of hotel properties, pay down outstanding borrowings under our revolving credit facility and for general corporate purposes. The notes are presented on our consolidated balance sheet in Mortgages and Notes Payable.

We will continue to evaluate each of our investments and contractual relationships to determine if consolidation is required based upon the provisions of FIN 46.

Use of Estimates

The preparation of 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 amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Investment in Hotel Properties



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Investment in hotel properties is stated at cost. Depreciation for financial reporting purposes is principally based upon the straight-line method.

The estimated lives used to depreciate the hotel properties are as follows:

Building and Improvements	15 to 40 Years
Furniture and Fixtures	5 to 7 Years

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**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Revenue Recognition

We directly recognize revenue and expense for all consolidated hotels as “Hotel Operating Revenue” and “Hotel Operating Expense” when earned and incurred. Included in hotel operating revenues is primarily room revenues and revenue from other hotel operating departments. These revenues are recorded net of any sales or occupancy taxes collected from our guests. All revenues are recorded on an accrual basis, as earned. We participate in frequent guest programs sponsored by the brand owners of our hotels and we expense the charges associated with those programs, as incurred.

Stock Compensation

We apply Statement of Financial Accounting Standards No. 123R, “Share-Based Payments” (SFAS 123R) where by we measure the cost of employee service received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost is recognized over the period during which an employee is required to provide service in exchange for the award.

Earnings Per Common Share

We compute earnings per share in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 128, “Earnings Per Share.”

Minority Interest

Minority Interest in the Partnership represents the limited partner’s proportionate share of the equity of the Partnership. Income (Loss) is allocated to minority interest in accordance with the weighted average percentage ownership of the Partnership during the period. At the end of each reporting period the appropriate adjustments to the income (loss) are made based upon the weighted average percentage ownership of the Partnership during the period. Our ownership interest in the Partnership as of March 31, 2006 and 2005 was 85.4% and 87.7%, respectively.

We also maintain minority interests for the equity interest owned by third parties in Logan Hospitality Associates, LLC; LTD Associates One, LLC; LTD Associates Two, LLC; and Affordable Hospitality, LP. Third parties own a 45% interest in Logan Hospitality Associates, LLC; a 25% interest in each of LTD Associates One LLC and LTD Associates Two, LLC; and a 20% interest in Affordable Hospitality Associates, LP. We allocate the income (loss) of these joint venture’s to the minority interest in consolidated joint venture account based upon the ownership of the entities, preferences in distributions of cash available and the terms of each ventures liquidation.

Impairment of Long-Lived Assets

We review the carrying value of each hotel property in accordance with SFAS No. 144 to determine if circumstances exist indicating an impairment in the carrying value of the investment in the hotel property or if depreciation periods should be modified. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We perform undiscounted cash flow analyses to determine if impairment exists. If impairment is determined to exist, any related impairment loss

is calculated based on fair value. Hotel properties held for sale are presented at the lower of carrying amount or fair value less cost to sell.

Investment in Unconsolidated Joint Ventures

The equity method of accounting is used for joint ventures in which we have the ability to exercise significant influence. Under this method, the investment, originally recorded at cost, is adjusted to recognize our share of net earnings or losses of the affiliates as they occur rather than as dividends or other distributions are received, limited to the extent of our investment in, advances to and commitments for the investee.

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**NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Income Taxes

The Company qualifies as a REIT under applicable provisions of the Internal Revenue Code, as amended, and intends to continue to qualify as a REIT. In general, under such provisions, a trust which has made the required election and, in the taxable year, meets certain requirements and distributes to its shareholders at least 90% of its REIT taxable income will not be subject to Federal income tax to the extent of the income which it distributes. Earnings and profits, which determine the taxability of dividends to shareholders, differ from net income reported for financial reporting purposes due primarily to differences in depreciation of hotel properties for Federal income tax purposes.

Deferred income taxes relate primarily to the TRS Lessee and are accounted for using the asset and liability method. Under this method, deferred income taxes are recognized for temporary differences between the financial reporting bases of assets and liabilities of the TRS Lessee and their respective tax bases and for their operating loss and tax credit carry forwards based on enacted tax rates expected to be in effect when such amounts are realized or settled. However, deferred tax assets are recognized only to the extent that it is more likely than not that they will be realized based on consideration of available evidence, including tax planning strategies and other factors. There were no income taxes recorded in the Statement of Operations.

Under the REIT Modernization Act ("RMA"), which became effective January 1, 2001, the Company is permitted to lease hotels to a wholly owned taxable REIT subsidiary ("TRS") and may continue to qualify as a REIT provided the TRS enters into management agreements with an "eligible independent contractor" who will manage the hotels leased by the TRS. The Company formed the TRS Lessee in 2003. The TRS Lessee currently leases 37 properties from the Partnership. The TRS Lessee is subject to taxation as a C-Corporation. The TRS Lessee had an operating loss for financial reporting purposes for the period ended March 31, 2006. Although the TRS Lessee is expected to operate at a profit for Federal income tax purposes in future periods, the value of the deferred tax asset is not able to be quantified with certainty. Therefore, no deferred tax assets have been recorded as we have not concluded that it is more likely than not that these deferred tax assets will be realizable.

Derivatives

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps and caps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps limit the Company's exposure to increasing interest payments when interest rates increase. During 2006 and 2005, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt. As of March 31, 2006 and 2005, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations.

The Company does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

Reclassification

Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation.

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**NOTE 2 - INVESTMENT IN HOTEL PROPERTIES**

Investment in Hotel Properties consist of the following at March 31, 2006 and December 31, 2005:

	<b>March 31,</b>	<b>December</b>
	<b>2006</b>	<b>31, 2005</b>
Land	\$ 51,552	\$ 32,430
Buildings and Improvements	362,272	283,791
Furniture, Fixtures and Equipment	55,346	43,528
	469,170	359,749
Less Accumulated Depreciation	(45,239)	(41,769)
<b>Total Investment in Hotel Properties</b>	<b>\$ 423,931</b>	<b>\$ 317,980</b>

*2006 Transactions*

*New Jersey and Pennsylvania Portfolio.* On January 3, 2006, we acquired the 118-room Fairfield Inn & Suites in Mt. Laurel, New Jersey, the 103-room Fairfield Inn & Suites in Bethlehem, New Jersey, and the 118-room Langhorne Courtyard in Langhorne, Pennsylvania in one transaction, for a total purchase price of approximately \$41.3 million, which included \$250 in deposits included in the balance sheet on December 31, 2005. The total purchase price is subject to a post closing adjustment on June 30, 2007, which may increase the purchase price by an amount of up to \$2.5 million.

*Courtyard, Scranton, Pennsylvania.* On February 1, 2006, we acquired the 120-room Courtyard in Scranton, Pennsylvania for approximately \$8.9 million in cash.

*Residence Inn, Tyson's Corner, Virginia.* On February 2, 2006, we acquired the 96-room Residence Inn in Tyson's Corner, Virginia for approximately \$20.1 million, which included the assumption of \$9.6 million in debt.

*Hampton Inn, Philadelphia.* On February 15, 2006, we acquired an 80% interest in Affordable Hospitality Associates, LP, the owner of the land, improvements and certain personal property of the 250-room Hampton Inn (Center City) in Philadelphia for approximately \$25.0 million, which included \$3.0 million in deposits included in the balance sheet on December 31, 2005. Our ownership interests entitles us to a 9.0% participating preferred return on our capital contribution.

*Hilton Garden Inn, JFK Airport, New York.* On February 16, 2006, we acquired 100% of the outstanding ownership interests in Metro JFK Associates, LLC, the owner of a leasehold interest in the land, improvements and certain personal property of the Hilton Garden Inn - JFK Airport, located in Jamaica, New York, for approximately \$29.1 million. The purchase price includes the assumption of \$13.0 million in debt, \$6.0 million in newly issued units of our

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operating partnership, \$5.0 million in deposits that were on the balance sheet as of December 31, 2005, and cash.

The purchase price, including transaction costs, and the allocation of purchase price to land; building and improvements; lease intangibles; furniture, fixtures and equipment; and franchise fees and loan costs is as follows:

Hotel	Location	Rooms	Acquisition Date	Land	Buildings and Improvements	Furniture and Equipment	Franchise		Leasehold Intangible	Total Purchase Price	Assumed Debt
							Fees	and Loan Costs			
NJ and PA Portfolio		339	1/3/2006	\$ 6,207	\$ 30,951	\$ 3,978	\$ 181	-	\$ 41,317	-	
Courtyard by Marriott	Scranton, PA	120	2/1/2006	761	7,168	831	91	-	8,851	-	
Residence Inn	Tyson's Corner, VA	96	2/2/2006	11,233	7,331	1,382	151	-	20,097	9,596	
Hilton Garden Inn	JFK Airport, NY	188	2/16/2006	N/A	24,974	3,621	317	226	29,138	13,000	
<b>2006 TOTAL</b>		<b>743</b>		<b>\$ 18,201</b>	<b>\$ 70,424</b>	<b>\$ 9,812</b>	<b>\$ 740</b>	<b>\$ 226</b>	<b>\$ 99,403</b>	<b>\$ 22,596</b>	

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**NOTE 2 - INVESTMENT IN HOTEL PROPERTIES (Continued)**

All of the newly acquired hotels above are leased to the TRS Lessee and managed by HHMLP.

Included in the acquisition of the Hilton Garden Inn at the JFK Airport, NY, was a land lease for the underlying land with a remaining term of approximately 93 years. The remaining lease payments were determined to be below market value and as a result purchase price was allocated to an intangible asset with a value of \$226. Included in the acquisition of the Courtyard by Marriott in Brookline, MA in 2005, was a prepaid land lease for the underlying land with a remaining term of approximately 90 years. This prepaid land lease is classified as an intangible asset with a value of \$3,570. Both lease intangibles are recorded in other assets on the consolidated balance sheet and are being amortized over the remaining life of the leases.

On February 15, 2006, we acquired an 80% interest in Affordable Hospitality Associates, LP, (Affordable Hospitality) the owner of the land, improvements and certain personal property of the 250-room Hampton Inn (Center City) in Philadelphia for approximately \$25.0 million. Our ownership interests entitle us to a 9.0% participating preferred return on our capital contribution.

Hotel	Location	Rooms	Acquisition Date	Land	Buildings and Improvements	Furniture and Fixtures and Equipment	Franchise Fees and Loan Costs	Total Assets	Assumed Lease and Debt
Hampton Inn (Affordable Hospitality)	Philadelphia, PA	250	2/15/2006	\$ 2,928	\$ 21,062	\$ 3,029	\$ 117	\$ 27,136	\$ 873
<b>2006 Total Consolidated Joint Ventures</b>		250		\$ 2,928	\$ 21,062	\$ 3,029	\$ 117	\$ 27,136	\$ 873

Subsequent to March 31, 2006, we closed on the acquisition of the following properties:

*KW Portfolio.* On April 25, 2006, we acquired the 100-room Hawthorn Inn & Suites in Franklin, Massachusetts for \$12.0 million. On May 1, 2006 we acquired the 96-room Residence Inn and the 84-room Comfort Inn for \$15.0 million and \$4.75 million, respectively.

*Holiday Inn Express, Cambridge, Massachusetts.* On May 3, 2006, we acquired the 112-room Holiday Inn Express, Cambridge, Massachusetts for approximately \$12.0 million.

The following condensed pro forma financial is presented as if the acquisitions of the NY and PA Portfolio; Courtyard by Marriott, Scranton, PA; Residence Inn, Tyson's Corner, VA; Hampton Inn, Philadelphia, PA; Fairfield Inn, Laurel, MD; McIntosh Portfolio; Courtyard by Marriott, Brookline, MA; Springhill Suites, Williamsburg, VA; and Residence Inn, Williamsburg, VA had been consummated as of January 1, 2005. All of the other acquisitions listed above were either purchased without any operating history or did not have a full year's operating history in 2005. The condensed pro forma information is not necessarily indicative of what actual results of operations of the Company would have been assuming the acquisitions had been consummated at the beginning of the respective periods presented, nor does



it purport to represent the results of operations for future periods.

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**NOTE 2 - INVESTMENT IN HOTEL PROPERTIES (Continued)**

	<b>Three Months Ended</b>	
	<b>2006</b>	<b>2005</b>
Pro Forma Total Revenues	\$ 26,150	\$ 21,649
Pro Forma Loss from Continuing Operations	\$ (3,257)	\$ (1,262)
Pro Forma Loss from Continuing Operations per Common Share — Basic	\$ (0.16)	\$ (0.06)
Pro forma Loss from Continuing Operations per Common Share — Diluted	\$ (0.16)	\$ (0.07)
<b>Weighted Average Common Shares Outstanding</b>		
Basic	20,308,225	20,291,234
Diluted	20,379,225	20,291,234

Assets Held for Sale consisted of the following at March 31, 2006 and December 31, 2005:

	<b>March 31, 2006</b>	<b>December 31, 2005</b>
Land	\$ 2,008	\$ -
Buildings and improvements	19,256	2,644
Furniture, fixtures and equipment	4,572	1,119
Deferred costs	225	-
	26,061	3,763
Less accumulated depreciation and amortization	(5,512)	(356)
	\$ 20,549	\$ 3,407

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**NOTE 3 - NOTES RECEIVABLE**

On September 26, 2002, in connection with the sale of the Clarion Suites, Philadelphia, PA, we provided financing in the amount of \$200, of which \$20 and \$25 was outstanding as of March 31, 2006 and December 31, 2005, respectively. The note is unsecured and accrues interest at a rate of 12%. This note matures on June 30, 2006. For the three months ended March 31, 2006 and 2005, we recorded interest income of \$1 and \$2, respectively, which is included in "Other Revenue" on the statement of operations.

On May 13, 2005, in connection with the sale of the Doubletree Club, Jamaica, NY, we provided financing in the amount of \$1,700 to the buyer. The note receivable bears interest at a rate of 12% per annum and is due on April 30, 2006. Interest payments are due quarterly with repayment of the principal due upon maturity. The balance as of March 31, 2006 and December 31, 2005 was \$1,918 and \$1,861, respectively and includes accrued interest of \$193 and \$137 respectively. For the three months ended March 31, 2006, we recorded interest income of \$56, which is included in "Interest Income-Secured Loans" on the statement of operations. Subsequent to March 31, 2006, the note and all accrued interest was repaid in accordance with the terms of the agreement.

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**NOTE 4 - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES**

On August 29, 2003, HT/CNL Metro Hotels, LP purchased the Hampton Inn, (Manhattan) Chelsea, NY. We own a one-third equity interest in this joint venture partnership while CNL Hospitality Partners LP owns the remaining equity interests.

On November 13, 2003, we purchased a 40% joint venture interest in PRA Glastonbury, LLC. The only asset owned by PRA Glastonbury, LLC is the Hilton Garden Inn, Glastonbury, CT.

On July 1, 2004, we purchased a 50% joint venture interest in Inn America Hospitality at Ewing, LLC. The only asset owned by this entity is the Courtyard by Marriott, Ewing-Hopewell, NJ.

In July of 2005, the Emerging Issues task Force (EITF) agreed on a framework for evaluating whether a general partner or a group of general partners controls a limited partnership and therefore should consolidate it. EITF Issue 04-5, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights" (EITF 04-5), amends the guidance in AICPA Statement of Position No. 78-9, "Accounting for Investments in Real Estate Ventures" (SOP 78-9) and states that the presumption of general-partner control would be overcome only when the limited partners have either of two types of rights. The first type—referred to as "kick-out rights"—is the right to dissolve or liquidate the partnership or otherwise remove the general partner "without cause." The second type—referred to as "participating rights"—is the right to effectively participate in significant decisions made in the ordinary course of the partnership's business. The kick-out rights and the participating rights must be substantive in order to overcome the presumption of general-partner control. EITF 04-5's guidance is effective immediately for all newly formed limited partnerships and for existing limited partnership agreements that are modified. The guidance will be effective for existing limited-partnership agreements no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. As of January 1, 2006, the Company has adopted EITF 04-5 for all partnerships. The adoption of EITF 04-5 did not have a material effect on its consolidated financial statements.

On July 1, 2005, we acquired a 49.9% interest in Hiren Boston, LLC ("Hiren"), the owner of a 164 room Courtyard by Marriott in South Boston, Massachusetts, for approximately \$5,031, including settlement costs of approximately \$331. This hotel is leased to South Bay Boston, LLC, a joint venture owned by 44 New England and our joint venture partner, and managed by an affiliate of our joint venture partner. Our joint venture partner and the manager of the property are unaffiliated with the Company. The Hiren joint venture agreement provides for a 10% preferred return during the first two years of the venture based on the equity interest in Hiren. Cash distributions will be made from cash available for distribution, first, to us to provide a 10% annual non-compounded return on our capital contributions and then to our joint venture partner to provide a 10% annual non-compounded return of their contributions. The 10% returns are not cumulative. Any remaining cash available for distribution will be distributed 50% to us. Subsequent to this initial two year period, cash distributions will be made 50% to us and 50% to our joint venture partners in Hiren. In accordance with AICPA Statement of Position 78-9 "Accounting for Investments in Real Estate Ventures" (SOP 78-9), Hiren will allocate income to HHLP and our joint venture partner consistent with the allocation of cash distributions and liquidating distributions.

On October 7, 2005, we acquired a 49.9% interest in SB Partners, LLC ("SB Partners"), the owner of a 118 room Holiday Inn Express in South Boston, Massachusetts, for approximately \$2,250. This hotel will be leased to South Bay Sandeep, LLC, a TRS wholly owned by SB Partners, and managed by an affiliate of our joint venture partner.

Our joint venture partner and the manager of the property are owned by certain members that have an interest in Hiren and are unaffiliated with the Company. The SB Partners joint venture agreement provides for a 10% preferred return during the first two years of the venture based on the equity interest in SB Partners. Cash distributions will be made from cash available for distribution, first, to us to provide a 10% annual non-compounded return on our capital contributions and then to our joint venture partner to provide a 10% annual non-compounded return of their contributions. The 10% returns are not cumulative. Any remaining cash available for distribution will be distributed 50% to us. Subsequent to this initial two year period, cash distributions will be made 50% to us and 50% to our joint venture partners in SB Partners. In accordance with SOP 78-9, SB Partners allocates income to us and our joint venture partner consistent with the allocation of cash distributions and liquidating distributions.

In June 2005, we entered into a joint venture with Waterford Hospitality and Mystic Hotel Investors, LLC (“MHI,” and together with Waterford, the “Waterford Parties”), pursuant to which the parties agreed to establish Mystic Partners, LLC (“Mystic”). The Waterford Parties contributed to Mystic Partners its membership interests in a portfolio of nine entities that own nine Marriott- or Hilton-branded hotels in Connecticut and Rhode Island. Aggregate fair value of the contributed properties was approximately \$250,000. We contributed approximately \$40,000 in cash to Mystic Partners in exchange for a 66.7% preferred equity interest in the seven stabilized hotel properties in the portfolio and a 50% preferred equity interest in the two newly-developed hotel properties in the portfolio, subject to minority interest participations in certain hotels.

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**NOTE 4 - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES (Continued)**

On February 8, 2006, Mystic Partners closed on the acquisition of the 409 room Hartford Marriott in Hartford, Connecticut, the final hotel in the Waterford portfolio to be acquired by Mystic. The acquisition included the hotel, improvements, certain personal property and a pre-paid airspace sublease relating to airspace comprising a portion of the Hartford Convention Center. The Company contributed approximately \$6,700 to Mystic Partners, and the Waterford Parties contributed its Membership Interests in the Owner of the Hartford Marriott. In conjunction with this closing, the Mystic Partners agreed to adjust each party's equity ownership interest in the two development properties, the Hartford Hilton and the Hartford Marriott, as follows:

	Hersha	Waterford
Hartford Hilton	8.8%	79.2%
Hartford Marriott	15%	81%

Both the Hartford Hilton and the Hartford Marriott properties maintain minority interest ownership from unrelated third party investors for approximately 12.0% and 4.0%, respectively.

Additionally, the amendment provides us with the option to purchase up to a 50.0% equity ownership interest in Mystic Partners' equity interest in the Hartford Hilton and the Hartford Marriott, respectively, at a price determined in accordance with Amendment. Also, the Company entered into an agreement whereby we and MHI jointly and severally guarantee the performance of the terms of a loan to Adriaen's Landing Hotel, LLC, owner of the Hartford Marriott, in the amount of \$50,000, and 315 Trumbull Street Associates, LLC, in the amount of \$27,000 if at any time during the term of the note and during such time as the net worth of Mystic falls below the amount of the guarantee.

The Mystic Partners joint venture agreement provides for an 8.5% preferred return based on our preferred equity interest in the stabilized and newly-developed hotel properties. Cash distributions will be made from cash available for distribution, first, to us to provide an 8.5% annual non-compounded return on our unreturned capital contributions and then to the Waterford Parties to provide an 8.5% annual non-compounded return of their unreturned contributions. The 8.5% returns are not cumulative. Any remaining cash available for distribution will be distributed to us 56.7%, with respect to the net cash flow from the stabilized properties, 10.5% with respect to the net cash flow from the Hartford Marriott, and 7.0% with respect to the Hartford Hilton. In accordance with SOP 78-9, Mystic Partners will allocate income to us and the Waterford Parties consistent with the allocation of cash distributions and liquidating distributions.

The nine hotels acquired by Mystic through March 31, 2006 are:

Hotel Name	Location	Date Acquired	Owner	Hersha Ownership	Number of Rooms
Mystic Marriott Hotel & Spa	Mystic, CT	August 9, 2005	Exit 88 Hotel, LLC	66.7%	285
Danbury Residence Inn	Danbury, CT	August 9, 2005	Danbury Suites, LLC	66.7%	78
Southington Residence Inn	Southington, CT	August 9, 2005	Southington Suites, LLC and 790 West Street, LLC	44.7%	94
	Norwich, CT	August 9, 2005	Norwich Hotel, LLC	66.7%	144

Norwich Courtyard by  
Marriott and Rosemont  
Suites

Warwick Courtyard by Marriott	Warwick, RI	August 9, 2005	Warwick Lodgings, LLC	66.7%	92
Waterford SpringHill Suites	Waterford, CT	August 9, 2005	Waterford Suites, LLC	66.7%	80
Mystic Residence Inn	Mystic, CT	September 15, 2005	Whitehall Mansion Partners, LLC	66.7%	133
Hartford Hilton	Hartford, CT	October 6, 2005	315 Trumbull Street, LLC	8.8%	393
Marriott Downtown	Hartford, CT	February 8, 2006	Adriaen's Landing Hotel, LLC	15.0%	409

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**NOTE 4 - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES (Continued)**

Each of the Mystic Partners hotel properties, except the Hartford Hilton, is under an Asset Management Agreement with 44 New England to provide asset management services. Fees for these services are paid monthly to 44 New England and recognized as income in the amount 1% of operating revenues, except for the Hartford Marriott which is 0.25% of operating revenues. Each property owned by the joint venture is managed by Waterford Hotel Group, Inc., an affiliate of Waterford. The property manager will receive a base fee of 3% or 4% of gross revenues of the property, depending on the property, and an incentive fee of 10% of net operating income less debt service after each of HHLP and the Waterford Parties receive a 12.0% annual non-compounded return on its unreturned capital contributions.

We account for our investment in the above mentioned unconsolidated joint ventures using the equity method of accounting.

As of March 31, 2006 and December 31, 2005 our investment in unconsolidated joint ventures consists of the following:

	<b>Percent Owned</b>	<b>3/31/2006</b>	<b>12/31/2005</b>
HT/CNL Metro Hotels, LP	33.33%	\$ 4,050	\$ 4,487
HT/PRA Glastonbury, LLC	40.00%	534	2,379
Inn American Hospitality at Ewing, LLC	50.00%	1,466	1,456
Hiren Boston, LLC	49.90%	4,700	5,034
SB Partners, LLC	49.90%	2,102	2,232
Mystic Partners, LLC	8.80%-66.70%	39,188	40,393
		\$ 52,040	\$ 55,981

The following tables set forth the total assets, liabilities, equity and components of net income, including the Company's share, related to the unconsolidated joint ventures discussed above as of March 31, 2006 and December 31, 2005 and for the three months ended March 31, 2006 and 2005.

**Balance Sheet**

	<b>March 31, 2006</b>	<b>December 31, 2005</b>
<b>Assets</b>		
Investment in hotel property, net	\$ 262,466	\$ 182,708
Other assets	23,720	22,708
<b>Total Assets</b>	<b>\$ 286,186</b>	<b>\$ 205,416</b>
<b>Liabilities and Equity</b>		
Mortgages and notes payable	\$ 215,409	\$ 166,564
Capital Leases	327	357
Other liabilities	11,750	8,021
Equity:		



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Hersha Hospitality Trust	52,007	56,291
Other Interests in Joint Ventures	6,694	(25,817)
<b>Total Liabilities and Equity</b>	<b>\$ 286,187</b>	<b>\$ 205,416</b>

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**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
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**NOTE 4 - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES (Continued)**

**Statement of Operations**

	<b>Three Months Ended</b>	
	<b>3/31/2006</b>	<b>3/31/2005</b>
Room revenue	\$ 16,380	\$ 3,618
Other revenue	6,195	357
Operating expenses	(18,123)	(2,322)
Interest expense	(3,459)	(587)
Land Lease Expense	(117)	0
Property taxes	(1,289)	(265)
Income taxes	-	(26)
Depreciation, amortization and other	(3,785)	(640)
Minority interest	168	
<b>Net (loss) income</b>	<b>\$ (4,030)</b>	<b>\$ 135</b>

Equity income (loss) recognized during the three months ended March 31, 2006 and 2005 for our Equity Investments in Unconsolidated Joint Ventures:

	<b>Three Months Ended</b>	
	<b>3/31/2006</b>	<b>3/31/2005</b>
HT/CNL	\$ 38	\$ 36
HT/PRA Glastonbury	(259)	2
Inn American Hospitality at Ewing, LLC	10	11
Hiren Boston, LLC	(334)	-
S B Partners, LLC	(131)	-
Mystic Partners, LLC	(434)	-
<b>Total equity in income (loss)</b>	<b>\$ (1,110)</b>	<b>\$ 49</b>

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**NOTE 5 - DEBT**

Mortgages and Notes Payable

The total mortgages payable balances at March 31, 2006, and December 31, 2005, were \$251,560 and \$204,598, respectively, and consisted of mortgages with fixed and variable interest rates ranging from 4.0% to 9.43%. In addition, we had mortgages on our held for sale properties of \$ 10,375 and \$-0- as of March 31, 2006 and December 31, 2005, respectively, which is classified in Debt and Capital Lease Payable Related to Hotel Assets Held for Sale on the consolidated balance sheets. The maturities for the outstanding mortgages ranged from August 2007 to January 2032. Aggregate interest expense incurred under the mortgages payable totaled \$4,080 and \$1,726 for the three months ended March 31, 2006 and 2005, respectively.

In the second quarter of 2005, HHLP issued two junior subordinated notes payable in the aggregate amount of \$51,548 to the Hersha Statutory Trusts pursuant to indenture agreements. The \$25,774 note issued to Hersha Statutory Trust I will mature on June 30, 2035, but may be redeemed at HHLP's option, in whole or in part, beginning on June 30, 2010 in accordance with the provisions of the indenture agreement. The \$25,774 note issued to Hersha Statutory Trust II will mature on July 30, 2035, but may be redeemed at our option, in whole or in part, beginning on July 30, 2010 in accordance with the provisions of the indenture agreement. The note issued to Hersha Statutory Trust I bears interest at a fixed rate of 7.34% per annum through June 30, 2010, and the note issued to Hersha Statutory Trust II bears interest at a fixed rate of 7.173% per annum through July 30, 2010. Subsequent to June 30, 2010 for notes issued to Hersha Statutory Trust I and July 30, 2010 for notes issued to Hersha Statutory Trust II, holders the notes bear interest at a variable rate of LIBOR plus 3.0% pre annum. Interest expense in amount of \$925 was recorded during the three months ended March 31, 2006.

Revolving Line of Credit

On January 17, 2006, we entered into a revolving credit loan and security agreement with Commerce Bank, N.A. with a maximum amount of \$60,000. Outstanding borrowings under the line of credit bear interest at the Company's option of either the bank's prime rate of interest minus .50% or LIBOR available for the periods of 1, 2, 3, or 6 months plus 2.25%. The line of credit is collateralized by a first lien-security interest in all existing and future assets of HHLP, and title-insured, first-lien mortgages on the Holiday Inn Express, Harrisburg, PA, the Mainstay Suites and Sleep Inn, King of Prussia, PA, the Fairfield Inn, Laurel, MD, the Hampton Inn, Philadelphia, PA, and collateral assignment of all hotel management contracts from which HHLP or its affiliates derive revenue. The line of credit includes certain financial covenants and requires that we maintain (1) a minimum tangible net worth of \$110.0 million; (2) a maximum accounts and other receivables from affiliates of \$75.0 million; and (3) certain financial ratios. The line of credit expires on December 31, 2008 and replaces the Sovereign Bank Line of Credit. This revolving credit loan replaced both the secured and unsecured lines of credit that we previously maintained. As a result of the termination of the Sovereign Bank Line of Credit, we expensed \$255 in unamortized deferred costs related to the origination of the Sovereign Bank Line of Credit.

The Company maintained a Line of Credit balance of \$37,243 at March 31, 2006 and \$-0- at December 31, 2005. The Company recorded interest expense of \$399 and \$18, for the three months ended March 31, 2006 and 2005, respectively. The weighted average interest rate on our Line of Credit during the three months ended March 31, 2006 and 2005 was 6.92% and 5.33%, respectively.



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**NOTE 6 - COMMITMENTS AND CONTINGENCIES AND RELATED PARTY TRANSACTIONS**

We are the sole general partner in the Partnership, which is indirectly the sole general partner of the subsidiary partnerships. The Company does not anticipate any losses as a result of our obligations as general partner.

Management Agreements

44 New England engages HHMLP as the property manager for hotels it leases from us pursuant to management agreements. Each management agreement provides for a five-year term and is subject to early termination upon the occurrence of defaults and certain other events described therein. As required under the REIT qualification rules, HHMLP must qualify as an "eligible independent contractor" during the term of the management agreements. Under the management agreements, HHMLP generally pays the operating expenses of our hotels. All operating expenses or other expenses incurred by HHMLP in performing its authorized duties are reimbursed or borne by the TRS Lessee to the extent the operating expenses or other expenses are incurred within the limits of the applicable approved hotel operating budget. HHMLP is not obligated to advance any of its own funds for operating expenses of a hotel or to incur any liability in connection with operating a hotel.

As of March 31, 2006, HHMLP managed all 37 hotels leased to the TRS Lessee, and we consolidated the financial statements of these 37 hotels in these financial statements. HHMLP also manages two consolidated joint venture hotel properties and three unconsolidated joint venture hotel properties in which we maintain an investment. For its services, HHMLP receives a base management fee, and if a hotel meets and exceeds certain thresholds, an additional incentive management fee. The base management fee for a hotel is due monthly and is equal to 3% of gross revenues associated with each hotel managed for the related month. The incentive management fee, if any, for a hotel is due annually in arrears on the ninetieth day following the end of each fiscal year and is based upon the financial performance of the hotel. For the three months ended March 31, 2006 and 2005, management fees incurred totaled \$789 and \$544, respectively. These fees are recorded as Hotel Operating Expenses.

Administrative Services Agreement

Prior to July 1, 2005, under the terms of an administrative service agreement, HHMLP provided accounting and reporting services for the Company. The terms of the agreement provided for us to pay HHMLP an annual fee of \$10 per property (prorated from the time of acquisition) for each hotel in our portfolio. On July 1, 2005, the administrative service fee was replaced by monthly accounting and information technology fees for each of our wholly owned hotels. Monthly fees for accounting services are \$2 per property and monthly information technology fees are \$0.5 per property. For the three months ended March 31, 2006 and 2005, the Company incurred administrative services fees of \$0 and \$65, respectively. For the three months ended March 31, 2006, the Company incurred accounting fees of \$227 and information technology fees of \$57. Administrative services fees, accounting fees, and information technology fees are included in General and Administrative expenses.

Franchise Agreements

The hotel properties are operated under franchise agreements assumed by the hotel property lessee. The franchise agreements have 10 to 20 year terms but may be terminated by either the franchisee or franchisor on certain anniversary dates specified in the agreements. The franchise agreements require annual payments for franchise royalties, reservation, and advertising services, and such payments are based upon percentages of gross room revenue.

These payments are paid by the lessees and charged to expenses as incurred. The initial fees incurred to enter into the franchise agreements are amortized over the life of the franchise agreements.

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**NOTE 6 - COMMITMENTS AND CONTINGENCIES AND RELATED PARTY TRANSACTIONS**  
**(Continued)**

Acquisitions from Affiliates

We have acquired from entities owned or controlled by certain of our executive officers and our related party trustees, newly-developed or newly-renovated hotels that do not have an operating history that would allow us to make purchase price decisions based on historical performance. In buying these hotels, we previously utilized, a “re-pricing” methodology that, in effect, adjusted the initial purchase price for the hotel, one or two years after we initially purchased the hotel, based on the actual operating performance of the hotel during the twelve months prior to the repricing. As part of our lease termination agreement with HHMLP, the original sellers of all of these properties, HHMLP and the Company have waived their respective rights to any and all purchase price adjustments for all properties. In the future, we do not intend to use any re-pricing methodology in acquisitions from entities controlled by our officers and trustees.

We have entered into an option agreement with each of our officers and related party trustees such that we obtain a first right of refusal to purchase any hotel owned or developed in the future by these individuals or entities controlled by them. This right of first refusal would apply to each party until one year after such party ceases to be an officer or related party trustee of our Company. Since our initial public offering in 1999, we have acquired, wholly or through joint ventures, a total of 57 hotels, including 18 hotels acquired from entities controlled by our officers or trustees. Of the 18 acquisitions from these entities, 16 were newly-constructed or newly-renovated by these entities prior to our acquisition. Our Acquisition Committee of the Board of Trustees is comprised solely of independent trustees, and the purchase prices and all material terms of the purchase of hotels from related parties are negotiated with the Acquisition Committee. In addition, we have hired an independent accounting firm to provide our Board of Trustees with an “Agreed Upon Procedures” report for all acquisitions and dispositions to related parties.

Hotel Supplies

For the three months ended March 31, 2006 and 2005, we incurred expenses of \$226 and \$262, respectively, for hotel supplies from Hersha Hotel Supply, an unconsolidated related party, which are expenses included in Hotel Operating Expenses. Approximately \$27 and \$52 is included in accounts payable at March 31, 2006 and December 31, 2005.

Due From Related Parties

The Due from Related Party balance as of March 31, 2006 and December 31, 2005 was approximately \$1,276 and \$2,799, respectively. The balance as of March 31, 2006 and December 31, 2005 consisted of accrued interest due on our development loans and receivables owed from our unconsolidated joint ventures.

Due to Related Parties

The due to related party balance as of March 31, 2006 and December 31, 2005, totaled \$3,902 and \$4,655, respectively. The due to related party balances at March 31, 2006 and December 31, 2005 consists of monies payable to HHMLP for administrative, management, and benefit related fees.

Land Leases

In conjunction with the acquisition of the Hilton Garden Inn, Edison, NJ, we assumed a land lease from a third party with an original term of 75 years. Monthly payments as determined by the lease agreement are due through the expiration in August 2074. On February 16, 2006, in conjunction with the acquisition of the Hilton Garden Inn, JFK Airport, NY, we assumed a land lease with an original term of 99 years. Monthly payments as determined by the lease agreement are due through the expiration in July of 2100. Both land leases provide rent increases at scheduled intervals. We record rent expense on a straight-line basis over the life of the lease from the beginning of the lease term. For the three months ended March 31, 2006 and 2005, we incurred \$162 and \$108 respectively, in lease expense under the agreements.

On January 6, 2005, we purchased land in Carlisle, PA for \$700 plus closing costs from a related party entity and leased the land to 44 Carlisle Associates, L.P., a related party. In July 2005, 44 Carlisle Associates, L.P. exercised their option to purchase the land from us. The purchase price consisted of \$700 for the land plus all fees and expenses.



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**NOTE 6 - COMMITMENTS AND CONTINGENCIES AND RELATED PARTY TRANSACTIONS**  
**(Continued)**

On February 18, 2005, we purchased land at the Bradley International Airport, Windsor Locks, CT for \$1,000 plus closing costs and leased the land to 44 Windsor Locks Associates, LLC, a related party. In addition to the purchase price, the terms of the lease required 44 Windsor Locks Associates, LLC to post a \$350 deposit. In July 2005, 44 Windsor Locks Associates, LLC exercised their option to purchase the land from us. The purchase price consisted of \$1,000 for the land plus all fees and expenses, and the \$350 deposit was returned.

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**NOTE 7 - DEVELOPMENT LOANS RECEIVABLE**

We have approved mortgage lending to entities in which our executive officers and affiliated trustees own an interest to enable such entities to construct hotels and conduct related improvements on specific hotel projects at interest rates ranging from 8.0% to 10.0% ("Development Line Funding"). As of March 31, 2006 and December 31, 2005, we had Development Loans Receivable from Related Parties of \$14,100 and \$32,450, respectively. Interest income from these advances included in "Interest - Secured Loans Related Party," was \$421 and \$1,000 for the three months ended March 31, 2006 and 2005, respectively.

As of March 31, 2006, our development loans to related parties consist of the following:

<b>Hotel Property</b>	<b>Borrower</b>	<b>Principal Outstanding 3/31/2006</b>	<b>Interest Rate</b>	<b>Interest Income Earned for the three months ended 3/31/2006</b>	<b>Interest Due and Accrued as of 3/31/2006</b>	<b>Maturity Date</b>
Hampton Inn - Seaport, New York, NY	HPS Seaport, LLC and BCM, LLC	13,000	10%	321	321	March 31, 2006
Candlewood Suites - Windsor Locks, NY	44 Windsor Locks Hospitality Associates, LLC	1,100	10%	16	16	August 31, 2006
		<b>\$ 14,100</b>		<b>\$ 337</b>	<b>\$ 337</b>	

Subsequent to March 31, 2006, development loans receivable from HPS Seaport, LLC and BCM, LLC were paid in full. On April 3, 2006, we provided a development loan to Risingsam Hospitality LLC in the amount of \$7.0 million. The loan bears interest at an annual rate of 10%.

As of December 31, 2005 our development loans to related parties consisted of the following:

<b>Hotel Property</b>	<b>Borrower</b>	<b>Principal Outstanding 12/31/2005</b>	<b>Interest Rate</b>	<b>Interest Income Earned for the year ended 12/31/2005</b>	<b>Interest Due and Accrued as of 12/31/2005</b>	<b>Maturity Date</b>
Boutique Hotel - 35th Street, New York, NY	44 Fifth Avenue, LLC	\$ 9,100	9%	\$ 599	\$ 181	August 31, 2006
Hampton Inn - Seaport,	HPS Seaport, LLC and	13,000	10%	908	734	March 31, 2006

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New York, NY	BCM, LLC					
Boutique Hotel - Tribeca, New York, NY	5444 Associates, LP	9,500	10%	570	381	August 31, 2006
Hilton Garden Inn - JFK Airport, NY	Metro Ten Hotels, LLC	850	10%	1,258	239	December 31, 2005
		\$ 32,450		\$ 3,335	\$ 1,535	

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**NOTE 8 - DERIVATIVE INSTRUMENTS**

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps and interest rate caps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps designated as cash flow hedges limit the Company's exposure to increased cash payments due to increases in variable interest rates.

On July 1, 2005, the Company acquired an interest rate cap with a notional amount of \$34,230 to hedge against the variability in cash flows on a variable interest rate debt instrument. The principal of the variable interest rate debt being hedged equals the notional amount of the interest rate cap. The interest rate cap effectively fixes interest payments when LIBOR exceeds 5.0%. The interest rate cap matures on January 11, 2007.

During 2006, these derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

As of March 31, 2006, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. The Company does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

At March 31, 2006, the fair values of the interest rate cap and the interest rate swap were \$51 and \$93, respectively and are included in assets. At December 31, 2005, the fair value of the interest rate cap was \$23 and is included in assets and the fair value of the interest rate swap was \$0. The change in net unrealized gains/losses of \$117 and \$198 for the three months ended March 31, 2006 and 2005, respectively, for derivatives designated as cash flow hedges. Hedge ineffectiveness of \$4 and \$4 on cash flow hedges was recognized in unrealized gain/loss on derivatives during the three months ended March 31, 2006 and 2005, respectively.

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**NOTE 9 - SHARE-BASED PAYMENTS**

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123R") which is a revision of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123"). SFAS No. 123R supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB Opinion No. 25") and its related implementation guidance. SFAS No. 123R requires companies to record compensation expense for share-based payments to employees, including grants of employee stock options and stock awards, at fair value. Effective April 1, 2005, the Company has adopted SFAS 123R. No stock-based payments were outstanding at the time SFAS 123R was adopted. In 2004, the Company established the Hersha Hospitality Trust 2004 Equity Incentive Plan which provides for the grant of stock options, stock appreciation rights, stock awards, performance shares and incentive awards. The maximum number of shares of common stock that can be issued under this plan is 1.5 million shares. No share-based payments were granted under this plan during the year ended December 31, 2004.

On June 1, 2005, the Compensation Committee of the Board of Trustees granted 71,000 restricted share awards to executives. The restricted share awards vest 25% each year over four years and compensation expense is recognized ratably over the four year vesting period based on the fair value of the shares on the date of grant. The fair value of the restricted share awards on the grant date was \$9.60 per share. Compensation expense of \$43 was incurred during the three months ended March 31, 2006 related to the restricted share awards and is recorded in general and administrative expense on the statement of operations. Unearned compensation as of March 31, 2006 and December 31, 2005 was \$540 and \$582, respectively. For the quarter ended March 31, 2006, no restricted shares were vested or forfeited.

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**NOTE 10 - EARNINGS PER SHARE**

The following table is a reconciliation of the income (numerator) and weighted average shares (denominator) used in the calculation of basic earnings per common share and diluted earnings per common share in accordance with SFAS No. 128, Earnings Per Share.

The Partnership Units (which may be converted to common shares of beneficial interest) have been excluded from the diluted earnings per share calculation as there would be no effect on the amounts since the income attributed to the Common Partnership Units would also be added back to net income. The computation of basic and diluted earnings per share is presented below.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Numerator:</b>		
<b>Loss from Continuing Operations</b>	\$ (3,854)	\$ (857)
Distributions to 8.0% Series A Preferred Shareholders	(1,200)	-
<b>Loss from continuing operations applicable to common shareholders</b>	\$ (5,054)	\$ (857)
<b>Income (Loss) from Discontinued operations</b>	(30)	(117)
<b>Net Loss applicable to common shareholders</b>	\$ (5,084)	\$ (974)
<b>Denominator:</b>		
Weighted average number of common shares - basic	20,308,225	20,291,234
Effect of Dilutive Securities:		
Stock Awards	71,000	-
Weighted average number of common shares - diluted	20,379,225	20,291,234
<b>Basic and diluted earnings per share</b>		
Loss from continuing operations applicable to common shareholders	\$ (0.25)	\$ (0.04)
Discontinued operations	-	(0.01)
Loss from continuing operations applicable to common shareholders	\$ (0.25)	\$ (0.05)

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**NOTE 11 - CASH FLOW DISCLOSURES AND NON-CASH INVESTING AND FINANCING ACTIVITIES**

Interest paid during the three months ended March 31, 2006 and 2005 totaled \$5,031 and \$1,960, respectively.

The following additional non-cash investing and financing activities occurred during the three months ended March 31, 2006 and 2005:

	<b>Three Months Ended</b>			
	<b>March 31,</b>			
	<b>2006</b>		<b>2005</b>	
Common shares issued as part of the Dividend Reinvestment Plan	\$	6	\$	6
Issuance of Stock to Board of Trustees		46		-
Compensation Expense from vesting of Stock Awards		43		-
Issuance of Common LP Units		6,000		-
Increase to minority interest as result of issuance of Common LP Units		5,847		-
Debt assumed in hotel property acquisitions		22,596		-

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**NOTE 12 - DISCONTINUED OPERATIONS**

The Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," effective January 1, 2002 which requires, among other things, that the operating results of certain real estate assets which have been sold subsequent to January 1, 2002, or otherwise qualify as held for disposition (as defined by SFAS No. 144), be included in discontinued operations in the statements of operations for all periods presented.

On May 13, 2005, we completed the disposition of the Doubletree Club, Jamaica, NY and the Holiday Inn Express, Long Island City, NY in a sale of the land, improvements and certain personal property to unaffiliated buyers for \$20,500, plus transaction costs. Assets sold had a net book value of \$18,806 and were classified as assets held for sale on the balance sheet. Debt related to assets held for sale of \$12,952 was assumed by the buyers. A note receivable for \$1,700 was received as part of the proceeds from the sale of the Doubletree Club. The notes receivable bears interest at a rate of 12% per annum and is due on April 30, 2006. Interest payments are due quarterly with repayment of the principal due upon maturity. Gain on the sale of the two properties was \$1,323, of which \$162 was allocated to minority interest in HHLP.

In September of 2005, our Board of Trustees authorized management of the Company to sell the Holiday Inn Express, Hartford, CT and this asset is classified as "held for sale" on the Company's Consolidated Balance Sheet as of March 31, 2006 and December 31, 2005. The operating results for this hotel have been reclassified to discontinued operations in the statements of operations for the three months ended March 31, 2006 and 2005. The hotel was acquired by the Company in January 2004. We closed on the sale of this hotel in April of 2006. Proceeds from the sale were \$3,600 and we estimate the gain on the sale of the property to be approximately \$125.

In March of 2006, our Board of Trustees authorized management of the Company to sell four properties located in metropolitan Atlanta, Georgia. These four properties are the Holiday Inn Express, Duluth, Comfort Suites, Duluth, Hampton Inn, Newnan and the Hampton Inn Peachtree City. These assets are classified as "held for sale" on the Company's Consolidated Balance Sheet as of March 31, 2006. The operating results for this hotel have been reclassified to discontinued operations in the statements of operations for the three months ended March 31, 2006 and 2005. These hotels were acquired by the Company in April and May 2000.

As of March 31, 2006, Debt and Capital Lease Payable related to the assets Held for Sale was \$10,730 and consisted of capital lease obligations for the Holiday Inn Express, Hartford, CT and mortgages on the four properties in Georgia. This capital lease obligation is from a third party assumed during the acquisition of the Holiday Inn Express, Hartford, CT. The six year lease is secured by furniture, fixtures and equipment and the hotel property and is amortized over a six year period from the acquisition at a fixed rate of 8.3%. As of December 31, 2005, Debt and Capital Lease payable related to the assets held for sale as of the date was \$375 and related to the Holiday Inn Express, Hartford, CT, capital lease.

In addition, during 2004, in conjunction with the acquisition of the Holiday Inn Express, Hartford, CT we assumed a land lease from a third party with an original term of 99 years. Monthly payments as determined by the lease agreement are due through the expiration in September 2101. For the three months ended March 31, 2006 and 2005, we incurred \$75 and \$75 in lease expense under this agreement, which have been reclassified to discontinued operations in the statement of operations.



We allocate interest and capital lease expense to discontinued operations for debt that is to be assumed or that is required to be repaid as a result of the disposal transaction. We allocated \$238 and \$440 of interest and capital lease expense to discontinued operations for the three months ended March 31, 2006 and 2005, respectively.

The following table sets forth the components of discontinued operations for the three months ended March 31, 2006 and 2005:

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**NOTE 12 - DISCONTINUED OPERATIONS (Continued)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Revenue:</b>		
Hotel Operating Revenues	\$ 1,953	\$ 3,053
<b>Expenses:</b>		
Interest and Capital Lease expense	\$ 238	\$ 440
Land Lease	75	75
Hotel Operating Expenses	1,306	2,208
Real Estate and Personal Property Taxes and Property Insurance	110	137
General and Administrative	-	18
Depreciation and Amortization	259	308
<b>Total Expenses</b>	<b>\$ 1,988</b>	<b>\$ 3,186</b>
<b>Loss from Discontinued Operations before Minority Interest</b>	<b>(35)</b>	<b>(133)</b>
<b>Allocation to Minority Interest</b>	<b>(5)</b>	<b>(16)</b>
<b>Loss from Discontinued Operations</b>	<b>\$ (30)</b>	<b>\$ (117)</b>

**HERSHA HOSPITALITY TRUST AND SUBSIDIARIES**  
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**NOTE 13 - SUBSEQUENT EVENTS**

On March 17, 2006, our Board of Trustees declared quarterly cash dividends of \$0.18 per common share and unit of limited partnership interest in our operating partnership for the quarter ending March 31, 2006. The common share dividend and limited partnership unit distribution were paid on April 21, 2006 to shareholders and unitholders of record on March 31, 2006. The quarterly dividend pertaining to the Series A Preferred Shares for the first quarter of 2006 was declared on March 17, 2006 to shareholders of record on April 1, 2006 at a rate of \$0.50 per share. The dividend was paid on April 17, 2006.

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

All statements contained in this section that are not historical facts are based on current expectations. Words such as "believes", "expects", "anticipates", "intends", "plans" and "estimates" and variations of such words and similar words also identify forward-looking statements. Our actual results may differ materially, including the following: economic conditions generally and the real estate market specifically; the effect of threats of terrorism and increased security precautions on travel patterns and demand for hotels; the threatened or actual outbreak of hostilities and international political instability; governmental actions; legislative/regulatory changes, including changes to laws governing the taxation of REITs; level of proceeds from asset sales; cash available for capital expenditures; availability of capital; ability to refinance debt; rising interest rates; rising insurance premiums; competition; supply and demand for hotel rooms in our current and proposed market areas, including the existing and continuing weakness in business travel and lower-than expected daily room rates; other factors that may influence the travel industry, including health, safety and economic factors; and changes in generally accepted accounting principles, policies and guidelines applicable to REITs. Additional risks are discussed in the Company's filings with the Securities and Exchange Commission. We caution you not to place undue reliance on any such forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, subsequent events or any other circumstances.

**General**

As of March 31, 2006, we owned interests in 55 hotels in the eastern United States including 18 hotels owned through joint ventures. For purposes of the REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must lease our hotels. In 2001, the REIT rules were modified, allowing a hotel REIT to lease its hotels to a taxable REIT subsidiary, or TRS, provided that the TRS engages an eligible independent contractor to manage the hotels. Accordingly, as of March 31, 2006, we have leased 37 of our hotels to a wholly-owned TRS, which pays qualifying rent, and the TRS has entered into management contracts with HHMLP with respect to those hotels. We intend to lease all newly acquired hotels to a TRS. As of March 31, 2006, we also owned interests in 18 hotels through joint ventures and those hotels are leased to TRSs that are wholly owned by those joint ventures or to TRSs that are owned jointly by our TRS Lessee and our partners in the joint venture. The hotels owned by the joint ventures are managed, pursuant to the terms of certain management agreements, by HHMLP or management companies affiliated with our joint venture partners. As all of our hotels have been leased to the TRS Lessee or a joint venture TRS, we are participating more directly in the operating performance of our hotels. The TRSs directly receive all revenue from, and are required to fund all expenses relating to, hotel operations. The TRSs are also subject to income tax on their earnings.

**Operating Results**

The following table outlines operating results for the Company's portfolio of wholly owned hotels and those owned through a joint venture interest that are consolidated in our financial statements for the three months ended March 31, 2006 and 2005.

**Consolidated Hotels:**

	<b>Three Months Ended 3/31/06</b>	<b>Three Months Ended 3/31/05</b>	<b>Percent Increase</b>
Rooms Available	375,448	235,230	59.61%
Rooms Occupied	240,603	140,046	71.80%
Occupancy	64.08%	59.54%	7.63%
ADR	\$ 97.80	\$ 88.54	10.46%
RevPar	\$ 62.67	\$ 52.71	18.90%
Room Revenue	\$ 23,530,527	\$ 12,399,540	89.77%

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Total Revenue \$ 25,854,060 \$ 14,073,813 83.70%

The following table outlines operating results for hotels we own through an unconsolidated joint venture interest for the three months ended March 31, 2006 and 2005.

**Unconsolidated Joint Ventures:**

	<b>Three Months Ended 3/31/06</b>	<b>Three Months Ended 3/31/05</b>	<b>Percent Increase</b>
Rooms Available	201,628	38,304	426.39%
Rooms Occupied	133,947	27,863	380.73%
Occupancy	66.43%	72.74%	(8.67)%
ADR	\$ 122.77	\$ 124.28	(1.21)%
RevPar	\$ 81.56	\$ 90.40	(9.78)%
Room Revenue	\$ 16,444,330	\$ 3,462,683	374.90%
Total Revenue	\$ 22,652,509	\$ 3,829,943	491.46%

**Comparison of the three month period ended March 31, 2006 and 2005 (in thousands, except per share data).**

***Revenue***

Our total revenue for the three month period ended March 31, 2006 consisted substantially of hotel operating revenues for hotels leased to our wholly owned TRS, 44 New England. Our total revenue was approximately \$23,901 representing an increase of \$12,880 or 116.87% compared to total revenues of \$11,021 for the three month period ended March 31, 2005. The increase in revenues is primarily attributable to the acquisitions consummated since the comparable period in 2005 and improved performance at certain of our hotels. Between March 31, 2005 and December 31, 2005, the Company acquired nine hotels. Revenues for the nine acquired hotels are included in Hotel Operating Revenues for the entire first quarter of 2006. Further, the first quarter of 2006 included revenues for substantially all of the quarter related to a portfolio of three hotels that were purchased on January 3, 2006. In addition to increased revenue from our acquisitions, revenue per available room (RevPAR), average daily rate (ADR), and occupancy at our consolidated hotels have increased in the three months ended March 31, 2006 compared to the same period in 2005.

Since March 31, 2005, the Company has disposed of three properties and has committed to dispose of an additional four properties. Revenues and expenses from the disposed properties and the properties that we have committed to sell are included in income from discontinued operations on the statement of operations for all periods presented.

We acquired unconsolidated joint venture interests in eleven hotel properties since March 31, 2005. The income (loss) from our unconsolidated joint ventures is accounted for utilizing the equity method of accounting, and our portion of the net income (loss) from joint ventures is recorded as "Income (Loss) from Unconsolidated Joint Venture Investments" in our Statement of Operations. Included in Income (Loss) from Unconsolidated Joint Venture Investments for the three months ended March 31, 2006 is our portion of net income (loss) from our joint venture interests in one hotel acquired July 1, 2005, six hotels acquired on August 9, 2005, one hotel acquired on September 15, 2005, one hotel acquired on October 7, 2005, one hotel acquired on October 6, 2005 and one hotel acquired on February 8, 2006 in addition to the three joint venture interests that were in existence for the full three month period ended March 31, 2005. We recognized a loss of \$211 for the three months ended March 31, 2006 for the three joint venture interests that were included in our results during the same period in 2005. The loss was driven, in part, by costs incurred to extinguish debt at PRA Glastonbury LLC in the amount of \$517. Our investment in unconsolidated joint ventures acquired subsequent to March 31, 2005 contributed \$898 in loss for the three months ended March 31, 2006.

Interest and other revenue decreased to approximately \$780 during the three month period ended March 31, 2006 from \$1,064 in 2005. The Company recorded interest revenue of \$428 on its secured development loans during the three month period ended March 31, 2006 as compared to \$1,000 during the comparable period in 2005. Additionally, the Company earned interest on short term investments and escrow accounts of \$158 and had other revenue of \$194 during the period.

***Expenses***

Total operating expenses increased to approximately \$15,958 for the three month period ended March 31, 2006 from \$8,092 for the three month period ended March 31, 2005.

Hotel operating expenses increased primarily due to the acquisitions consummated since the comparable period in 2005 as mentioned above.

Depreciation and amortization increased from approximately \$1,655 in 2005 to \$3,796 in 2006, an increase of \$2,141 due to additional depreciation expense incurred for the properties acquired since the comparable period in 2005.

Interest expense increased approximately \$3,992 from \$1,630 in 2005 to \$5,622 in 2006. The increase is related to indebtedness for the properties acquired since the comparable period in 2005. Real estate and Personal Property Taxes and Property Insurance increased from approximately \$775 to \$1,487 due to additional expense incurred for the properties acquired since the comparable period in 2005.

General and administrative expense increased by approximately \$187 from \$977 in 2005 to \$1,164 in 2006. General and administrative expenses increased primarily due to higher compensation expense and increased audit and legal expenses incurred during the period and costs associated with the compliance work related to the Sarbanes-Oxley Act.

### *Net Loss*

Net Loss applicable to common shareholders for the three month period ended March 31, 2006 was approximately \$5,084 compared to Net Loss of \$974 for the same period in 2005.

Operating income for the three months ended March 31, 2006 was \$1,338 compared to an operating loss of \$582 during the same period in 2005. The \$1,920 increase in operating income resulted from improved performance of our portfolio and increased scale of operations that is able leverage administrative costs.

The increase in our operating income was offset by increases in interest expense, which increased \$3,992 from \$1,630 for the three months ended March 31, 2005 to \$5,622 for the three months ended March 31, 2006. The increase in interest expense is the result of our issuance of \$51,548 of notes payable in the second quarter of 2005 and mortgages placed on newly acquired properties.

Net loss applicable to common shareholders was also negatively impacted by \$1,200 in preferred dividends resulting from our issuance of 8.0% cumulative preferred securities in the third quarter of 2005.

Included in Net loss applicable to common shareholders for the three months ended March 31, 2006 is \$30 loss from discontinued operations compared to \$117 loss during the same period in 2005. Loss from discontinued operations results from the operations of two properties that were sold in June of 2005 and the hotel properties we have committed to sell.

In addition to the loss from Unconsolidated Joint Venture Investments, net loss was negatively impacted due to additional interest expense, real estate and personal property taxes and property insurance. Net Loss was also negatively impacted by the payment of dividends on our 8.0% Series A Preferred Shares. Dividends on these shares increased the Net Loss applicable to common shareholders by \$1,200.

### *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 line of credit. We believe that the net cash provided by operations will be adequate to fund the Company's operating requirements, debt service and the payment of dividends in accordance with REIT requirements of the federal income tax laws. We expect to meet our long-term liquidity requirements, such as scheduled debt maturities and property acquisitions, through long-term secured and unsecured borrowings, the issuance of additional equity securities or, in connection with acquisitions of hotel properties, the issuance of units of operating partnership interest in our operating partnership subsidiary.

In the second quarter of 2005, HHLP issued two junior subordinated notes payable in the aggregate amount of \$51,548 to the Hersha Statutory Trusts, pursuant to indenture agreements. The \$25,774 note issued to Hersha Statutory Trust I will mature on June 30, 2035, but may be redeemed at HHLP's option, in whole or in part, beginning on June 30, 2010 in accordance with the provisions of the indenture agreement. The \$25,774 note issued to Hersha Statutory Trust II will mature on July 30, 2035, but may be redeemed at our option, in whole or in part, beginning on July 30, 2010 in accordance with the provisions of the indenture agreement. The note issued to Hersha Statutory Trust I bears interest at a fixed rate of 7.34% per annum through June 30, 2010 and the note issued to Hersha Statutory Trust II bears interest at a fixed rate of 7.173% per annum through July 30, 2010. Subsequent to June 30, 2010 for notes issued to Hersha Statutory Trust I and July 30, 2010 for notes issued to Hersha Statutory Trust II, holders the notes bear interest at a variable rate of LIBOR plus 3.0% pre annum. Interest expense in amount of \$935 was recorded for the three months ended March 31, 2006.

On August 5, 2005, the Company completed a public offering of 2.4 million of its 8.00% Series A Cumulative Redeemable Preferred Shares of Beneficial Interest, liquidation preference \$25.00 per share. Net proceeds of the offering, less expenses and underwriters commissions, were approximately \$57,750. Proceeds from the offering were used to finance the acquisition of the Company's interests in Mystic Partners, LLC ("Mystic") and SB Partners, LLC ("SB Partners"). The remaining net proceeds have been principally allocated to be principally allocated to fund secured development loans and for general corporate purposes.

On April 28, 2006, we completed a public offering of 6,520,000 common shares at \$9.00 per share. On May 9, 2006, the underwriter exercised its over-allotment option with respect to this offering, and we issued an additional 977,500 common shares at \$9.00 per share. Proceeds to the Company, net of underwriting discounts and commissions and expenses, were approximately \$63,400. Immediately upon closing the offering, the Company contributed all of the net proceeds of the offering to the Partnership in exchange for additional Partnership interests. Of the net offering proceeds, approximately \$30,000 was used to repay indebtedness and approximately \$19,500 was used to fund property acquisitions.

On January 17, 2006, we entered into a revolving credit loan and security agreement with Commerce Bank, N.A. with a maximum amount of \$60,000. Outstanding borrowings under the line of credit bear interest at the Company's option of either the bank's prime rate of interest minus .50% or LIBOR available for the periods of 1, 2, 3, or 6 months plus 2.25%. The line of credit is collateralized by a first lien-security interest in all existing and future assets of HHLP, and title-insured, first-lien mortgages on the Holiday Inn Express, Harrisburg, PA, the Mainstay Suites and Sleep Inn, King of Prussia, PA, the Fairfield Inn, Laurel, MD, the Hampton Inn, Philadelphia, PA, and collateral assignment of all hotel management contracts from which HHLP or its affiliates derive revenues. The line of credit expires on December 31, 2008 and replaces the Sovereign Bank Line of Credit. This revolving credit loan replaced both the



secured and unsecured lines of credit that we previously maintained.

We intend to invest in additional hotels only as suitable opportunities arise and adequate sources of financing are available. Our bylaws require the approval of a majority of our Board of Trustees, including a majority of the independent trustees, to acquire any additional hotel in which one of our trustees or officers, or any of their affiliates, has an interest (other than solely as a result of his status as our trustee, officer or shareholder). We expect that future investments in hotels will depend on and will be financed by, in whole or in part, our existing cash, the proceeds from additional issuances of common shares, issuances of operating partnership units or other securities or borrowings. We make available to the TRS of our hotels 4% (6% for full service properties) of gross revenues per quarter, on a cumulative basis, for periodic replacement or refurbishment of furniture, fixtures and equipment at each of our hotels. We believe that a 4% (6% for full service hotels) reserve is a prudent estimate for future capital expenditure requirements. We intend to spend amounts in excess of the obligated amounts if necessary to comply with the reasonable requirements of any franchise license under which any of our hotels operate and otherwise to the extent we deem such expenditures to be in our best interests. We are also obligated to fund the cost of certain capital improvements to our hotels. We will use undistributed cash or borrowings under credit facilities to pay for the cost of capital improvements and any furniture, fixture and equipment requirements in excess of the set aside referenced above.

### ***Cash Flow Analysis***

Net cash provided by operating activities for the three months ended March 31, 2006 and 2005 was \$3,315 and \$286 respectively. The increase in net cash provided by operating activities was primarily the result of an increase in the number of hotels owned and operated over the same period in 2005. Also, cash distributions from unconsolidated joint ventures of \$1,135 were received during the three months ended March 31, 2006. A decrease in due from related parties and an increase in accounts payable and accrued expenses resulted in increased cash provided by operating activities over the same period in 2005. This was partially offset by an increases in hotel accounts receivable.

Net cash used in investing activities for the three months ended March 31, 2006 and 2005 increased \$63,979, from \$9,606 in the three months ended March 31, 2005 compared to \$73,585 for the three months ended March 31, 2006. Net cash used for the purchase of hotel properties and advances and capital contributions for unconsolidated joint ventures increased \$81,567 in the three months ended March 31, 2006 over the same period in 2005. In addition, cash used for deposits on hotel acquisitions that closed subsequent quarter end increased \$2,515. These uses of cash were partially offset by an increase in the repayments of development loans to related parties, net of additional investments, of \$17,100. Cash provided by distributions from unconsolidated joint ventures during the three months ended March 31, 2006 increased \$2,760 over the same period in 2005.

Net cash provided by financing activities for the three months ended March 31, 2006 was \$66,169 compared to cash used in financing activities of \$5,197 for the three month period ended March 31, 2005. This was, in part, the result of an increase of \$35,500 in proceeds from mortgages and notes payable related to hotels acquired during the three months ended March 31, 2006 over the same period in 2005. Also, net borrowings under our line of credit were \$37,243 during the three months ended March 31, 2006, we had net repayments of borrowings under our line of credit of \$627 during the same period in 2005. The increase in net cash provided by financing activities for the three months ended March 31, 2006 was partially offset by in an increase in dividends paid of \$1,200 due to the issuance of preferred shares in the third quarter of 2005.

### **Funds From Operations**

The National Association of Real Estate Investment Trusts (“NAREIT”) developed Funds from Operations (“FFO”) as a relative non-GAAP financial measure of performance and liquidity of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO as defined by NAREIT is net income (loss) (computed in accordance with GAAP) excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated assets, plus certain non-cash items, such as depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. With respect to FFO from unconsolidated joint ventures, we also add back depreciation resulting from purchase price of the joint venture interest in excess of the joint ventures basis in its hotels.

FFO does not represent cash flows from operating activities in accordance with GAAP and should not be considered an alternative to net income as an indication of Hersha’s performance or to cash flow as a measure of liquidity or ability to make distributions. We consider FFO to be meaningful, additional measures of operating performance because they excludes the effects of the assumption that the value of real estate assets diminishes predictably over time, and because they are widely used by industry analysts as a performance measure. We show both FFO from consolidated hotels and FFO from unconsolidated joint ventures because we believe it is meaningful for the investor to understand the relative contributions from our consolidated and unconsolidated hotels. The display of both FFO from consolidated hotels and FFO from unconsolidated joint ventures allows for a detailed analysis of the operating performance of our hotel portfolio by management and investors. Comparison of our presentation of FFO to similarly titled measures for other REITs is not necessarily meaningful due to the differences in the calculations used by us and other REITs.



The following table reconciles FFO for the periods presented to the most directly comparable GAAP measure, net income, for the same periods.

(in thousands, except per share data)

	Three Months Ending	
	3/31/2006	3/31/2005
Net Loss applicable to common shares		
Less:	\$ (5,084)	\$ (974)
Loss (Income) from Unconsolidated Joint Ventures		
Add:	1,110	(49)
Depreciation and amortization		
<b>Funds from Consolidated Hotel Operations</b>	3,796	1,655
	(178)	632
(Loss) Income from Unconsolidated Joint Ventures		
Add:	(1,110)	49
Depreciation and amortization of purchase price in excess of historical cost	475	-
Interest in depreciation and amortization of unconsolidated joint venture	1,021	257
<b>Funds from Unconsolidated Joint Ventures Operations</b>	386	306
<b>Funds from Operations</b>	\$ 208	\$ 938

FFO was \$208 for the three month period ended March 31, 2006, which was decrease of \$730 over FFO in the comparable period in 2005, which was \$938. The decrease in FFO was primarily a result of increases in interest expense of \$3,992 over the same period in 2005 and preferred dividends of \$1,200 as a result of issuance of preferred shares in the third quarter of 2005. FFO was negatively impacted by start up costs at hotels that were recently acquired and are still in the ramp up or stabilization phase. FFO was also negatively impacted by increases in our general and administrative expenses during the period ended March 31, 2006 as a result of additional compensation, legal and accounting expenses incurred during the period. This was offset by a strengthened economy; the benefits of asset acquisitions since March 31, 2005, continued stabilization and maturation of the existing portfolio and continued attention to the average daily rate.

### Critical Accounting Policies and Estimates

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

On an on-going basis, all estimates are evaluated by us, including those related to carrying value of investments in hotel properties. All estimates are based upon historical experience and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:



### ***Revenue Recognition***

We directly recognize revenue and expense for all consolidated hotels as “Hotel Operating Revenue” and “Hotel Operating Expense” when earned and incurred. Included in hotel operating revenues is primarily room revenues and revenue from other hotel operating departments. These revenues are recorded net of any sales or occupancy taxes collected from our guests. All revenues are recorded on an accrual basis, as earned. We participate in frequent guest programs sponsored by the brand owners of our hotels and we expense the charges associated with those programs, as incurred.

### ***Stock Compensation***

We apply Statement of Financial Accounting Standards No. 123R, “Share-Based Payments” (SFAS 123R) whereby we measure the cost of employee service received in exchange for an award of equity instruments based on the grant -date fair value of the award. The cost is recognized over the period during which an employee is required to provide service in exchange for the award. We granted 71,000 shares of Stock Awards in the second quarter of 2005, at fair value of \$9.60 per share vesting over four years. This resulted in \$43 in compensation expense for the three months ended March 31, 2006. There were no options issued during the three months ended March 31, 2006. There were no shares or options issued in the three months ended March 31, 2005.

### ***Allowance for Doubtful Accounts***

Accounts receivable are charged to bad debt expense when they are determined to be uncollectible based upon a periodic review of the accounts by management. Accounting principles generally accepted in the United States of America require that the allowance method be used to recognize bad debts. Our evaluation of the adequacy of the allowance for doubtful accounts is based on known or inherent credit risks, economic conditions in the markets our hotels operate, past experience, and other factors. This evaluation requires judgment and is inherently subjective. Deterioration in the quality of our hotel accounts receivable or other receivables could require us to record additional allowance.

### ***Derivatives***

The Company’s objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps designated as cash flow hedges limit the Company's exposure to increased cash payments due to increases in variable interest rates. During the three months ended March 31, 2006, these derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

As of March 31, 2006, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Company does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

### ***Investment in Unconsolidated Joint Ventures***

The equity method of accounting is used for joint ventures in which we have the ability to exercise significant influence. Under this method, the investment, originally recorded at cost, is adjusted to recognize our share of net earnings or losses of the affiliates as they occur rather than as dividends or other distributions are received, limited to the extent of our investment in, advances to and commitments for the investee.

### ***Impairment of Long-Lived Assets.***

We review the carrying value of each hotel property in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144 to determine if circumstances exist indicating an impairment in the carrying value of the investment in the hotel property or if depreciation periods should be modified. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We perform undiscounted cash flow analyses to determine if an impairment exists. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Hotel properties held for sale are presented at the lower of carrying amount or fair value less cost to sell.

We would record an impairment charge if we believe an investment in hotel property has been impaired such that future undiscounted cash flows would not recover the book basis of the investment in the hotel property. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment’s carrying value, thereby possibly requiring an impairment charge in the future. We have reviewed each of our hotel properties at March 31, 2006 for impairment and, based on our estimate of each hotel’s future undiscounted cash flows, determined that no impairment existed at any of our hotels.

## Impact of FIN 46

The Financial Accounting Standards Board issued FASB Interpretation No. 46, (“FIN 46”) “Consolidation of Variable Interest Entities (VIE’s), an interpretation of Accounting Research Bulletin No. 51 (ARB No. 51),” in January 2003 and a further interpretation of FIN 46 in December 2003 (“FIN 46-R” and FIN 46, collectively “FIN 46”). FIN 46 addresses how a business enterprise should evaluate whether it has a controlling financial interest in any variable interest entity (“VIE”) through means other than voting rights, and accordingly, should include the VIE in its consolidated financial statements. We have adopted FIN 46 effective as of March 31, 2004.

Our investments and contractual relationships with the following entities have been evaluated to determine whether they meet the guidelines of consolidation in accordance with FIN 46: HHMLP; Logan Hospitality Associates, LLC; HT CNL Metro Hotels, LP; PRA Glastonbury, LLC; Inn America Hospitality at Ewing, LLC; Mystic Partners, LLC; Mystic Partners Leaseco, LLC; Hiren Boston, LLC; South Bay Boston, LLC, SB Partners, LLC; LTD Associates One, LLC; HT LTD Williamsburg LLC; LTD Associates Two, LLC; HT LTD Williamsburg Two LLC; Hersha Statutory Trust I; Hersha Statutory Trust II; HPS Seaport LLC & BCM, LLC; Affordable Hospitality Associates, LP; Philly One TRS, LLC; and 44 Windsor Locks Hospitality, LLC.

Our examination consisted of reviewing the sufficiency of equity at risk, controlling financial interests, voting rights, and the obligation to absorb expected losses and expected gains, including residual returns. Based on our examination, each of the following entities were determined to be a VIE: Mystic Partners, LLC; Mystic Partners Leaseco, LLC; South Bay Boston, LLC; HT LTD Williamsburg LLC; HT LTD Williamsburg Two LTD LLC; Philly One TRS, LLC; Hersha Statutory Trust I; and Hersha Statutory Trust II.

We have consolidated the operations of the Logan Hospitality Associates, LLC; LTD Associates One, LLC; LTD Associates Two, LLC; and Affordable Hospitality Associates, LP joint ventures because each entity is a voting interest entity and the Company owns a majority voting interest in the venture.

Our investments in HT/CNL Metro Hotels, LP; PRA Glastonbury, LLC; Inn America Hospitality at Ewing, LLC; Hiren Boston, LLC; and SB Partners, LLC represent non-controlling ownership interests in the ventures. All of these entities are voting interest entities. These investments are accounted for using the equity method of accounting. These investments are recorded initially at cost and subsequently adjusted for net equity in income (loss), which is allocated in accordance with the provisions of the applicable partnership or joint venture agreements.

We hold an investment in development loan receivables with HPS Seaport LLC & BCM, LLC and 44 Windsor Locks Hospitality, LLC. We have determined that each borrower has sufficient equity at risk, a controlling financial interest and an obligation to absorb expected losses and expected gains, including residual returns of the entity. These entities are voting interest entities and because we have no voting interest they are not consolidated.

Mystic Partners, LLC is a VIE entity, however because we are not the primary beneficiary it is not consolidated by the Company. Also, Mystic Partners Leaseco, LLC; South Bay Boston, LLC; HT LTD Williamsburg LLC; HT LTD Williamsburg Two LTD LLC; and Philly One TRS, LLC lease hotel properties from our joint venture interests and are variable interest entities. These entities are consolidated by the lessors, the primary beneficiaries of each entity.

During the second quarter of 2005, we formed Hersha Statutory Trust I and Hersha Statutory Trust II, Delaware statutory trusts (collectively, the “Hersha Statutory Trusts”), to collectively issue \$50,000 of trust preferred securities in private placements. We acquired, for \$1,548, residual interests (common securities) in the Hersha Statutory Trusts. Preferred equity securities of \$25,000 issued by Hersha Statutory Trust I will mature on June 30, 2035, and the remaining \$25,000 preferred equity securities issued by Hersha Statutory Trust II will mature on July 30, 2035, at par. The preferred equity securities issued by Hersha Statutory Trust I and Hersha Statutory Trust II may be redeemed by the trusts beginning on June 30, 2010 and July 30, 2010, respectively. The holders of both the preferred equity and



common securities will receive quarterly distributions from the Hersha Statutory Trusts, at a fixed rate of 7.34% per annum through June 30, 2010 for Hersha Statutory Trust I and 7.173% per annum through July 30, 2010 for Hersha Statutory Trust II. Subsequent to June 30, 2010, for Hersha Statutory Trust I and July 30, 2010 for Hersha Statutory Trust II, holders of the trusts preferred equity and common securities will receive quarterly distributions at a variable rate of LIBOR plus 3.0% per annum. The Hersha Statutory Trusts used the proceeds from the issuance of the preferred and common securities to acquire \$51,548 of junior subordinated notes from HHLP pursuant to indenture agreements. The note acquired by Hersha Statutory Trust I will mature on June 30, 2035, but may be redeemed at our option, in whole or in part, beginning on June 30, 2010 in accordance with the provisions of the indenture agreement. The note acquired by Hersha Statutory Trust II will mature on July 30, 2035, but may be redeemed at our option, in whole or in part, beginning on July 30, 2010 in accordance with the provisions of the indenture agreement. The note acquired by Hersha Statutory Trust I bears interest at a fixed rate of 7.34% per annum through June 30, 2010 and the note acquired by Hersha Statutory Trust II bears interest at a fixed rate of 7.173% per annum through July 30, 2010. Subsequent to June 30, 2010 for Hersha Statutory Trust I and July 30, 2010 for Hersha Statutory Trust II, holders the notes bear interest at a variable rate of LIBOR plus 3.0% per annum.

The Hersha Statutory Trusts are VIEs under FIN 46, because the equity holders at risk hold no substantial decision-making rights. Because HHLP is not the primary beneficiary in the Hersha Statutory Trusts, the accounts of the trusts are not consolidated with and into HHLP. HHLP's investment in the Hersha Statutory Trusts is accounted for using the equity method of accounting and is presented on our consolidated balance sheet in other assets.

The proceeds received by HHLP in exchange for the notes were used to fund acquisitions of hotel properties, pay down outstanding borrowings under our revolving credit facility and for general corporate purposes. The notes are presented on our consolidated balance sheet in Mortgages and Notes Payable.

We will continue to evaluate each of our investments and contractual relationships to determine if consolidation is required based upon the provisions of FIN 46.

### **Inflation**

Operators of hotels in general possess the ability to adjust room rates. However, competitive pressures may limit the hotel operator's ability to raise room rates in the face of inflation.

### **Seasonality**

Our hotels' operations historically have been seasonal in nature, reflecting higher occupancy rates during the second and third quarters. This seasonality can be expected to cause fluctuations in our quarterly lease revenue to the extent that we receive percentage rent.

### **Subsequent Events**

On March 17, 2006, our Board of Trustees declared quarterly cash dividends of \$0.18 per common share and unit of limited partnership interest in our operating partnership for the quarter ending March 31, 2006. The common share dividend and limited partnership unit distribution were paid on April 21, 2006 to shareholders and unitholders of record on March 31, 2006. The quarterly dividend pertaining to the Series A Preferred Shares for the first quarter of 2006 was declared on March 17, 2006 to shareholders of record on April 1, 2006 at a rate of \$0.50 per share. The dividend was paid on April 17, 2006.

On April 28, 2006, we completed a public offering of 6,520,000 common shares at \$9.00 per share. On May 9, 2006, the underwriter exercised its over-allotment option on these shares, and we issued an additional 977,500 common shares at \$9.00 per share. Proceeds to the Company, net of underwriting discounts and commissions and expenses, were approximately \$63,400. Immediately upon closing the offering, the Company contributed all of the net proceeds of the offering to the Partnership in exchange for additional Partnership interests. Of the net offering proceeds, approximately \$30,000 was used to repay indebtedness and approximately \$19,500 was used to fund property acquisitions.

On April 25, 2006, we acquired the 100-room Hawthorn Inn & Suites in Franklin, Massachusetts for \$12.0 million.

On May 1, 2006 we acquired the 96-room Residence Inn and the 84-room Comfort Inn for \$15.0 million and \$4.75 million, respectively.

On May 3, 2006, we acquired the 112-room Holiday Inn Express, Cambridge, Massachusetts for approximately \$12.0 million.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our primary market risk exposure is to changes in interest rates on our variable rate Line of Credit and other floating rate debt. At March 31, 2006, we maintained a balance under our Line of Credit of \$37,243. The total floating rate mortgages payable of \$72,602 had a current weighted average interest rate of 7.85%. The total fixed rate mortgages payable of \$240,881 had a current weighted average interest rate of 6.71%. The carrying value of all of our fixed rate debt approximates fair value.

Our interest rate risk objectives are to limit the impact of interest rate fluctuations on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, we manage our exposure to fluctuations in market interest rates for a portion of our borrowings through the use of fixed rate debt instruments to the extent that reasonably favorable rates are obtainable with such arrangements. We may enter into derivative financial instruments such as interest rate swaps or caps and treasury options or locks to mitigate our interest rate risk on a related financial instrument or to effectively lock the interest rate on a portion of our variable rate debt. Currently, we have one interest rate swap related to debt on the Four Points by Sheraton, Revere and interest rate cap related to debt on the McIntosh Portfolio of hotels acquired in May and June of 2005. We do not intend to enter into derivative or interest rate transactions for speculative purposes.

Approximately 76.8% of our outstanding mortgages payable are subject to fixed rates, including the debt whose rate is fixed through an interest rate swap, while approximately 23.2% of our outstanding mortgages payable are subject to floating rates, including the debt whose rate is limited by an interest rate cap. The total weighted average interest rate on our debt and Line of Credit as of March 31, 2006 was approximately 7.00%. If the interest rate for our Line of Credit and other variable rate debt was 100 basis points higher or lower during the period ended March 31, 2006, our interest expense for the three months ended March 31, 2006 would have been increased or decreased by approximately \$196.

We regularly review interest rate exposure on our outstanding borrowings in an effort to minimize the risk of interest rate fluctuations. For debt obligations outstanding at March 31, 2006, the following table presents expected principal repayments and related weighted average interest rates by expected maturity dates (in thousands):

	2006	2007	2008	2009	2010	Thereafter	Total
Fixed Rate Debt	\$ 1,951	\$ 5,392	\$ 20,323	\$ 15,633	\$ 26,503	\$ 171,079	\$ 240,881
Average Interest Rate	6.66%	6.63%	6.66%	6.65%	6.34%	6.34%	6.55%
Floating Rate Debt	\$ 602	\$ 815	\$ 35,061	\$ 21,202	\$ 12,298	\$ 2,624	\$ 72,602
Average Interest Rate	7.88%	7.88%	8.01%	7.72%	7.58%	7.58%	7.77%

The table incorporates only those exposures that existed as of March 31, 2006 and does not consider exposure or positions that could arise after that date. As a result, our ultimate realized gain or loss with respect to interest rate fluctuations will depend on the exposures that arise during the future period, prevailing interest rates, and our hedging strategies at that time.

At March 31, 2006, the fair value of the interest rate cap and the interest rate swap were \$51 and \$93, respectively and are included in assets. At December 31, 2005, the fair value of the interest rate cap was \$23 and is included in assets and the fair value of the interest rate swap was \$0. The change in net unrealized gains/losses of \$117 and \$198 for the three months ended March 31, 2006 and 2005, respectively, for derivatives designated as cash flow hedges. Hedge ineffectiveness of \$4 and \$4 on cash flow hedges was recognized in unrealized gain/loss on derivatives during the three months ended March 31, 2006 and 2005, respectively.

### Item 4. Controls and Procedures.

*Disclosure Controls and Procedures*

The Company's management, under the supervision of and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective and reasonably designed to ensure that all material information relating to the Company required to be included in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

*Changes in Internal Control Over Financial Reporting*

In connection with our annual assessment of internal control over financial reporting, management identified certain material weaknesses in internal control, which are described in our Annual Report on Form 10-K for the year ended December 31, 2005. In response to the material weaknesses identified by the Company, the Company and HHMLP have taken certain remedial measures in response to identified material weaknesses. To date, those remedial measures include the following:

- HHMLP has hired a Corporate Controller and is seeking to hire additional senior accounting professionals. The Company intends to continue its oversight of the internal control improvements being implemented by HHMLP and other third party service providers.
- The Company is working with HHMLP to establish additional and more rigorous procedures to be performed by HHMLP to prepare and review financial information prior to release to the Company for inclusion in the consolidated financial statements.
- HHMLP, in cooperation with the Company, is taking steps to better inform and train hotel level accounting employees regarding controls over revenue accounting, account reconciliations and account analysis.

Except as described above, there was no change in our internal control over financial reporting during the quarter ended March 31, 2005, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II  
OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

**Item 1A. Risk Factors.**

None.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Default Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

**(a) Exhibits Required by Item 601 of Regulation S-K.**

- 10.1 Revolving Credit Loan and Security Agreement, dated January 17, 2006, by and between Hersha Hospitality Limited Partnership, Hersha Hospitality Trust and Commerce Bank N.A (filed with the SEC as Exhibit 10.1 to the Form 8-K filed on January 23, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.2 Contribution Agreement, dated as of January 19, 2006, by and among Shanti III Associates, Kunj Associates, Devi Associates, Shree Associates, David L. Desfor, Ashish R. Parikh, Sal Shahriar, The Hasu and Hersha Shah 2004 Trust FBO Neil H. Shah, The Hasu and Hersha Shah 2004 Trust FBO Jay H. Shah, Metro JFK Associates LLC, and Hersha Hospitality Limited Partnership (filed with the SEC as Exhibit 10.1 to the Form 8-K filed on January 25, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.3 Limited Partnership Interests Purchase Agreement, dated as of the 19<sup>th</sup> day of January, 2006, by and among Affordable Hospitality, Inc.; 3344 Associates; Hersha Capital, Inc.; Affordable Hospitality Associates, LP; Hersha Hospitality Limited Partnership and Race Street, LLC (filed with the SEC as Exhibit 10.2 to the Form 8-K filed on January 25, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.4 Sixth Amendment to Membership Interests Contribution Agreement, dated February 8, 2006, by and among Hersha Hospitality Limited Partnership, Mystic Hotel Investors, LLC; Waterford Hospitality Group, LLC and First American Title Insurance Company (filed with the SEC as Exhibit 10.5 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).

- 10.5 Second Amendment to Limited Liability Company Operating Agreement of Mystic Partners, LLC, dated February 8, 2006 (filed with the SEC as Exhibit 10.6 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.6 First Amendment to Limited Liability Company Operating Agreement of Mystic Partners Leaseco, LLC, dated February 8, 2006 (filed with the SEC as Exhibit 10.7 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.7 Conditional Payment Guaranty, dated February 8, 2006, made by Hersha Hospitality Limited Partnership and Mystic Hotel Investors, LLC to and for the benefit of Merrill Lynch Capital (filed with the SEC as Exhibit 10.8 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.8 Conditional Payment Guaranty, dated February 8, 2006, made by Hersha Hospitality Limited Partnership and Mystic Hotel Investors, LLC to and for the benefit of Merrill Lynch Capital (filed with the SEC as Exhibit 10.9 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).
- 10.9 Supplemental Limited Joinder, dated February 8, 2006, made by Hersha Hospitality Limited Partnership and Mystic Hotel Investors LLC (filed with the SEC as Exhibit 10.10 to the Form 8-K filed on February 14, 2006 (SEC File No. 001-14765) and incorporated by reference herein).

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HERSHA HOSPITALITY TRUST  
(Registrant)

May 10, 2006

/s/ Ashish R. Parikh  
Ashish R. Parikh  
Chief Financial Officer