

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2023

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 001-32319

Sunstone Hotel Investors, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

15 Enterprise, Suite 200
Aliso Viejo, California
(Address of Principal Executive Offices)

20-1296886
(I.R.S. Employer
Identification Number)

92656
(Zip Code)

Registrant's telephone number, including area code: **(949) 330-4000**

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	SHO	New York Stock Exchange
Series H Cumulative Redeemable Preferred Stock, \$0.01 par value	SHO.PRH	New York Stock Exchange
Series I Cumulative Redeemable Preferred Stock, \$0.01 par value	SHO.PRI	New York Stock Exchange

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

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

As of November 1, 2023, there were 205,444,026 shares of Sunstone Hotel Investors, Inc.'s common stock, \$0.01 par value per share, outstanding.

SUNSTONE HOTEL INVESTORS, INC.
QUARTERLY REPORT ON
FORM 10-Q

For the Quarterly Period Ended September 30, 2023

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

SUNSTONE HOTEL INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	September 30, 2023 (unaudited)	December 31, 2022
ASSETS		
Investment in hotel properties, net	\$ 2,580,421	\$ 2,840,928
Operating lease right-of-use assets, net	13,884	15,025
Cash and cash equivalents	113,768	101,223
Restricted cash	71,228	55,983
Accounts receivable, net	28,646	42,092
Prepaid expenses and other assets, net	33,106	27,566
Assets held for sale	247,776	—
Total assets	<u>\$ 3,088,829</u>	<u>\$ 3,082,817</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Debt, net of unamortized deferred financing costs	\$ 814,702	\$ 812,681
Operating lease obligations	17,884	19,012
Accounts payable and accrued expenses	60,854	73,735
Dividends and distributions payable	17,765	13,995
Other liabilities	74,542	78,433
Liabilities of assets held for sale	15,397	—
Total liabilities	<u>1,001,144</u>	<u>997,856</u>
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized:		
Series G Cumulative Redeemable Preferred Stock, 2,650,000 shares issued and outstanding at both September 30, 2023 and December 31, 2022, stated at liquidation preference of \$25.00 per share	66,250	66,250
6.125% Series H Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at both September 30, 2023 and December 31, 2022, stated at liquidation preference of \$25.00 per share	115,000	115,000
5.70% Series I Cumulative Redeemable Preferred Stock, 4,000,000 shares issued and outstanding at both September 30, 2023 and December 31, 2022, stated at liquidation preference of \$25.00 per share	100,000	100,000
Common stock, \$0.01 par value, 500,000,000 shares authorized, 205,623,316 shares issued and outstanding at September 30, 2023 and 209,320,447 shares issued and outstanding at December 31, 2022	2,056	2,093
Additional paid in capital	2,434,649	2,465,595
Distributions in excess of retained earnings	(630,270)	(663,977)
Total stockholders' equity	<u>2,087,685</u>	<u>2,084,961</u>
Total liabilities and stockholders' equity	<u>\$ 3,088,829</u>	<u>\$ 3,082,817</u>

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
REVENUES				
Room	\$ 158,467	\$ 158,400	\$ 484,304	\$ 428,893
Food and beverage	64,007	63,476	213,634	174,717
Other operating	25,226	22,438	69,317	64,299
Total revenues	<u>247,700</u>	<u>244,314</u>	<u>767,255</u>	<u>667,909</u>
OPERATING EXPENSES				
Room	41,034	38,791	122,756	106,594
Food and beverage	47,777	47,181	148,309	125,959
Other operating	6,129	6,440	18,031	17,965
Advertising and promotion	12,767	12,325	39,686	34,420
Repairs and maintenance	10,060	9,382	29,112	27,369
Utilities	7,784	7,708	21,644	19,652
Franchise costs	4,278	4,145	12,756	11,429
Property tax, ground lease and insurance	21,709	19,714	60,320	53,160
Other property-level expenses	29,020	29,032	92,654	83,333
Corporate overhead	7,127	7,879	23,991	27,310
Depreciation and amortization	33,188	31,750	97,927	94,003
Total operating expenses	<u>220,873</u>	<u>214,347</u>	<u>667,186</u>	<u>601,194</u>
Interest and other income	1,218	270	6,398	4,766
Interest expense	(11,894)	(9,269)	(34,911)	(20,288)
Gain on sale of assets	—	—	—	22,946
Gain (loss) on extinguishment of debt, net	9	(770)	9,930	(962)
Income before income taxes	16,160	20,198	81,486	73,177
Income tax (provision) benefit, net	(602)	290	(1,763)	126
NET INCOME	<u>15,558</u>	<u>20,488</u>	<u>79,723</u>	<u>73,303</u>
Income from consolidated joint venture attributable to noncontrolling interest	—	—	—	(3,477)
Preferred stock dividends	(3,226)	(3,351)	(10,762)	(10,897)
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	<u>\$ 12,332</u>	<u>\$ 17,137</u>	<u>\$ 68,961</u>	<u>\$ 58,929</u>
Basic and diluted per share amounts:				
Basic income attributable to common stockholders per common share	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.33</u>	<u>\$ 0.27</u>
Diluted income attributable to common stockholders per common share	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.33</u>	<u>\$ 0.27</u>
Basic weighted average common shares outstanding	<u>205,570</u>	<u>211,010</u>	<u>206,257</u>	<u>213,799</u>
Diluted weighted average common shares outstanding	<u>205,782</u>	<u>211,289</u>	<u>206,553</u>	<u>213,869</u>

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF EQUITY
(In thousands, except share and per share data)

	Preferred Stock		Common Stock		Additional	Distributions	
	Number of	Amount	Number of	Amount	Paid in Capital	in Excess of	Total
	Shares		Shares			Retained Earnings	
Balance at December 31, 2022 (audited)	11,250,000	\$ 281,250	209,320,447	\$ 2,093	\$ 2,465,595	\$ (663,977)	\$ 2,084,961
Amortization of deferred stock compensation	—	—	—	—	2,545	—	2,545
Issuance of restricted common stock, net	—	—	55,970	1	(3,349)	—	(3,348)
Forfeiture of restricted common stock	—	—	(1,435)	—	—	—	—
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	(10,449)	(10,449)
Series G preferred stock dividends and dividends payable at \$0.219536 per share	—	—	—	—	—	(582)	(582)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	(1,425)
Repurchase of outstanding common stock	—	—	(1,964,923)	(20)	(18,606)	—	(18,626)
Net income	—	—	—	—	—	21,087	21,087
Balance at March 31, 2023	11,250,000	\$ 281,250	207,410,059	\$ 2,074	\$ 2,446,185	\$ (657,107)	\$ 2,072,402
Amortization of deferred stock compensation	—	—	—	—	3,442	—	3,442
Issuance of restricted common stock	—	—	82,552	1	(429)	—	(428)
Forfeiture of restricted common stock	—	—	(6,459)	—	—	—	—
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	(10,448)	(10,448)
Series G preferred stock dividends and dividends payable at \$0.219536 per share	—	—	—	—	—	(582)	(582)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	(1,425)
Repurchase of outstanding common stock	—	—	(301,461)	(3)	(2,852)	—	(2,855)
Acquisition of noncontrolling interest, net	—	—	—	—	(299)	—	(299)
Net income	—	—	—	—	—	43,078	43,078
Balance at June 30, 2023	11,250,000	\$ 281,250	207,184,691	\$ 2,072	\$ 2,446,047	\$ (628,245)	\$ 2,101,124
Amortization of deferred stock compensation	—	—	—	—	2,628	—	2,628
Common stock distributions and distributions payable at \$0.07 per share	—	—	—	—	—	(14,357)	(14,357)
Series G preferred stock dividends and dividends payable at \$0.015182 per share	—	—	—	—	—	(40)	(40)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	(1,425)
Repurchase of outstanding common stock	—	—	(1,561,375)	(16)	(14,026)	—	(14,042)
Net income	—	—	—	—	—	15,558	15,558
Balance at September 30, 2023	11,250,000	\$ 281,250	205,623,316	\$ 2,056	\$ 2,434,649	\$ (630,270)	\$ 2,087,685

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF EQUITY
(In thousands, except share and per share data)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid in Capital</u>	<u>Distributions in Excess of Retained Earnings</u>	<u>Noncontrolling Interest in Consolidated Joint Venture</u>	<u>Total</u>
	<u>Number of Shares</u>	<u>Amount</u>	<u>Number of Shares</u>	<u>Amount</u>				
Balance at December 31, 2021 (audited)	11,250,000	\$ 281,250	219,333,783	\$ 2,193	\$ 2,631,484	\$ (715,960)	\$ 40,807	\$ 2,239,774
Amortization of deferred stock compensation	—	—	—	—	3,701	—	—	3,701
Issuance of restricted common stock, net	—	—	213,179	2	(3,353)	—	—	(3,351)
Series G preferred stock dividends and dividends payable at \$0.221475 per share	—	—	—	—	—	(587)	—	(587)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	—	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	—	(1,425)
Repurchase of outstanding common stock	—	—	(3,879,025)	(38)	(43,427)	—	—	(43,465)
Net income	—	—	—	—	—	13,989	1,134	15,123
Balance at March 31, 2022	11,250,000	\$ 281,250	215,667,937	\$ 2,157	\$ 2,588,405	\$ (705,744)	\$ 41,941	\$ 2,208,009
Amortization of deferred stock compensation	—	—	—	—	2,971	—	—	2,971
Issuance of restricted common stock	—	—	53,616	1	(92)	—	—	(91)
Forfeiture of restricted common stock	—	—	(34,807)	—	—	—	—	—
Series G preferred stock dividends and dividends payable at \$0.221475 per share	—	—	—	—	—	(587)	—	(587)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	—	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	—	(1,425)
Repurchase of outstanding common stock	—	—	(3,235,958)	(33)	(34,482)	—	—	(34,515)
Distribution to noncontrolling interest	—	—	—	—	—	—	(5,500)	(5,500)
Acquisition of noncontrolling interest, net	—	—	—	—	(62,564)	—	(38,784)	(101,348)
Net income	—	—	—	—	—	35,349	2,343	37,692
Balance at June 30, 2022	11,250,000	\$ 281,250	212,450,788	\$ 2,125	\$ 2,494,238	\$ (674,168)	\$ —	\$ 2,103,445
Amortization of deferred stock compensation	—	—	—	—	2,350	—	—	2,350
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	(10,610)	—	(10,610)
Series G preferred stock dividends and dividends payable at \$0.062081 per share	—	—	—	—	—	(165)	—	(165)
Series H preferred stock dividends and dividends payable at \$0.382813 per share	—	—	—	—	—	(1,761)	—	(1,761)
Series I preferred stock dividends and dividends payable at \$0.356250 per share	—	—	—	—	—	(1,425)	—	(1,425)
Repurchase of outstanding common stock	—	—	(880,577)	(9)	(8,657)	—	—	(8,666)
Net income	—	—	—	—	—	20,488	—	20,488
Balance at September 30, 2022	<u>11,250,000</u>	<u>\$ 281,250</u>	<u>211,570,211</u>	<u>\$ 2,116</u>	<u>\$ 2,487,931</u>	<u>\$ (667,641)</u>	<u>\$ —</u>	<u>\$ 2,103,656</u>

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Nine Months Ended September 30,	
	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 79,723	\$ 73,303
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	184	846
Gain on sale of assets	—	(22,946)
(Gain) loss on extinguishment of debt, net	(9,930)	962
Noncash interest on derivatives, net	(3,348)	(2,904)
Depreciation	97,540	93,573
Amortization of franchise fees and other intangibles	332	387
Amortization of deferred financing costs	1,960	1,940
Amortization of deferred stock compensation	8,263	8,661
Gain on hurricane-related damage	(3,722)	(4,369)
Changes in operating assets and liabilities:		
Accounts receivable, net	7,477	(16,279)
Prepaid expenses and other assets	(5,804)	5,465
Accounts payable and other liabilities	(3,851)	12,109
Operating lease right-of-use assets and obligations	(82)	(1,050)
Net cash provided by operating activities	<u>168,742</u>	<u>149,698</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of assets	—	191,291
Disposition deposit	10,000	—
Proceeds from property insurance	3,722	4,369
Acquisitions of hotel properties and other assets	—	(232,506)
Renovations and additions to hotel properties and other assets	(73,944)	(97,539)
Net cash used in investing activities	<u>(60,222)</u>	<u>(134,385)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Acquisition of noncontrolling interest, including transaction costs	(299)	(101,348)
Payment of common stock offering costs	(428)	(91)
Repurchases of outstanding common stock	(35,523)	(86,646)
Repurchases of common stock for employee tax obligations	(3,348)	(3,351)
Proceeds from credit facility	—	230,000
Payment on credit facility	—	(230,000)
Proceeds from note payable	225,000	243,615
Payments on notes payable	(221,554)	(38,405)
Payments of deferred financing costs	(2,332)	(7,404)
Dividends and distributions paid	(42,246)	(11,059)
Distribution to noncontrolling interest	—	(5,500)
Net cash used in financing activities	<u>(80,730)</u>	<u>(10,189)</u>
Net increase in cash and cash equivalents and restricted cash	27,790	5,124
Cash and cash equivalents and restricted cash, beginning of period	157,206	162,717
Cash and cash equivalents and restricted cash, end of period	<u>\$ 184,996</u>	<u>\$ 167,841</u>

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

Supplemental Disclosure of Cash Flow Information

	September 30,	
	2023	2022
Cash and cash equivalents	\$ 113,768	\$ 117,588
Restricted cash	71,228	50,253
Total cash and cash equivalents and restricted cash shown on the consolidated statements of cash flows	<u>\$ 184,996</u>	<u>\$ 167,841</u>

	Nine Months Ended September 30,	
	2023	2022
Cash paid for interest	\$ 39,013	\$ 24,279
Cash paid for income taxes, net	\$ 1,272	\$ 218
Operating cash flows used for operating leases	<u>\$ 4,150</u>	<u>\$ 5,080</u>
Changes in operating lease right-of-use assets	\$ 3,304	\$ 3,020
Changes in operating lease obligations	(3,386)	(4,070)
Changes in operating lease right-of-use assets and lease obligations, net	<u>\$ (82)</u>	<u>\$ (1,050)</u>

Supplemental Disclosure of Noncash Investing and Financing Activities

	Nine Months Ended September 30,	
	2023	2022
Accrued renovations and additions to hotel properties and other assets	\$ 12,029	\$ 17,630
Disposition deposit received in prior year in connection with sale of hotel	\$ —	\$ 4,000
Operating lease right-of-use asset obtained in exchange for operating lease obligation	\$ 2,163	\$ —
Assignment of finance lease right-of-use asset in connection with sale of hotel	\$ —	\$ 44,712
Assignment of finance lease obligation in connection with sale of hotel	\$ —	\$ 15,569
Assignment of operating lease right-of-use asset in connection with sale of hotel	\$ —	\$ 2,275
Assignment of operating lease obligation in connection with sale of hotel	\$ —	\$ 2,609
Amortization of deferred stock compensation — construction activities	\$ 352	\$ 361
Dividends and distributions payable	<u>\$ 17,765</u>	<u>\$ 13,961</u>

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sunstone Hotel Investors, Inc. (the “Company”) was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes, commencing with its taxable year ended on December 31, 2004. The Company, through its 100% controlling interest in Sunstone Hotel Partnership, LLC (the “Operating Partnership”), of which the Company is the sole managing member, and the subsidiaries of the Operating Partnership, including Sunstone Hotel TRS Lessee, Inc. (the “TRS Lessee”) and its subsidiaries, invests in hotels where it can add value through capital investment, hotel repositioning and asset management. In addition, the Company seeks to capitalize on its portfolio’s embedded value and balance sheet strength to actively recycle past investments into new growth and value creation opportunities in order to deliver strong stockholder returns and superior per share net asset value growth.

As a REIT, certain tax laws limit the amount of “non-qualifying” income the Company can earn, including income derived directly from the operation of hotels. The Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company’s hotels, in transactions that are intended to generate qualifying income.

As of September 30, 2023, the Company owned 15 hotels, one of which was considered held for sale, leaving 14 hotels (the “14 Hotels”) currently held for investment. The Company’s third-party managers included the following:

	<u>Number of Hotels</u>
Subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc.	6
Hyatt Hotels Corporation	2
Four Seasons Hotels Limited	1
Highgate Hotels L.P. and an affiliate	1 (1)
Hilton Worldwide	1
Interstate Hotels & Resorts, Inc.	1
Montage North America, LLC	1
Sage Hospitality Group	1
Singh Hospitality, LLC	1
Total hotels owned as of September 30, 2023	15

- (1) The Boston Park Plaza was considered held for sale as of September 30, 2023, and subsequently sold on October 26, 2023 (see Note 13).

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of September 30, 2023 and December 31, 2022, and for the three and nine months ended September 30, 2023 and 2022, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their controlled subsidiaries. All significant intercompany balances and transactions have been eliminated. If the Company determines that it has an interest in a variable interest entity, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity.

The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and in conformity with the rules and regulations of the Securities and Exchange Commission. In the Company’s opinion, the interim financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim financial statements. These financial statements should be read in conjunction with the financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022, filed with the Securities and Exchange Commission on February 23, 2023. Operating results for the three and nine months ended September 30, 2023 are not necessarily indicative of the results that may be expected for the year ending December 31, 2023.

The Company does not have any comprehensive income other than what is included in net income. If the Company has any comprehensive income in the future such that a statement of comprehensive income would be necessary, the Company will include such statement in one continuous consolidated statement of operations.

As of the third quarter of 2023, the Company changed its balance sheet presentation from classified (distinguishing between short-term and long-term accounts) to unclassified (no such distinction) to conform with its REIT peers in the lodging sector and reporting entities in the REIT industry more broadly. Given the nature of the Company's operations, the previous classified presentation did not provide additional information that was useful to derive any metric by which the Company is measured and made comparisons to similar reporting entities more challenging and less meaningful. As the Company is now presenting an unclassified balance sheet, adjustments have been made to the historical classified consolidated balance sheet at December 31, 2022 in order for it to conform with the current unclassified presentation.

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

Use of Estimates

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

Earnings Per Share

The Company applies the two-class method when computing its earnings per share. Net income per share for each class of stock is calculated assuming all of the Company's net income is distributed as dividends to each class of stock based on their contractual rights.

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid), which include the Company's time-based restricted stock awards, are considered participating securities and are included in the computation of earnings per share.

Basic earnings attributable to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted earnings attributable to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period, plus potential common shares considered outstanding during the period, as long as the inclusion of such awards is not anti-dilutive. Potential common shares consist of unvested restricted stock awards and units, using the more dilutive of either the two-class method or the treasury stock method.

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

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Numerator:				
Net income	\$ 15,558	\$ 20,488	\$ 79,723	\$ 73,303
Income from consolidated joint venture attributable to noncontrolling interest	—	—	—	(3,477)
Preferred stock dividends	(3,226)	(3,351)	(10,762)	(10,897)
Distributions paid to participating securities	(72)	(64)	(176)	(64)
Undistributed income allocated to participating securities	—	(40)	(178)	(301)
Numerator for basic and diluted income attributable to common stockholders	<u>\$ 12,260</u>	<u>\$ 17,033</u>	<u>\$ 68,607</u>	<u>\$ 58,564</u>
Denominator:				
Weighted average basic common shares outstanding	205,570	211,010	206,257	213,799
Unvested restricted stock units	212	279	296	70
Weighted average diluted common shares outstanding	<u>205,782</u>	<u>211,289</u>	<u>206,553</u>	<u>213,869</u>
Basic income attributable to common stockholders per common share	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.33</u>	<u>\$ 0.27</u>
Diluted income attributable to common stockholders per common share	<u>\$ 0.06</u>	<u>\$ 0.08</u>	<u>\$ 0.33</u>	<u>\$ 0.27</u>

In its calculation of diluted earnings per share, the Company excluded 1,032,564 anti-dilutive unvested time-based restricted stock awards for the three and nine months ended September 30, 2023 and 1,289,146 anti-dilutive unvested time-based restricted stock awards for the three and nine months ended September 30, 2022 (see Note 11).

The Company also had unvested performance-based restricted stock units as of September 30, 2023 and 2022 that are not considered participating securities as the awards contain forfeitable rights to dividends or dividend equivalents. The performance-based restricted stock units were granted based on either target market condition thresholds or pre-determined price targets. Based on the Company's common stock performance, the Company excluded 188,004 anti-dilutive performance-based restricted stock units from its calculations of diluted earnings per share for the three and nine months ended September 30, 2023 and 2022 (see Note 11).

Restricted Cash

Restricted cash primarily includes lender reserves required by the Company's debt agreements and reserves for operating expenses and capital expenditures required by certain of the Company's management and franchise agreements. At times, restricted cash also includes hotel acquisition or disposition-related earnest money held in escrow reserves pending completion of the associated transaction (see Note 4). In addition, restricted cash as of September 30, 2023 and December 31, 2022 included \$0.2 million and \$10.2 million, respectively, held in escrow related to certain current and potential employee-related obligations of one of the Company's former hotels and \$0.2 million held as collateral for certain letters of credit as of both September 30, 2023 and December 31, 2022 (see Note 12). Restricted cash as of December 31, 2022 also included \$3.1 million held in escrow for the purpose of satisfying any potential employee-related obligations that should arise in connection with the termination of hotel personnel and any employment claim by hotel personnel at the Four Seasons Resort Napa Valley (see Note 12).

Investments in Hotel Properties

Investments in hotel properties, including land, buildings, furniture, fixtures and equipment ("FF&E") and identifiable intangible assets are recorded at their respective relative fair values for an asset acquisition or at their estimated fair values for a business acquisition. Property and equipment purchased after the hotel acquisition date is recorded at cost. Replacements and improvements are capitalized, while repairs and maintenance are expensed as incurred. Upon the sale or retirement of a fixed asset, the cost and related accumulated depreciation is removed from the Company's accounts and any resulting gain or loss is included in the consolidated statements of operations.

Depreciation expense is based on the estimated life of the Company's assets. The life of the assets is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish the Company's hotels, as well as specific market and economic conditions. Hotel properties are depreciated using the straight-line method over estimated useful lives primarily ranging from five years to forty years for buildings and improvements and three years to twelve years for FF&E. Intangible assets are amortized using the straight-line method over the shorter of their estimated useful life or over the length of the related agreement.

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

While the Company believes its estimates are reasonable, a change in the estimated lives could affect depreciation expense and net income or the gain or loss on the sale of any of the Company's hotels. The Company has not changed the useful lives of any of its assets during the periods discussed.

Impairment losses are recorded on investments in hotel properties to be held and used by the Company when indicators of impairment are present and the future undiscounted net cash flows, including potential sale proceeds, expected to be generated by those assets based on the Company's anticipated investment horizon, are less than the assets' carrying amount. The Company evaluates its investments in hotel properties to determine if there are indicators of impairment on a quarterly basis. No single indicator would necessarily result in the Company preparing an estimate to determine if a hotel's future undiscounted cash flows are less than the carrying value of the hotel. The Company uses judgment to determine if the severity of any single indicator, or the fact there are a number of indicators of less severity that when combined, would result in an indication that a hotel requires an estimate of the undiscounted cash flows to determine if an impairment has occurred. The Company considers indicators of impairment such as, but not limited to, hotel disposition strategy and hold period, a significant decline in operating results not related to renovations or repositioning, physical damage to the property due to unforeseen events such as natural disasters, and other market and economic conditions. If the Company determines that an indicator of impairment is present, the Company performs an analysis to determine the recoverability of the hotel by comparing the future undiscounted cash flows expected to be generated by the hotel to the hotel's carrying amount.

If a hotel is considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment loss is recognized. The Company performs a fair value assessment using valuation techniques such as discounted cash flows and comparable sales transactions in the market to estimate the fair value of the hotel and, if appropriate and available, current estimated net sales proceeds from pending offers. The Company's judgment is required in determining the discount rate, terminal capitalization rate, the estimated growth of revenues and expenses, revenue per available room and margins, as well as specific market and economic conditions. Based on the Company's review, no hotels were impaired during either the three or nine months ended September 30, 2023 and 2022.

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

Leases

The Company determines if a contract is a lease at inception. Leases with an initial term of twelve months or less are not recorded on the balance sheet. Expense for these short-term leases is recognized on a straight-line basis over the lease term. For leases with an initial term greater than twelve months, the Company records a right-of-use ("ROU") asset and a corresponding lease obligation. ROU assets represent the Company's right to use an underlying asset for the lease term, and lease obligations represent the Company's obligation to make fixed lease payments as stipulated by the lease. The Company has elected to not separate lease components from nonlease components, resulting in the Company accounting for lease and nonlease components as one single lease component.

Leases are accounted for using a dual approach, classifying leases as either operating or financing based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the Company. This classification determines whether the lease expense is recognized on a straight-line basis over the term of the lease for operating leases or based on an effective interest method for finance leases.

Lease ROU assets are recognized at the lease commencement date and include the amount of the initial operating lease obligation, any lease payments made at or before the commencement date, excluding any lease incentives received, and any initial

direct costs incurred. For leases that have extension options that the Company can exercise at its discretion, management uses judgment to determine if it is reasonably certain that the Company will in fact exercise such option. If the extension option is reasonably certain to occur, the Company includes the extended term's lease payments in the calculation of the respective lease liability. None of the Company's leases contain any material residual value guarantees or material restrictive covenants.

Lease obligations are recognized at the lease commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate ("IBR") based on information available at the commencement date in determining the present value of lease payments over the lease term. The IBR is the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment. In order to estimate the Company's IBR, the Company first looks to its own unsecured debt offerings, and adjusts the rate for both length of term and secured borrowing using available market data as well as consultations with leading national financial institutions that are active in the issuance of both secured and unsecured notes.

The Company reviews its right-of-use assets for indicators of impairment. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment loss is recognized. The impairment loss recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Based on the Company's review, no ROU assets were impaired during either the three or nine months ended September 30, 2023 and 2022.

Revenue Recognition

Revenues are recognized when control of the promised goods or services is transferred to hotel guests, which is generally defined as the date upon which a guest occupies a room and/or utilizes the hotel's services. Room revenue and other occupancy based fees are recognized over a guest's stay at the previously agreed upon daily rate. Some of the Company's hotel rooms are booked through independent internet travel intermediaries. If the guest pays the independent internet travel intermediary directly, revenue for the room is recognized by the Company at the price the Company sold the room to the independent internet travel intermediary, less any discount or commission paid. If the guest pays the Company directly, revenue for the room is recognized by the Company on a gross basis, with the related discount or commission recognized in room expense. A majority of the Company's hotels participate in frequent guest programs sponsored by the hotel brand owners whereby the hotel allows guests to earn loyalty points during their hotel stay. The Company expenses charges associated with these programs as incurred, and recognizes revenue at the amount it will receive from the brand when a guest redeems their loyalty points by staying at one of the Company's hotels. In addition, some contracts for rooms or food and beverage services require an advance deposit, which the Company records as deferred revenue (or a contract liability) and recognizes once the performance obligations are satisfied. Cancellation fees and attrition fees, which are charged to groups when they do not fulfill their contracted minimum number of room nights or minimum food and beverage spending requirements, are typically recognized as revenue in the period the Company determines it is probable that a significant reversal in the amount of revenue recognized will not occur, which is generally the period in which these fees are collected.

Food and beverage revenue and other ancillary services revenue are generated when a customer chooses to purchase goods or services. The revenue is recognized when the goods or services are provided to the customer at the amount the Company expects to be entitled to in exchange for those goods or services. For ancillary services provided by third parties, the Company assesses whether it is the principal or the agent. If the Company is the principal, revenue is recognized based upon the gross sales price. If the Company is the agent, revenue is recognized based upon the commission earned from the third party.

Additionally, the Company collects sales, use, occupancy and other similar taxes from customers at its hotels at the time of purchase, which are not included in revenue. The Company records a liability upon collection of such taxes from the customer, and relieves the liability when payments are remitted to the applicable governmental agency.

Trade receivables and contract liabilities consisted of the following (in thousands):

	September 30, 2023 (unaudited)	December 31, 2022
Trade receivables, net (1)	\$ 12,362	\$ 19,751
Contract liabilities (2)	\$ 47,977	\$ 50,219

(1) Trade receivables, net are included in accounts receivable, net on the accompanying consolidated balance sheets.

(2) Contract liabilities consist of advance deposits and are included in other liabilities on the accompanying consolidated balance sheets.

During both the three months ended September 30, 2023 and 2022, the Company recognized approximately \$3.0 million in revenue related to its outstanding contract liabilities. During the nine months ended September 30, 2023 and 2022, the Company recognized approximately \$41.9 million and \$25.4 million, respectively, in revenue related to its outstanding contract liabilities.

Segment Reporting

The Company considers each of its hotels to be an operating segment and allocates resources and assesses the operating performance for each hotel. Because all of the Company's hotels have similar economic characteristics, facilities and services, the hotels have been aggregated into one single reportable segment, hotel ownership.

New Accounting Standards and Accounting Changes

In March 2020, the FASB issued Accounting Standards Update No. 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting" ("ASU No. 2020-04"), which provides temporary optional expedients and exceptions to the guidance in GAAP on contract modifications and hedge accounting to ease reporting burdens related to the expected market transition from the London Interbank Offered Rate ("LIBOR") and other interbank offered rates to alternative reference rates, such as the Secured Overnight Financing Rate ("SOFR"). Contracts that meet the following criteria are eligible for relief from the modification accounting requirements in GAAP: the contract references LIBOR or another rate that is expected to be discontinued due to reference rate reform; the modified terms directly replace or have the potential to replace the reference rate that is expected to be discontinued due to reference rate reform; and any contemporaneous changes to other terms that change or have the potential to change the amount and timing of contractual cash flows must be related to the replacement of the reference rate. For a contract that meets the criteria, the guidance generally allows an entity to account for and present modifications as an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination. That is, the modified contract is accounted for as a continuation of the existing contract. ASU No. 2020-04 was effective upon issuance, applied prospectively from any date beginning March 12, 2020, and generally could not be applied to contract modifications that occurred after December 31, 2022. In December 2022, the FASB issued Accounting Standards Update No. 2022-06, "Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848" ("ASU No. 2022-06"), which deferred the sunset date from December 31, 2022 to December 31, 2024.

In May 2023, the Company repaid the \$220.0 million loan secured by the Hilton San Diego Bayfront, which was subject to LIBOR, and the loan's related interest rate cap derivative, which was also subject to LIBOR, was terminated (see Note 5). The Company's adoptions of ASU No. 2020-04 and ASU No. 2022-06 in the second quarter of 2023 had no impact on its consolidated financial statements.

3. Investment in Hotel Properties

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

	September 30, 2023 (unaudited)	December 31, 2022
Land	\$ 614,112	\$ 672,531
Buildings and improvements	2,556,852	2,793,771
Furniture, fixtures and equipment	403,362	426,189
Intangible assets	42,187	42,187
Construction in progress	62,358	71,689
Investment in hotel properties, gross	3,678,871	4,006,367
Accumulated depreciation and amortization	(1,098,450)	(1,165,439)
Investment in hotel properties, net	<u>\$ 2,580,421</u>	<u>\$ 2,840,928</u>

4. Disposal

The Company classified the Boston Park Plaza as held for sale at September 30, 2023, and subsequently sold the hotel in October 2023 (see Note 13). The sale did not represent a strategic shift that had a major impact on the Company's business plan or its primary markets; therefore, the hotel did not qualify as a discontinued operation. The Company's accounts payable and accrued expenses at September 30, 2023 includes a \$10.0 million deposit of disposition-related earnest money received from the hotel's buyer and held in escrow reserves pending completion of the hotel's sale.

The Company classified the assets and liabilities of the Boston Park Plaza as held for sale at September 30, 2023 as follows (in thousands):

	September 30, 2023
Investment in hotel properties, net	\$ 239,560
Accounts receivable, net	5,880
Prepaid expenses and other assets, net	2,336
Assets held for sale	\$ 247,776
Accounts payable and accrued expenses	\$ 8,843
Other liabilities	6,554
Liabilities of assets held for sale	\$ 15,397

5. Fair Value Measurements and Interest Rate Derivatives

Fair Value Measurements

As of September 30, 2023 and December 31, 2022, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

A fair value measurement is based on the assumptions that market participants would use in pricing an asset or liability in an orderly transaction. The hierarchy for inputs used in measuring fair value is as follows:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

As of both September 30, 2023 and December 31, 2022, the Company measured its interest rate derivatives at fair value on a recurring basis. The Company estimated the fair value of its interest rate derivatives using Level 2 measurements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements.

Fair Value of Debt

As of September 30, 2023 and December 31, 2022, 51.2% and 42.4%, respectively, of the Company's outstanding debt had fixed interest rates, including the effects of interest rate swap derivatives and forward starting interest rate swap derivatives. The Company uses Level 3 measurements to estimate the fair value of its debt by discounting the future cash flows of each instrument at estimated market rates.

The Company's principal balances and fair market values of its consolidated debt as of September 30, 2023 (unaudited) and December 31, 2022 were as follows (in thousands):

	September 30, 2023		December 31, 2022	
	Carrying Amount (1)	Fair Value (2)	Carrying Amount (1)	Fair Value (2)
Debt	\$ 819,582	\$ 793,280	\$ 816,136	\$ 809,141

- (1) The principal balance of debt is presented before any unamortized deferred financing costs.
- (2) Due to prevailing market conditions and the current uncertain economic environment, actual interest rates could vary materially from those estimated, which would result in variances in the Company's calculations of the fair market value of its debt.

Interest Rate Derivatives

The Company's interest rate derivatives, which are not designated as effective cash flow hedges, consisted of the following at September 30, 2023 (unaudited) and December 31, 2022 (in thousands):

Hedged Debt	Type	Strike / Capped Rate	Index	Effective Date	Maturity Date	Notional Amount	Estimated Fair Value of Assets (1)	
							September 30, 2023	December 31, 2022
Hilton San Diego Bayfront	Cap	6.000 %	1-Month LIBOR	December 9, 2022	December 9, 2023	\$ N/A	\$ N/A	\$ 60
Term Loan 1	Swap	3.675 %	CME Term SOFR	March 17, 2023	March 17, 2026	\$ 75,000	1,822	N/A
Term Loan 1	Swap	3.931 %	CME Term SOFR	September 14, 2023	September 14, 2026	\$ 100,000	1,794	N/A
Term Loan 2	Swap	1.853 %	1-Month LIBOR	January 29, 2016	January 31, 2023	N/A	N/A	208
							<u>\$ 3,616</u>	<u>\$ 268</u>

- (1) In May 2023, the cap derivative was terminated in conjunction with the Company's repayment of the loan secured by the Hilton San Diego Bayfront (see Note 7). The fair values of the cap and swap derivatives are included in prepaid expenses and other assets, net on the accompanying consolidated balance sheets as of September 30, 2023 and December 31, 2022.

Noncash changes in the fair values of the Company's interest rate derivatives resulted in decreases to interest expense for the three and nine months ended September 30, 2023 and 2022 as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Noncash interest on derivatives, net	<u>\$ (1,469)</u>	<u>\$ (39)</u>	<u>\$ (3,348)</u>	<u>\$ (2,904)</u>

6. Prepaid Expenses and Other Assets

Prepaid expenses and other assets, net consisted of the following (in thousands):

	September 30, 2023 (unaudited)	December 31, 2022
Prepaid expenses	\$ 11,751	\$ 6,478
Inventory	8,426	7,922
Deferred financing costs	3,978	5,031
Property and equipment, net	3,311	3,685
Interest rate derivatives	3,616	268
Deferred rent on straight-lined third-party tenant leases	648	2,413
Liquor licenses	930	933
Other	446	836
Total prepaid expenses and other assets, net	<u>\$ 33,106</u>	<u>\$ 27,566</u>

7. Notes Payable

Notes payable consisted of the following (in thousands):

	September 30, 2023		Maturity Date	Balance Outstanding as of		
	Rate Type	Interest Rate		September 30, 2023	December 31, 2022	
				(unaudited)		
Mortgage Loans						
Hilton San Diego Bayfront	N/A	(1)	N/A	December 9, 2023	\$ —	\$ 220,000
JW Marriott New Orleans	Fixed		4.15 %	December 11, 2024	74,582	76,136
Total mortgage loans					\$ 74,582	\$ 296,136
Unsecured Corporate Credit Facilities						
Term Loan 1	Fixed	(2)	5.25 %	July 25, 2027	\$ 175,000	\$ 175,000
Term Loan 2	Variable	(3)	6.76 %	January 25, 2028	175,000	175,000
Term Loan 3	Variable	(4)	6.78 %	May 1, 2025	225,000	—
Total unsecured corporate credit facilities					\$ 575,000	\$ 350,000
Unsecured Senior Notes						
Series A	Fixed		4.69 %	January 10, 2026	\$ 65,000	\$ 65,000
Series B	Fixed		4.79 %	January 10, 2028	105,000	105,000
Total unsecured senior notes					\$ 170,000	\$ 170,000
Unamortized deferred financing costs					(4,880)	(3,455)
Debt, net of unamortized deferred financing costs					\$ 814,702	\$ 812,681

- (1) The mortgage loan secured by the Hilton San Diego Bayfront was repaid on May 9, 2023, using proceeds received from the Company's Term Loan 3. The mortgage loan was subject to an interest rate cap derivative (see Note 5). The effective interest rate on the loan was 5.571% at December 31, 2022.
- (2) Term Loan 1 is subject to two interest rate swap derivatives (see Note 5). The variable interest rate is based on a pricing grid with a range of 1.35% to 2.20%, depending on the Company's leverage ratios, plus SOFR and a 0.10% adjustment. In May 2023, the pricing grid was reduced by 0.02% to a range of 1.33% to 2.18% as the Company achieved the 2022 sustainability performance metric specified in the Second Amended Credit Agreement. The reduction in the pricing grid will be evaluated annually and is subject to the Company's continued ability to satisfy its sustainability metric. The effective interest rates on the term loan were 5.25% and 5.82% at September 30, 2023 and December 31, 2022, respectively.
- (3) Term Loan 2 was subject to an interest rate swap derivative until the swap expired in January 2023 (see Note 5). The variable interest rate is based on a pricing grid with a range of 1.35% to 2.20%, depending on the Company's leverage ratios, plus SOFR and a 0.10% adjustment. In May 2023, the pricing grid was reduced by 0.02% to a range of 1.33% to 2.18% as the Company achieved the 2022 sustainability performance metric specified in the Second Amended Credit Agreement. The reduction in the pricing grid will be evaluated annually and is subject to the Company's continued ability to satisfy its sustainability metric. The effective interest rates on the term loan were 6.76% and 4.27% at September 30, 2023 and December 31, 2022, respectively.
- (4) On May 1, 2023, the Company entered into a term loan agreement ("Term Loan 3") and drew a total of \$225.0 million, of which \$220.0 million was used to repay the mortgage loan secured by the Hilton San Diego Bayfront. The variable interest rate is based on a pricing grid with a range of 1.35% to 2.20%, depending on the Company's leverage ratios, plus SOFR and a 0.10% adjustment. Term Loan 3 matures on May 1, 2025, with a one-time option to extend the loan by twelve months to May 1, 2026 upon the payment of applicable fees and the satisfaction of certain customary conditions. The Company also has the right to increase Term Loan 3 in an amount up to \$50.0 million, for an aggregate facility of \$275.0 million from lenders that are willing at such time to provide such increase. The effective interest rate on the term loan was 6.78% at September 30, 2023.

As of September 30, 2023, the Company had no amount outstanding on its credit facility, with \$500.0 million of capacity available for borrowing under the facility. The Company's ability to draw on the credit facility is subject to the Company's compliance with various financial covenants.

Interest Expense

Total interest incurred and expensed on the notes payable and finance lease obligation was as follows (unaudited and in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Interest expense on debt and finance lease obligation	\$ 12,623	\$ 8,719	\$ 36,299	\$ 21,252
Noncash interest on derivatives, net	(1,469)	(39)	(3,348)	(2,904)
Amortization of deferred financing costs	740	589	1,960	1,940
Total interest expense	<u>\$ 11,894</u>	<u>\$ 9,269</u>	<u>\$ 34,911</u>	<u>\$ 20,288</u>

8. Other Liabilities

Other Liabilities

Other liabilities consisted of the following (in thousands):

	<u>September 30,</u> <u>2023</u> <u>(unaudited)</u>	<u>December 31,</u> <u>2022</u>
Advance deposits	\$ 47,977	\$ 50,219
Property, sales and use taxes payable	12,976	7,500
Accrued interest	4,202	6,915
Deferred rent	3,029	3,981
Management fees payable	566	1,584
Other	5,792	8,234
Total other liabilities	<u>\$ 74,542</u>	<u>\$ 78,433</u>

9. Leases

As of both September 30, 2023 and December 31, 2022, the Company had operating leases for ground, office, equipment and airspace leases with maturity dates ranging from 2024 through 2097, excluding renewal options. Including renewal options available to the Company, the lease maturity date extends to 2147.

Operating leases were included on the Company's consolidated balance sheets as follows (in thousands):

	<u>September 30,</u> <u>2023</u> <u>(unaudited)</u>	<u>December 31,</u> <u>2022</u>
Right-of-use assets, net	\$ 13,884	\$ 15,025
Lease obligations	\$ 17,884	\$ 19,012
Weighted average remaining lease term	32 years	
Weighted average discount rate	5.3 %	

In January 2023, the Company relocated its corporate headquarters and recognized a \$2.2 million operating lease right-of-use asset and related lease obligation.

The components of lease expense were as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Finance lease cost (1):				
Interest on lease obligation	\$ —	\$ —	\$ —	\$ 117
Operating lease cost	1,360	1,325	4,068	4,041
Variable lease cost (2)	2,481	2,241	6,764	5,100
Sublease income (3)	(296)	—	(890)	—
Total lease cost	<u>\$ 3,545</u>	<u>\$ 3,566</u>	<u>\$ 9,942</u>	<u>\$ 9,258</u>

- (1) Finance lease cost for the nine months ended September 30, 2022 included expenses for the Hyatt Centric Chicago Magnificent Mile's finance lease obligation before the hotel's sale in February 2022.
- (2) Several of the Company's hotels pay percentage rent, which is calculated on operating revenues above certain thresholds.
- (3) During the fourth quarter of 2022, the Company entered into a sublease agreement on its previous corporate headquarters, which became effective in January 2023. Sublease income is included in corporate overhead in the accompanying consolidated statement of operations for the three and nine months ended September 30, 2023.

10. Stockholders' Equity

Series G Cumulative Redeemable Preferred Stock

Contemporaneous with the Company's April 2021 purchase of the Montage Healdsburg, the Company issued 2,650,000 shares of its Series G Cumulative Redeemable Preferred Stock ("Series G preferred stock") to the hotel's seller as partial payment of the hotel. The Series G preferred stock, which is callable at its \$25.00 redemption price plus accrued and unpaid dividends by the Company at any time, accrues dividends at an initial rate equal to the Montage Healdsburg's annual net operating income yield on the Company's investment in the resort. The annual dividend rate is expected to increase in 2024 to the greater of 3.0% or the rate equal to the Montage Healdsburg's annual net operating income yield on the Company's total investment in the resort. The Series G preferred stock is not convertible into any other security.

Series H Cumulative Redeemable Preferred Stock

In May 2021, the Company issued 4,600,000 shares of its 6.125% Series H Cumulative Redeemable Preferred Stock ("Series H preferred stock") with a liquidation preference of \$25.00. On or after May 24, 2026, the Series H preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control, as defined by the Articles Supplementary for Series H preferred stock, the Company may at its option redeem the Series H preferred stock for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. If the Company chooses not to redeem the Series H preferred stock upon the occurrence of a change of control, holders of the Series H preferred stock may convert their preferred shares into shares of the Company's common stock.

Series I Cumulative Redeemable Preferred Stock

In July 2021, the Company issued 4,000,000 shares of its 5.70% Series I Cumulative Redeemable Preferred Stock ("Series I preferred stock") with a liquidation preference of \$25.00. On or after July 16, 2026, the Series I preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control, as defined by the Articles Supplementary for Series I preferred stock, the Company may at its option redeem the Series I preferred stock for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. If the Company chooses not to redeem the Series I preferred stock upon the occurrence of a change of control, holders of the Series I preferred stock may convert their preferred shares into shares of the Company's common stock.

Common Stock

Stock Repurchase Program. In February 2021, the Company's board of directors reauthorized the Company's existing stock repurchase program, allowing the Company to acquire up to \$500.0 million of the Company's common and preferred stock. The stock repurchase program has no stated expiration date. In February 2023, the Company's board of directors reauthorized the existing stock

repurchase program and restored the \$500.0 million of aggregate common and preferred stock allowed to be repurchased under the program.

Details of the Company's repurchases were as follows (dollars in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Number of common shares repurchased	1,561,375	880,577	3,827,759	7,995,560
Cost, including fees and commissions	\$ 14,042	\$ 8,666	\$ 35,523	\$ 86,646
Number of preferred shares repurchased	—	—	—	—

As of September 30, 2023, \$475.5 million remains available for repurchase under the stock repurchase program (see Note 13). Future repurchases will depend on various factors, including the Company's capital needs and restrictions under its various financing agreements, as well as the price of the Company's common and preferred stock.

ATM Agreements. In February 2017, the Company entered into separate "At the Market" Agreements (the "2017 ATM Agreements") with several financial institutions. In accordance with the terms of the 2017 ATM Agreements, the Company could from time to time offer and sell shares of its common stock having an aggregate offering price of up to \$300.0 million. In February 2023, the Company's board of directors reauthorized the \$300.0 million 2017 ATM Agreements, or new similar agreements.

In March 2023, the Company terminated the 2017 ATM Agreements and entered into similar separate "At the Market" Agreements (the "2023 ATM Agreements") with several financial institutions. In accordance with the terms of the 2023 ATM Agreements, the Company may from time to time offer and sell shares of its common stock having an aggregate offering price of up to \$300.0 million. No common stock was issued under either the 2017 ATM Agreements or the 2023 ATM Agreements during the three and nine months ended September 30, 2023 and 2022, leaving \$300.0 million available for sale.

11. Incentive Award Plan

The Company's Incentive Award Plan (the "Plan") provides for granting discretionary awards to employees, consultants and non-employee directors. The awards may be made in the form of options, restricted stock awards, dividend equivalents, stock payments, restricted stock units, other incentive awards, LTIP units or share appreciation rights.

Should a stock grant be forfeited prior to its vesting, the shares covered by the stock grant are added back to the Plan and remain available for future issuance. Shares of common stock tendered or withheld to satisfy the grant or exercise price or tax withholding obligations upon the vesting of a stock grant are not added back to the Plan.

Restricted shares and units are measured at fair value on the date of grant and amortized as compensation expense over the relevant requisite service period or derived service period. The Company has elected to account for forfeitures as they occur.

As of both September 30, 2023 and 2022, the Company's issued and outstanding awards consisted of both time-based and performance-based restricted stock grants. The Company's amortization expense, including forfeitures related to restricted shares was as follows (unaudited and in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Amortization expense, including forfeitures	\$ 2,511	\$ 2,230	\$ 8,263	\$ 8,661
Capitalized compensation cost (1)	\$ 117	\$ 120	\$ 352	\$ 361

- (1) The Company capitalizes compensation costs related to restricted shares granted to certain employees whose work is directly related to the Company's capital investment in its hotels.

Restricted Stock Awards

The Company's restricted stock awards are time-based restricted shares that generally vest over periods ranging from three years to five years from the date of grant. The following is a summary of non-vested restricted stock award activity for the nine months ended September 30, 2023:

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested at January 1, 2023	1,289,146	\$ 11.65
Granted	450,964	\$ 10.58
Vested	(699,652)	\$ 11.76
Forfeited	(7,894)	\$ 11.14
Unvested at September 30, 2023	1,032,564	\$ 11.11

Restricted Stock Units

The Company's restricted stock units are performance-based restricted shares that generally vest based on the Company's total relative shareholder return and the achievement of pre-determined stock price targets during performance periods ranging from two years to five years. The following is a summary of non-vested restricted stock unit activity, at target performance, for the nine months ended September 30, 2023:

	Target Number of Shares	Weighted-Average Grant Date Fair Value
Unvested at January 1, 2023	612,584	\$ 10.40
Granted	463,576	\$ 11.07
Unvested at September 30, 2023	1,076,160	\$ 10.69

The restricted stock units granted during the first nine months of 2023 vest based on the Company's total relative shareholder return following a three year performance period. The number of shares that may become vested ranges from zero to 200%. The grant date fair values of the restricted stock units were determined using a Monte Carlo simulation model with the following assumptions:

Expected volatility	38.0 %
Dividend yield (1)	—
Risk-free rate	4.18 %
Expected term	3 years

- (1) Dividend equivalents are assumed to be reinvested in shares of the Company's common stock and dividend equivalents will only be paid to the extent the award vests.

12. Commitments and Contingencies

Management Agreements

Management agreements with the Company's third-party hotel managers currently require the Company to pay between 2.0% and 3.0% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers.

Total basic management and incentive management fees were included in other property-level expenses on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Basic management fees	\$ 6,774	\$ 6,695	\$ 21,101	\$ 18,310
Incentive management fees	604	736	6,546	5,361
Total basic and incentive management fees	\$ 7,378	\$ 7,431	\$ 27,647	\$ 23,671

License and Franchise Agreements

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

Total license and franchise fees were included in franchise costs on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Franchise assessments (1)	\$ 4,025	\$ 3,877	\$ 11,842	\$ 10,564
Franchise royalties	253	268	914	865
Total franchise costs	<u>\$ 4,278</u>	<u>\$ 4,145</u>	<u>\$ 12,756</u>	<u>\$ 11,429</u>

(1) Includes advertising, reservation and frequent guest program assessments.

Renovation and Construction Commitments

At September 30, 2023, the Company had various contracts outstanding with third parties in connection with the ongoing renovations of certain of its hotels. The remaining commitments under these contracts at September 30, 2023 totaled \$40.4 million.

Concentration of Risk

The concentration of the Company's hotels in California, Florida and Hawaii exposes the Company's business to economic and severe weather conditions, competition and real and personal property tax rates unique to these locales.

As of September 30, 2023, 9 of the 14 Hotels were geographically concentrated as follows (unaudited):

	Number of Hotels	Percentage of Total Rooms	Trailing 12-Month Total Consolidated Revenue
California	5	39 %	45 %
Florida	3	19 %	17 %
Hawaii	1	8 %	17 %

Other

In June 2023, the Company entered into an agreement to finalize its Hurricane Ida-related property damage claim and its business interruption claim at the Hilton New Orleans St. Charles, resulting in the receipt of \$3.7 million for property damage expenses incurred and \$0.5 million in business interruption proceeds, which are included in interest and other income and other operating revenue, respectively, on the accompanying consolidated statements of operations for the nine months ended September 30, 2023.

In accordance with the assignment-in-lieu agreement executed in December 2020 between the Company and the mortgage holder of the Hilton Times Square, the Company was required to retain approximately \$11.6 million related to certain current and potential employee-related obligations (the "potential obligation"), of which the Company was relieved of \$1.0 million as of December 31, 2022. In February 2023, the Company was relieved of an additional \$9.8 million of the potential obligation and the funds were released from escrow to the Company, resulting in a \$9.8 million gain on extinguishment of debt. The remaining potential obligation is reassessed at the end of every quarter, resulting in a total gain on extinguishment of debt of \$9,000 and \$9.9 million included on the accompanying consolidated statements of operations for the three and nine months ended September 30, 2023, respectively. As of September 30, 2023 and December 31, 2022, restricted cash on the accompanying consolidated balance sheets included \$0.2 million and \$10.2 million, respectively, which will continue to be held in escrow until the potential obligation is resolved. The potential obligation balances of \$0.2 million and \$10.2 million were included in accounts payable and accrued expenses on the accompanying consolidated balance sheets as of September 30, 2023 and December 31, 2022, respectively.

Coterminous with the Company's acquisition of the Four Seasons Resort Napa Valley in 2021, the Company was required to deposit \$3.1 million into a restricted bank account owned by the Company, but to which the hotel's management company, Four Seasons, had sole and unrestricted access to withdraw funds for the purpose of satisfying any potential employee-related obligations that should arise in connection with potential future severance obligations, if those claims were not previously satisfied. The estimated future severance obligations total of \$3.1 million was included in restricted cash on the accompanying consolidated balance sheet as of December 31, 2022. In January 2023, Four Seasons released the \$3.1 million to the Company and the Company agreed to provide an unconditional guaranty to Four Seasons for the full and prompt payment of all amounts payable by the Company to Four Seasons relating to employee liability.

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

At September 30, 2023, the Company had \$0.2 million of outstanding irrevocable letters of credit to guarantee the Company's financial obligations related to workers' compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon the letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through September 30, 2023. The letters of credit are collateralized with \$0.2 million held in a restricted bank account owned by the Company, which is included in restricted cash on the accompanying consolidated balance sheets as of both September 30, 2023 and December 31, 2022.

The Company is subject to various claims, lawsuits and legal proceedings, including routine litigation arising in the ordinary course of business, regarding the operation of its hotels, its managers and other Company matters. While it is not possible to ascertain the ultimate outcome of such matters, the Company believes that the aggregate identifiable amount of such liabilities, if any, in excess of amounts covered by insurance will not have a material adverse impact on its financial condition or results of operations. The outcome of claims, lawsuits and legal proceedings brought against the Company, however, is subject to significant uncertainties.

13. Subsequent Events

On October 26, 2023, the Company sold the Boston Park Plaza for a gross sale price of \$370.0 million.

Subsequent to the end of the third quarter of 2023 and through the date of issuance of these financial statements, the Company repurchased 233,692 shares of its common stock for \$2.1 million, including fees and commissions, leaving \$473.4 million remaining for repurchase under the Company's stock repurchase program.

Cautionary Statement

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. The Company intends such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe the Company's future plans, strategies and expectations, are generally identifiable by use of the words "anticipate," "believe," "estimate," "expect," "intend," "project," or similar expressions. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond the Company's control, and which could materially affect actual results, performances or achievements. Accordingly, there is no assurance that the Company's expectations will be realized. In evaluating these statements, you should specifically consider the risks outlined in detail in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 23, 2023, under the caption "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q, including but not limited to the following factors:

- competition from hotels not owned by us or from new hotel supply or alternative lodging options such as timeshare, vacation rentals or sharing services such as Airbnb, which could harm our occupancy levels and revenue at our hotels;
- events beyond our control, including economic slowdowns or recessions, pandemics, natural disasters, civil unrest and terrorism;
- increased inflation adversely affecting consumer confidence and increasing our hotel operating expenses, including wages, employee-related benefits, food costs, commodity costs, including those used to renovate or reposition our hotels, property taxes, property and liability insurance and utilities that may not be offset by increased room rates;
- system security risks, data protection breaches, cyber-attacks and systems integration issues, including those impacting our suppliers, our third-party hotel managers or our franchisors;
- risks associated with the physical and transitional effects of climate change, which can include more frequent or severe storms, hurricanes, flooding, droughts and wildfires adversely affecting our hotels;
- the need for business-related group and transient travel, including the increased use of business-related technology;
- the need for renovations, repositionings and other capital expenditures for our hotels;
- the impact, including any delays, of renovations and repositionings on hotel operations;
- volatility in the debt and equity markets that may adversely affect our ability to acquire, renovate, refinance or sell our hotels;
- competition for the acquisition of hotels, and our ability to complete acquisitions and dispositions;
- the ground lease for one of our hotels;
- relationships with, and the requirements, performance and reputation of, the managers of our hotels;
- relationships with, and the requirements and reputation of, our franchisors and hotel brands;
- interest rate volatility, which could reduce our access to capital markets or increase the cost of funding our debt requirements;
- our hotels may become impaired, which may adversely affect our financial condition and results of operations;
- corporate responsibility, specifically related to ESG factors and commitments, which may impose additional costs and expose us to new risks;
- our level of debt, including secured, unsecured, fixed and variable rate debt and the corresponding interest expense associated with our debt;
- financial and other covenants on our debt and preferred stock and the impact on our business of potential defaults by us on our debt agreements or ground lease;
- our need to operate as a REIT and comply with other applicable laws and regulations, including new laws, interpretations or court decisions that may change the federal or state tax laws or the federal or state income tax consequences of our qualification as a REIT; and
- potential adverse tax consequences in the event that our operating leases with our taxable REIT subsidiaries are not held to have been made on an arm's-length basis.

These factors may cause our actual events to differ materially from the expectations expressed or implied by any forward-looking statement. Except as otherwise required by federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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

Overview

Sunstone Hotel Investors, Inc. (the “Company,” “we,” “our” or “us”) is a Maryland corporation. We operate as a self-managed and self-administered real estate investment trust (“REIT”). A REIT is a corporation that directly or indirectly owns real estate assets and has elected to be taxable as a real estate investment trust for federal income tax purposes. To qualify for taxation as a REIT, the REIT must meet certain requirements, including regarding the composition of its assets and the sources of its income. REITs generally are not subject to federal income taxes at the corporate level as long as they pay stockholder dividends equivalent to 100% of their taxable income. REITs are required to distribute to stockholders at least 90% of their REIT taxable income. We own, directly or indirectly, 100% of the interests of Sunstone Hotel Partnership, LLC (the “Operating Partnership”), which is the entity that directly or indirectly owns our hotels. We also own 100% of the interests of our taxable REIT subsidiary, Sunstone Hotel TRS Lessee, Inc. (the “TRS Lessee”), which, directly or indirectly, leases all of our hotels from the Operating Partnership, and engages independent third-parties to manage our hotels.

We own hotels in urban and resort destinations that benefit from significant barriers to entry by competitors and diverse economic drivers. As of September 30, 2023, we owned 15 hotels, one of which, the Boston Park Plaza, was classified as held for sale due to its sale in October 2023. All but two of our hotels (the Boston Park Plaza and the Oceans Edge Resort & Marina) are operated under nationally recognized brands. Our two unbranded hotels are located in top urban and resort destination markets that have enabled them to establish awareness with both group and transient customers. Excluding the Boston Park Plaza, our hotels average 477 rooms in size.

Operating Activities

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

- *Room revenue*, which is comprised of revenue realized from the sale of rooms at our hotels;
- *Food and beverage revenue*, which is comprised of revenue realized in the hotel food and beverage outlets as well as banquet and catering events; and
- *Other operating revenue*, which includes ancillary hotel revenue and other items primarily driven by occupancy such as telephone/internet, parking, spa, facility and resort fees, entertainment and other guest services. Additionally, this category includes, among other things, attrition and cancellation revenue, tenant revenue derived from hotel space and marina slips leased by third parties, winery revenue, any business interruption proceeds and any performance guarantee or reimbursements to offset net losses.

Expenses. Our expenses consist of the following:

- *Room expense*, which is primarily driven by occupancy and, therefore, has a significant correlation with room revenue;
- *Food and beverage expense*, which is primarily driven by hotel food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenue;
- *Other operating expense*, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities and franchise costs;
- *Property tax, ground lease and insurance expense*, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense, however property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality, along with our cash and noncash operating lease expenses, general excise tax assessed by Hawaii and city taxes imposed by San Francisco;
- *Other property-level expenses*, which includes our property-level general and administrative expenses, such as payroll, benefits and other employee-related expenses, contract and professional fees, credit and collection expenses, employee recruitment, relocation and training expenses, labor dispute expenses, consulting fees, management fees and other expenses;
- *Corporate overhead expense*, which includes our corporate-level expenses, such as payroll, benefits and other employee-related expenses, amortization of deferred stock compensation, business acquisition and due diligence expenses, legal

expenses, association, contract and professional fees, board of director expenses, entity-level state franchise and minimum taxes, travel expenses, office rent and other customary expenses; and

- *Depreciation and amortization expense*, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment (“FF&E”), along with amortization on our finance lease right-of-use asset (prior to the related hotel’s sale in February 2022), franchise fees and certain intangibles. Additionally, this category includes depreciation and amortization related to FF&E for our corporate office.

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

- *Interest and other income*, which includes interest we have earned on our restricted and unrestricted cash accounts, as well as any energy or other rebates, property insurance proceeds we have received, miscellaneous income and any gains or losses we have recognized on sales or redemptions of assets other than real estate investments;
- *Interest expense*, which includes interest expense incurred on our outstanding fixed and variable rate debt and finance lease obligation (prior to the related hotel’s sale in February 2022), gains or losses on interest rate derivatives, amortization of deferred financing costs, and any loan or waiver fees incurred on our debt;
- *Gain on sale of assets*, which includes the gains we recognized on our hotel sales that do not qualify as discontinued operations;
- *Gain (loss) on extinguishment of debt, net*, which includes gains related to the resolution of contingencies on extinguished debt and losses recognized on amendments or early repayments of mortgages or other debt obligations from the accelerated amortization of deferred financing costs, along with any other costs;
- *Income tax (provision) benefit, net*, which includes federal and state income taxes related to continuing operations charged to the Company net of any refundable credits or refunds received, any adjustments to deferred tax assets, liabilities or valuation allowances, and any adjustments to unrecognized tax positions, along with any related interest and penalties incurred;
- *Income from consolidated joint venture attributable to noncontrolling interest*, which includes the net income attributable to a third-party’s 25.0% ownership interest in the joint venture that owned the Hilton San Diego Bayfront prior to our acquisition of the interest in June 2022; and
- *Preferred stock dividends*, which includes dividends accrued on our Series G Cumulative Redeemable Preferred Stock (“Series G preferred stock”), Series H Cumulative Redeemable Preferred Stock (“Series H preferred stock”) and Series I Cumulative Redeemable Preferred Stock (“Series I preferred stock”).

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

- *Occupancy*, which is the quotient of total rooms sold divided by total rooms available;
- *Average daily room rate*, or ADR, which is the quotient of room revenue divided by total rooms sold;
- *Revenue per available room*, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;
- *RevPAR index*, which is the quotient of a hotel’s RevPAR divided by the average RevPAR of its competitors, multiplied by 100. A RevPAR index in excess of 100 indicates a hotel is achieving higher RevPAR than the average of its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;
- *EBITDAre*, which is net income (loss) excluding: interest expense; benefit or provision for income taxes, including any changes to deferred tax assets, liabilities or valuation allowances and income taxes applicable to the sale of assets; depreciation and amortization; gains or losses on disposition of depreciated property (including gains or losses on change in control); and any impairment write-downs of depreciated property;
- *Adjusted EBITDAre, excluding noncontrolling interest*, which is EBITDAre adjusted to exclude: the net income (loss) allocated to a third-party’s 25.0% ownership interest in the joint venture that owned the Hilton San Diego Bayfront prior to our acquisition of the interest in June 2022, along with the noncontrolling partner’s pro rata share of any EBITDAre components; amortization of deferred stock compensation; amortization of contract intangibles; amortization of right-of-

use assets and obligations; the cash component of ground lease expense for any finance lease obligation that was included in interest expense; the impact of any gain or loss from undepreciated asset sales or property damage from natural disasters; any lawsuit settlement costs; the write-off of development costs associated with abandoned projects; property-level restructuring, severance and management transition costs; debt resolution costs; and any other nonrecurring identified adjustments;

- *Funds from operations (“FFO”) attributable to common stockholders*, which is net income (loss) and preferred stock dividends and any redemption charges, excluding: gains and losses from sales of property; real estate-related depreciation and amortization (excluding amortization of deferred financing costs and right-of-use assets and obligations); any real estate-related impairment losses; and the noncontrolling partner’s pro rata share of net income (loss) and any FFO components prior to our acquisition of the noncontrolling partner’s interest in June 2022; and
- *Adjusted FFO attributable to common stockholders*, which is FFO attributable to common stockholders adjusted to exclude: amortization of deferred stock compensation; amortization of contract intangibles; real estate-related amortization of right-of-use assets and obligations; noncash interest on our derivatives and any finance lease obligations; income tax benefits or provisions associated with any changes to deferred tax assets, liabilities or valuation allowances, the application of net operating loss carryforwards and uncertain tax positions; gains or losses due to property damage from natural disasters; any lawsuit settlement costs; the write-off of development costs associated with abandoned projects; non-real estate-related impairment losses; property-level restructuring, severance and management transition costs; debt resolution costs; preferred stock redemption charges; the noncontrolling partner’s pro rata share of any Adjusted FFO components prior to our acquisition of the noncontrolling partner’s interest in June 2022; and any other nonrecurring identified adjustments.

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

- *Demand.* The demand for lodging has traditionally been closely linked with the performance of the general economy. Our hotels are classified as either upper upscale or luxury hotels. In an economic downturn, these types of hotels may be more susceptible to a decrease in revenue, as compared to hotels in other categories that have lower room rates in part because upper upscale and luxury hotels generally target business and high-end leisure travelers. In periods of economic difficulty, including those caused by pandemics and inflation, business and leisure travelers may reduce costs by limiting travel or by using lower cost accommodations. In addition, operating results at our hotels in resort markets may be negatively affected by reduced demand from domestic travelers due to pent up desire for international travel as pandemic-era travel restrictions have generally been lifted, and by changes in the value of the U.S. dollar in relation to other currencies which may make international travel more affordable; whereas operating results at our hotels in key gateway markets may be negatively affected by reduced demand from international travelers due to financial conditions in their home countries or a material strengthening of the U.S. dollar in relation to other currencies which makes travel to the U.S. less affordable. Also, volatility in transportation fuel costs, increases in air and ground travel costs, decreases in airline capacity and prolonged periods of inclement weather in our markets may reduce the demand for our hotels.
- *Supply.* The addition of new competitive hotels affects the ability of existing hotels to absorb demand for lodging and, therefore, impacts the ability to generate growth in RevPAR and profits. The development of new hotels is largely driven by construction costs, the cost and availability of financing, and the expected performance of existing hotels. Prior to the COVID-19 pandemic, U.S. hotel supply continued to increase. On a market-by-market basis, some markets experienced new hotel room openings at or greater than historic levels, including in Boston, Orlando and Portland. Additionally, an increase in the supply of vacation rental or sharing services such as Airbnb affects the ability of existing hotels to generate growth in RevPAR and profits. We believe that both new full-service hotel construction and new hotel openings will be delayed in the near-term due to several factors, including increased borrowing costs and increased materials and construction costs.
- *Revenues and expenses.* We believe that marginal improvements in RevPAR index, even in the face of declining revenues, are a good indicator of the relative quality and appeal of our hotels, and our operators’ effectiveness in maximizing revenues. Similarly, we also evaluate our operators’ effectiveness in minimizing incremental operating expenses in the context of increasing revenues or, conversely, in reducing operating expenses in the context of declining revenues. Inflationary pressures could increase operating costs, which could limit our operators’ effectiveness in minimizing expenses.

Operating Results. The following table presents our unaudited operating results for our total portfolio for the three months ended September 30, 2023 and 2022, including the amount and percentage change in the results between the two periods.

	Three Months Ended September 30,			
	2023	2022	Change \$	Change %
(in thousands, except statistical data)				
REVENUES				
Room	\$ 158,467	\$ 158,400	\$ 67	— %
Food and beverage	64,007	63,476	531	0.8 %
Other operating	25,226	22,438	2,788	12.4 %
Total revenues	247,700	244,314	3,386	1.4 %
OPERATING EXPENSES				
Hotel operating	151,538	145,686	5,852	4.0 %
Other property-level expenses	29,020	29,032	(12)	— %
Corporate overhead	7,127	7,879	(752)	(9.5) %
Depreciation and amortization	33,188	31,750	1,438	4.5 %
Total operating expenses	220,873	214,347	6,526	3.0 %
Interest and other income	1,218	270	948	351.1 %
Interest expense	(11,894)	(9,269)	(2,625)	(28.3) %
Gain (loss) on extinguishment of debt, net	9	(770)	779	101.2 %
Income before income taxes	16,160	20,198	(4,038)	(20.0) %
Income tax (provision) benefit, net	(602)	290	(892)	(307.6) %
NET INCOME	15,558	20,488	(4,930)	(24.1) %
Preferred stock dividends	(3,226)	(3,351)	125	3.7 %
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS				
	\$ 12,332	\$ 17,137	\$ (4,805)	(28.0) %

The following table presents our unaudited operating results for our total portfolio for the nine months ended September 30, 2023 and 2022, including the amount and percentage change in the results between the two periods.

	Nine Months Ended September 30,			
	2023	2022	Change \$	Change %
(in thousands, except statistical data)				
REVENUES				
Room	\$ 484,304	\$ 428,893	\$ 55,411	12.9 %
Food and beverage	213,634	174,717	38,917	22.3 %
Other operating	69,317	64,299	5,018	7.8 %
Total revenues	767,255	667,909	99,346	14.9 %
OPERATING EXPENSES				
Hotel operating	452,614	396,548	56,066	14.1 %
Other property-level expenses	92,654	83,333	9,321	11.2 %
Corporate overhead	23,991	27,310	(3,319)	(12.2) %
Depreciation and amortization	97,927	94,003	3,924	4.2 %
Total operating expenses	667,186	601,194	65,992	11.0 %
Interest and other income	6,398	4,766	1,632	34.2 %
Interest expense	(34,911)	(20,288)	(14,623)	(72.1) %
Gain on sale of assets	—	22,946	(22,946)	(100.0) %
Gain (loss) on extinguishment of debt, net	9,930	(962)	10,892	1,132.2 %
Income before income taxes	81,486	73,177	8,309	11.4 %
Income tax (provision) benefit, net	(1,763)	126	(1,889)	(1,499.2) %
NET INCOME	79,723	73,303	6,420	8.8 %
Income from consolidated joint venture attributable to noncontrolling interest	—	(3,477)	3,477	100.0 %
Preferred stock dividends	(10,762)	(10,897)	135	1.2 %
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS				
	\$ 68,961	\$ 58,929	\$ 10,032	17.0 %

Summary of Operating Results. The following items significantly impact the year-over-year comparability of our operations:

- **COVID-19:** Operations at most of our hotels during the first nine months of 2022 were negatively impacted by COVID-19's Omicron variant and subvariants. Consequently, the results of our operations for the first nine months of 2023 are not comparable to the same period in 2022.
- **Hotel Acquisition:** In June 2022, we purchased The Confidante Miami Beach, resulting in increased revenues, operating expenses and depreciation expense for the first nine months of 2023 as compared to the same period in 2022.
- **Hotel Dispositions:** In February 2022, we sold the Hyatt Centric Chicago Magnificent Mile, and in March 2022, we sold both the Embassy Suites Chicago and the Hilton Garden Inn Chicago Downtown/Magnificent Mile. As a result of these three hotel dispositions (the "Three Disposed Hotels"), our revenues, operating expenses and depreciation expense for the first nine months of 2023 are not comparable to the same period in 2022.

Room revenue. Room revenue remained relatively constant for the three months ended September 30, 2023 as compared to the three months ended September 30, 2022 as a 140 basis point increase in occupancy was offset by a 1.9% decrease in the average daily rate.

	Three Months Ended September 30,								
	2023			2022			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Total Portfolio	72.8 %	\$ 305.69	\$ 222.54	71.4 %	\$ 311.62	\$ 222.50	140 bps	(1.9)%	0.0 %

For the nine months ended September 30, 2023, room revenue increased \$55.4 million, or 12.9%, as compared to the nine months ended September 30, 2022 as follows:

- Room revenue at the 14 hotels we owned during the entirety of the first nine months of 2023 and 2022 (the “Existing Portfolio”) increased \$46.9 million. Occupancy increased 720 basis points and the average daily room rate increased 0.2%, resulting in an 11.1% increase in RevPAR.

	Nine Months Ended September 30,								
	2023			2022			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Existing Portfolio	73.6 %	\$ 313.88	\$ 231.02	66.4 %	\$ 313.28	\$ 208.02	720 bps	0.2 %	11.1 %
The Confidante Miami Beach	63.3 %	\$ 292.60	\$ 185.22	N/A	N/A	N/A	N/A	N/A	N/A

- The Confidante Miami Beach caused room revenue to increase by \$11.0 million.
- The Three Disposed Hotels caused room revenue to decrease by \$2.5 million.

Food and beverage revenue. Food and beverage revenue increased \$0.5 million, or 0.8%, for the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, primarily due to increased group demand partially offset by wildfire and renovation disruptions at the Wailea Beach Resort and The Confidante Miami Beach, respectively.

For the nine months ended September 30, 2023, food and beverage revenue increased \$38.9 million, or 22.3%, as compared to the nine months ended September 30, 2022 as follows:

- Food and beverage revenue at the Existing Portfolio increased \$34.1 million.
- The Confidante Miami Beach caused food and beverage revenue to increase by \$5.0 million.
- The Three Disposed Hotels caused food and beverage revenue to decrease by \$0.1 million.

Other operating revenue. Other operating revenue increased \$2.8 million, or 12.4%, for the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, primarily due to an increase in cancellation and attrition fees collected from groups who either did not perform at their contracted levels or who chose to indefinitely postpone or relocate their events. In addition, facility and resort fees, spa revenue, winery revenue, parking fees and hotel-related interest income increased corresponding to the increase in occupancy, partially offset by decreased contract commissions and retail revenue.

For the nine months ended September 30, 2023, other operating revenue increased \$5.0 million, or 7.8%, as compared to the nine months ended September 30, 2022 as follows:

- Other operating revenue at the Existing Portfolio increased \$4.1 million, primarily due to the increase in occupancy which resulted in increased revenue from facility and resort fees, parking fees, winery revenue, hotel-related interest income, spa revenue, tenant rent, and internet usage fees. These increases were partially offset by decreased COVID-19-related cancellation and attrition fees and contract commissions. In addition, other operating revenue in the first nine months of 2023 and 2022 included \$0.5 million and \$1.0 million, respectively, in business interruption proceeds at the Hilton New Orleans St. Charles related to Hurricane Ida disruption.
- The Confidante Miami Beach caused other operating revenue to increase by \$1.6 million.
- The Three Disposed Hotels caused other operating revenue to decrease by \$0.6 million.

Hotel operating expenses. Hotel operating expenses, which are comprised of room, food and beverage, advertising and promotion, repairs and maintenance, utilities, franchise costs, property tax, ground lease and insurance and other hotel operating expenses increased \$5.9 million, or 4.0%, for the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, primarily corresponding to the increases in revenues and occupancy rates, along with increased property and liability insurance and property taxes. In addition, utility expenses increased due to increases in the cost of natural gas and electricity.

For the nine months ended September 30, 2023, hotel operating expenses increased \$56.1 million, or 14.1%, as compared to the nine months ended September 30, 2022 as follows:

- Hotel operating expenses at the Existing Portfolio increased \$50.2 million, primarily corresponding to the increases in the Existing Portfolio’s revenues and occupancy rates, along with increased property and liability insurance and property taxes. In addition, utility expenses at the Existing Portfolio increased due to increases in the cost of natural gas and electricity. Partially offsetting these increased expenses, repairs and maintenance expenses decreased as our New Orleans hotels recognized \$1.6 million in Hurricane Ida-related restoration expenses in the first nine months of 2022, with no corresponding expense recognized in the first nine months of 2023.
- The Confidante Miami Beach caused hotel operating expenses to increase by \$10.3 million.

- The Three Disposed Hotels caused hotel operating expenses to decrease by \$4.5 million.

Other property-level expenses. Other property-level expenses remained relatively constant for the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, as increased payroll and related expenses and supply expenses were offset by decreased employee recruiting and training expenses and credit card commissions.

For the nine months ended September 30, 2023, other property-level expenses increased \$9.3 million, or 11.2%, as compared to the nine months ended September 30, 2022 as follows:

- Other property-level expenses at the Existing Portfolio increased \$7.6 million, including a \$3.5 million increase in management fees related to increases in the Existing Portfolio's revenues. Additional increases to other property-level expenses at the Existing Portfolio included payroll and related expenses, credit card commissions, supply expenses, travel expenses, license and permit fees and employee recruiting and training expenses. These increased expenses were partially offset by decreased contract and professional fees.
- The Confidante Miami Beach caused other property-level expenses to increase by \$2.5 million.
- The Three Disposed Hotels caused other property-level expenses to decrease by \$0.8 million.

Corporate overhead expense. Corporate overhead expense decreased \$0.8 million, or 9.5%, during the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, primarily due to decreased payroll and related expenses, due diligence expenses, office rent expense due to the relocation of our corporate office in January 2023, professional fees and recruitment expenses. These decreased expenses were partially offset by increased deferred stock amortization expense and entity-level state franchise and minimum taxes.

For the nine months ended September 30, 2023, corporate overhead expense decreased \$3.3 million, or 12.2%, as compared to the nine months ended September 30, 2022, primarily due to decreased payroll and related expenses and deferred stock amortization expense related to the chief executive officer transition costs recognized in the first nine months of 2022. Additional decreases to corporate overhead expense included office rent expense due to the relocation of our corporate office in January 2023, due diligence expenses and professional fees. These decreased expenses were partially offset by increased entity-level state franchise and minimum taxes, board of director expenses and environmental, social and governance expenses.

Depreciation and amortization expense. Depreciation and amortization expense increased \$1.4 million, or 4.5%, during the three months ended September 30, 2023 as compared to the three months ended September 30, 2022 due to increased depreciation and amortization at our newly renovated hotels, partially offset by decreased expense due to fully depreciated assets.

For the nine months ended September 30, 2023, depreciation and amortization expense increased \$3.9 million, or 4.2%, as compared to the nine months ended September 30, 2022 as follows:

- Depreciation and amortization expense related to the Existing Portfolio increased \$2.7 million due to increased depreciation and amortization at our newly renovated hotels, partially offset by decreased expense due to fully depreciated assets.
- The Confidante Miami Beach caused depreciation and amortization expense to increase by \$2.1 million.
- The Three Disposed Hotels resulted in a decrease in depreciation and amortization expense of \$0.9 million.

Interest and other income. Interest and other income totaled \$1.2 million and \$0.3 million for the three months ended September 30, 2023 and 2022, respectively, and \$6.4 million and \$4.8 million for the nine months ended September 30, 2023 and 2022, respectively.

During the third quarters of 2023 and 2022, we recognized interest income of \$1.2 million and \$0.3 million, respectively.

During the first nine months of 2023, we received insurance proceeds of \$3.7 million for Hurricane Ida-related property damage at the Hilton New Orleans St. Charles and recognized interest income of \$2.7 million. During the first nine months of 2022, we received insurance proceeds of \$4.4 million for Hurricane Ida-related property damage at the Hilton New Orleans St. Charles and recognized interest income of \$0.4 million.

Interest expense. We incurred interest expense as follows (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Interest expense on debt and finance lease obligation	\$ 12,623	\$ 8,719	\$ 36,299	\$ 21,252
Noncash interest on derivatives, net	(1,469)	(39)	(3,348)	(2,904)
Amortization of deferred financing costs	740	589	1,960	1,940
Total interest expense	<u>\$ 11,894</u>	<u>\$ 9,269</u>	<u>\$ 34,911</u>	<u>\$ 20,288</u>

Interest expense increased \$2.6 million, or 28.3%, during the three months ended September 30, 2023 as compared to the three months ended September 30, 2022, and \$14.6 million, or 72.1%, during the nine months ended September 30, 2023 as compared to the nine months ended September 30, 2022 as follows:

Interest expense on our debt and finance lease obligation increased \$3.9 million and \$15.0 million in the third quarter and first nine months of 2023, respectively, as compared to the same periods in 2022, primarily due to increased interest on our variable rate debt, our draw of the \$225.0 million available under our third term loan agreement in May 2023 and the additional amounts borrowed under two of our term loans in July 2022. These increases were partially offset due to our repayment of the \$220.0 million loan secured by the Hilton San Diego Bayfront in May 2023, partial repayments of the senior notes in February 2022, decreases in the interest rates on our senior notes due to our exiting the covenant relief period in March 2022, and decreased interest on our finance lease obligation due to our sale of the Hyatt Centric Chicago Magnificent Mile in February 2022.

Noncash changes in the fair market value of our derivatives caused interest expense to decrease \$1.4 million and \$0.4 million in the third quarter and first nine months of 2023, respectively, as compared to the same periods in 2022.

The amortization of deferred financing costs caused interest expense to increase \$0.2 million and a nominal amount in the third quarter and first nine months of 2023, respectively, as compared to the same periods in 2022 due to costs incurred on our third term loan.

Our weighted average interest rate per annum, including our variable rate debt obligations, was approximately 5.8% and 4.4% at September 30, 2023 and 2022, respectively. Approximately 51.2% and 42.4% of our outstanding notes payable had fixed interest rates or had been swapped to fixed interest rates at September 30, 2023 and 2022, respectively.

Gain on sale of assets. Gain on sale of assets totaled zero for both the three and nine months ended September 30, 2023, and zero and \$22.9 million for the three and nine months ended September 30, 2022, respectively. In the first quarter of 2022, we recognized an \$11.3 million gain on the sale of the Hyatt Centric Chicago Magnificent Mile and an \$11.6 million gain on the combined sale of the Embassy Suites Chicago and the Hilton Garden Inn Chicago Downtown/Magnificent Mile.

Gain (loss) on extinguishment of debt, net. Gain (loss) on extinguishment of debt, net totaled a nominal gain and a net loss of \$0.8 million for the three months ended September 30, 2023 and 2022, respectively. During the third quarters of 2023 and 2022, we recognized nominal gains due to reassessments of the remaining Hilton Times Square potential employee-related obligations currently held in escrow. During the third quarter of 2022, we also recognized a loss of \$0.8 million related to lender fees and the accelerated amortization of deferred financing costs associated with our July 2022 Amended Credit Agreement.

For the nine months ended September 30, 2023, gain (loss) on extinguishment of debt, net totaled a gain of \$9.9 million as compared to a net loss of \$1.0 million for the nine months ended September 30, 2022. During the first nine months of 2023, we recognized a gain of \$9.9 million, comprised of \$9.8 million from the relief of the majority of the Hilton Times Square potential employee-related obligations, with the funds released to us from escrow, and \$0.1 million due to reassessments of the remaining potential employee-related obligations currently held in escrow. During the first nine months of 2022, we recognized a loss of \$1.0 million related to lender fees and the accelerated amortization of deferred financing costs associated with our July 2022 Amended Credit Agreement and the February 2022 repayments of a portion of our senior notes. This loss was slightly offset by a nominal gain due to reassessments of the remaining Hilton Times Square potential employee-related obligations currently held in escrow.

Income tax (provision) benefit, net. We lease our hotels to the TRS Lessee and its subsidiaries, which are subject to federal and state income taxes. In addition, we and the Operating Partnership may also be subject to various state and local income taxes.

During the three and nine months ended September 30, 2023, we recognized current income tax provisions of \$0.6 million and \$1.8 million, respectively, resulting from current state and federal income tax expenses.

During the three and nine months ended September 30, 2022, we recognized net current income tax benefits of \$0.3 million and \$0.1 million, respectively. In September 2022, we recognized a state tax credit of \$0.4 million associated with solar improvements at the Wailea Beach Resort. This credit was partially offset by \$0.1 million in current state income tax expense. During the nine months ended September 30, 2022, the Wailea Beach Resort solar tax credit of \$0.4 million was partially offset by \$0.3 million in current state income tax expense.

Income from consolidated joint venture attributable to noncontrolling interest. Income from consolidated joint venture attributable to noncontrolling interest, which represented the outside 25.0% interest in the entity that owned the Hilton San Diego Bayfront, totaled zero for both the three and nine months ended September 30, 2023, and zero and \$3.5 million for the three and nine months ended September 30, 2022, respectively.

In June 2022, we acquired the outside 25.0% interest in the entity that owned the Hilton San Diego Bayfront, resulting in our 100% ownership of the hotel.

Preferred stock dividends. Preferred stock dividends were incurred as follows (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Series G preferred stock	\$ 40	\$ 165	\$ 1,204	\$ 1,339
Series H preferred stock	1,761	1,761	5,283	5,283
Series I preferred stock	1,425	1,425	4,275	4,275
Total preferred stock dividends	<u>\$ 3,226</u>	<u>\$ 3,351</u>	<u>\$ 10,762</u>	<u>\$ 10,897</u>

Non-GAAP Financial Measures. We use the following “non-GAAP financial measures” that we believe are useful to investors as key supplemental measures of our operating performance: EBITDAre; Adjusted EBITDAre, excluding noncontrolling interest; FFO attributable to common stockholders; and Adjusted FFO attributable to common stockholders. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with accounting principles generally accepted in the United States (“GAAP”). In addition, our calculation of these measures may not be comparable to other companies that do not define such terms exactly the same as the Company. These non-GAAP measures are used in addition to and in conjunction with results presented in accordance with GAAP. They should not be considered as alternatives to net income (loss), cash flow from operations, or any other operating performance measure prescribed by GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with our GAAP results and the reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

We present EBITDAre in accordance with guidelines established by the National Association of Real Estate Investment Trusts (“Nareit”), as defined in its September 2017 white paper “Earnings Before Interest, Taxes, Depreciation and Amortization for Real Estate.” We believe EBITDAre is a useful performance measure to help investors evaluate and compare the results of our operations from period to period in comparison to our peers. Nareit defines EBITDAre as net income (calculated in accordance with GAAP) plus interest expense, income tax expense, depreciation and amortization, gains or losses on the disposition of depreciated property (including gains or losses on change in control), impairment write-downs of depreciated property and of investments in unconsolidated affiliates caused by a decrease in the value of depreciated property in the affiliate, and adjustments to reflect the entity’s share of EBITDAre of unconsolidated affiliates.

We make additional adjustments to EBITDAre when evaluating our performance because we believe that the exclusion of certain additional items described below provides useful information to investors regarding our operating performance, and that the presentation of Adjusted EBITDAre, excluding noncontrolling interest, when combined with the primary GAAP presentation of net income, is beneficial to an investor’s complete understanding of our operating performance. In addition, we use both EBITDAre and Adjusted EBITDAre, excluding noncontrolling interest as measures in determining the value of hotel acquisitions and dispositions. We adjust EBITDAre for the following items, which may occur in any period, and refer to this measure as Adjusted EBITDAre, excluding noncontrolling interest:

- *Amortization of deferred stock compensation:* we exclude the noncash expense incurred with the amortization of deferred stock compensation as this expense is based on historical stock prices at the date of grant to our corporate employees and does not reflect the underlying performance of our hotels.
- *Amortization of contract intangibles:* we exclude the noncash amortization of any favorable or unfavorable contract intangibles recorded in conjunction with our hotel acquisitions. We exclude the noncash amortization of contract

intangibles because it is based on historical cost accounting and is of lesser significance in evaluating our actual performance for the current period.

- *Amortization of right-of-use assets and obligations:* we exclude the amortization of our right-of-use assets and related lease obligations, as these expenses are based on historical cost accounting and do not reflect the actual rent amounts due to the respective lessors or the underlying performance of our hotels.
- *Finance lease obligation interest – cash ground rent:* we include an adjustment for the cash finance lease expense recorded on the building lease at the Hyatt Centric Chicago Magnificent Mile (prior to the hotel's sale in February 2022). We determined that the building lease was a finance lease, and, therefore, we included a portion of the lease payment each month in interest expense. We adjusted EBITDAre for the finance lease in order to more accurately reflect the actual rent due to the hotel's lessor in the respective period, as well as the operating performance of the hotel.
- *Undepreciated asset transactions:* we exclude the effect of gains and losses on the disposition of undepreciated assets because we believe that including them in Adjusted EBITDAre, excluding noncontrolling interest is not consistent with reflecting the ongoing performance of our assets.
- *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired because, like interest expense, their removal helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure.
- *Noncontrolling interest:* we exclude the noncontrolling partner's pro rata share of the net (income) loss allocated to the Hilton San Diego Bayfront partnership prior to our acquisition of the noncontrolling partner's interest in June 2022, as well as the noncontrolling partner's pro rata share of any EBITDAre and Adjusted EBITDAre components.
- *Cumulative effect of a change in accounting principle:* from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting principle. We exclude these one-time adjustments, which include the accounting impact from prior periods, because they do not reflect our actual performance for that period.
- *Other adjustments:* we exclude other adjustments that we believe are outside the ordinary course of business because we do not believe these costs reflect our actual performance for the period and/or the ongoing operations of our hotels. Such items may include: lawsuit settlement costs; the write-off of development costs associated with abandoned projects; property-level restructuring, severance and management transition costs; debt resolution costs; lease terminations; property insurance restoration proceeds or uninsured losses; and other nonrecurring identified adjustments.

The following table reconciles our unaudited net income to EBITDAre and Adjusted EBITDAre, excluding noncontrolling interest for our total portfolio for the three and nine months ended September 30, 2023 and 2022 (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Net income	\$ 15,558	\$ 20,488	\$ 79,723	\$ 73,303
Operations held for investment:				
Depreciation and amortization	33,188	31,750	97,927	94,003
Interest expense	11,894	9,269	34,911	20,288
Income tax provision (benefit), net	602	(290)	1,763	(126)
Gain on sale of assets	—	—	—	(22,946)
EBITDAre	<u>61,242</u>	<u>61,217</u>	<u>214,324</u>	<u>164,522</u>
Operations held for investment:				
Amortization of deferred stock compensation	2,511	2,230	8,263	8,661
Amortization of right-of-use assets and obligations	(13)	(350)	(82)	(1,050)
Amortization of contract intangibles, net	(19)	(19)	(55)	(43)
Finance lease obligation interest — cash ground rent	—	—	—	(117)
(Gain) loss on extinguishment of debt, net	(9)	770	(9,930)	962
Hurricane-related insurance restoration proceeds net of losses	—	—	(3,722)	(2,755)
Noncontrolling interest	—	—	—	(5,175)
Adjustments to EBITDAre, net	<u>2,470</u>	<u>2,631</u>	<u>(5,526)</u>	<u>483</u>
Adjusted EBITDAre, excluding noncontrolling interest	<u>\$ 63,712</u>	<u>\$ 63,848</u>	<u>\$ 208,798</u>	<u>\$ 165,005</u>

Adjusted EBITDAre, excluding noncontrolling interest decreased \$0.1 million, or 0.2%, in the third quarter of 2023 as compared to the same period in 2022, primarily due to a decrease of \$2.5 million, or 3.6%, in Adjusted EBITDAre at the Company's hotels associated with the changes in the hotels' revenues and expenses included in the discussion above regarding the operating results for the third quarter of 2023.

Adjusted EBITDAre, excluding noncontrolling interest increased \$43.8 million, or 26.5%, in the first nine months of 2023 as compared to the same period in 2022 due to the following:

- Adjusted EBITDAre at the Existing Portfolio increased \$25.9 million, or 13.7%, primarily due to the changes in the Existing Portfolio's revenues and expenses included in the discussion above regarding the operating results for the first nine months of 2023.
- The Confidante Miami Beach recorded Adjusted EBITDAre of \$6.1 million in the first nine months of 2023, and \$1.3 million in the first nine months of 2022.
- The Three Disposed Hotels recorded net negative Adjusted EBITDAre of \$2.2 million in the first nine months of 2022.

We believe that the presentation of FFO attributable to common stockholders provides useful information to investors regarding our operating performance because it is a measure of our operations without regard to specified noncash items such as real estate depreciation and amortization, any real estate impairment loss and any gain or loss on sale of real estate assets, all of which are based on historical cost accounting and may be of lesser significance in evaluating our current performance. Our presentation of FFO attributable to common stockholders conforms to the Nareit definition of "FFO applicable to common shares." Our presentation may not be comparable to FFO reported by other REITs that do not define the terms in accordance with the current Nareit definition, or that interpret the current Nareit definition differently than we do.

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

- *Amortization of deferred stock compensation:* we exclude the noncash expense incurred with the amortization of deferred stock compensation as this expense is based on historical stock prices at the date of grant to our corporate employees and does not reflect the underlying performance of our hotels.
- *Amortization of contract intangibles:* we exclude the noncash amortization of any favorable or unfavorable contract intangibles recorded in conjunction with our hotel acquisitions. We exclude the noncash amortization of contract intangibles because it is based on historical cost accounting and is of lesser significance in evaluating our actual performance for the current period.

- *Real estate amortization of right-of-use assets and obligations:* we exclude the amortization of our real estate right-of-use assets and related lease obligations, which includes the amortization of both our finance and operating lease intangibles (with the exception of our corporate operating lease), as these expenses are based on historical cost accounting and do not reflect the actual rent amounts due to the respective lessors or the underlying performance of our hotels.
- *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired, as well as the noncash interest on our derivatives and finance lease obligation. We believe that these items are not reflective of our ongoing finance costs.
- *Noncontrolling interest:* we deduct the noncontrolling partner's pro rata share of any FFO adjustments related to our consolidated Hilton San Diego Bayfront partnership prior to our acquisition of the noncontrolling partner's interest in June 2022.
- *Cumulative effect of a change in accounting principle:* from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting principle. We exclude these one-time adjustments, which include the accounting impact from prior periods, because they do not reflect our actual performance for that period.
- *Other adjustments:* we exclude other adjustments that we believe are outside the ordinary course of business because we do not believe these costs reflect our actual performance for that period and/or the ongoing operations of our hotels. Such items may include: lawsuit settlement costs; the write-off of development costs associated with abandoned projects; changes to deferred tax assets, liabilities or valuation allowances; property-level restructuring, severance and management transition costs; debt resolution costs; preferred stock redemption charges; lease terminations; property insurance restoration proceeds or uninsured losses; income tax benefits or provisions associated with the application of net operating loss carryforwards, uncertain tax positions or with the sale of assets other than real estate investments; and other nonrecurring identified adjustments.

The following table reconciles our unaudited net income to FFO attributable to common stockholders and Adjusted FFO attributable to common stockholders for our total portfolio for the three and nine months ended September 30, 2023 and 2022 (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2023</u>	<u>2022</u>	<u>2023</u>	<u>2022</u>
Net income	\$ 15,558	\$ 20,488	\$ 79,723	\$ 73,303
Preferred stock dividends	(3,226)	(3,351)	(10,762)	(10,897)
Operations held for investment:				
Real estate depreciation and amortization	33,025	31,313	97,456	92,796
Gain on sale of assets	—	—	—	(22,946)
Noncontrolling interest	—	—	—	(4,933)
FFO attributable to common stockholders	<u>45,357</u>	<u>48,450</u>	<u>166,417</u>	<u>127,323</u>
Operations held for investment:				
Amortization of deferred stock compensation	2,511	2,230	8,263	8,661
Real estate amortization of right-of-use assets and obligations	(124)	(288)	(371)	(868)
Amortization of contract intangibles, net	84	141	252	344
Noncash interest on derivatives, net	(1,469)	(39)	(3,348)	(2,904)
(Gain) loss on extinguishment of debt, net	(9)	770	(9,930)	962
Hurricane-related insurance restoration proceeds net of losses	—	—	(3,722)	(2,755)
Noncontrolling interest	—	—	—	132
Adjustments to FFO attributable to common stockholders, net	<u>993</u>	<u>2,814</u>	<u>(8,856)</u>	<u>3,572</u>
Adjusted FFO attributable to common stockholders	<u>\$ 46,350</u>	<u>\$ 51,264</u>	<u>\$ 157,561</u>	<u>\$ 130,895</u>

Adjusted FFO attributable to common stockholders decreased \$4.9 million, or 9.6%, and increased \$26.7 million, or 20.4%, in the third quarter and first nine months of 2023, respectively, as compared to the same periods in 2022 primarily due to the same reasons noted in the discussion above regarding Adjusted EBITDAre, excluding noncontrolling interest.

Liquidity and Capital Resources

During the periods presented, our sources of cash included our operating activities and working capital, as well as proceeds from hotel dispositions, our credit facility and term loans, and business interruption and property insurance. Our primary uses of cash were for capital expenditures for hotels and other assets, acquisitions of hotels and other assets, operating expenses, repurchases of our common stock, repayments of notes payable and our credit facility and dividends and distributions on our preferred and common stock. We cannot be certain that traditional sources of funds will be available in the future.

Operating activities. Our net cash provided by or used in operating activities fluctuates primarily as a result of changes in hotel revenue and the operating cash flow of our hotels. Our net cash provided by or used in operating activities may also be affected by changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. Net cash provided by operating activities was \$168.7 million for the nine months ended September 30, 2023 as compared to \$149.7 million for the nine months ended September 30, 2022. The net increase in cash provided by operating activities during the first nine months of 2023 as compared to the same period in 2022 was primarily due to the increase in travel demand benefiting our hotels and additional operating cash provided by the newly-acquired The Confidante Miami Beach, partially offset by a decrease in operating cash caused by the sales of the Three Disposed Hotels.

Investing activities. Our net cash provided by or used in investing activities fluctuates primarily as a result of acquisitions, dispositions and renovations of hotels and other assets. Net cash used in investing activities during the first nine months of 2023 as compared to the first nine months of 2022 was as follows (in thousands):

	Nine Months Ended September 30,	
	2023	2022
Proceeds from sales of assets	\$ —	\$ 191,291
Disposition deposit	10,000	—
Proceeds from property insurance	3,722	4,369
Acquisitions of hotel properties and other assets	—	(232,506)
Renovations and additions to hotel properties and other assets	(73,944)	(97,539)
Net cash used in investing activities	\$ (60,222)	\$ (134,385)

During the first nine months of 2023, we received a disposition deposit of \$10.0 million from the buyer of the Boston Park Plaza, which we sold in October 2023, and we received insurance proceeds of \$3.7 million for hurricane-related property damage at the Hilton New Orleans St. Charles. These cash inflows were offset by \$73.9 million invested for renovations and additions to our portfolio and other assets.

During the first nine months of 2022, we received total proceeds of \$191.3 million from our sales of the Three Disposed Hotels, consisting of \$63.2 million for the Hyatt Centric Chicago Magnificent Mile (having already received a \$4.0 million disposition deposit in December 2021) and \$128.1 million for the Embassy Suites Chicago and the Hilton Garden Inn Chicago Downtown/Magnificent Mile. In addition, we received insurance proceeds of \$4.4 million for hurricane-related property damage at the Hilton New Orleans St. Charles. These cash inflows were offset by \$232.5 million paid to acquire hotel properties and other assets, consisting of \$232.0 million for The Confidante Miami Beach, including closing costs and prorations, and \$0.5 million paid to acquire additional wet and dry boat slips at the Oceans Edge Resort & Marina. In addition, we invested \$97.5 million for renovations and additions to our portfolio and other assets.

Financing activities. Our net cash provided by or used in financing activities fluctuates primarily as a result of our dividends and distributions paid, issuance and repurchase of common stock, issuance and repayment of notes payable and our credit facility and issuance and redemption of other forms of capital, including preferred equity. Net cash used in financing activities during the first nine months of 2023 as compared to the first nine months of 2022 was as follows (in thousands):

	Nine Months Ended September 30,	
	2023	2022
Acquisition of noncontrolling interest, including transaction costs	\$ (299)	\$ (101,348)
Payment of common stock offering costs	(428)	(91)
Repurchases of outstanding common stock	(35,523)	(86,646)
Repurchases of common stock for employee tax obligations	(3,348)	(3,351)
Proceeds from credit facility	—	230,000
Payment on credit facility	—	(230,000)
Proceeds from note payable	225,000	243,615
Payments on notes payable	(221,554)	(38,405)
Payments of deferred financing costs	(2,332)	(7,404)
Dividends and distributions paid	(42,246)	(11,059)
Distribution to noncontrolling interest	—	(5,500)
Net cash used in financing activities	<u>\$ (80,730)</u>	<u>\$ (10,189)</u>

During the first nine months of 2023, we paid an additional \$0.3 million to true-up the total acquisition cost of the outside 25.0% equity interest in the entity that owns the Hilton San Diego Bayfront and \$0.4 million in common stock offering costs related to our shelf registration statement. In addition, we paid \$35.5 million to repurchase 3,827,759 shares of our outstanding common stock, \$3.3 million to repurchase common stock to satisfy the tax obligations in connection with the vesting of restricted common stock issued to employees, and \$42.2 million in dividends and distributions to our preferred and common stockholders. We also entered into a term loan agreement, receiving \$225.0 million in proceeds and paying \$2.3 million in related deferred financing costs. We utilized the proceeds received from the term loan to repay the \$220.0 million loan secured by the Hilton San Diego Bayfront. We also paid \$1.6 million in scheduled principal payments on our notes payable.

During the first nine months of 2022, we paid \$101.3 million to acquire the outside 25.0% equity interest in the entity that owns the Hilton San Diego Bayfront, \$86.6 million to repurchase 7,995,560 shares of our outstanding common stock and \$0.1 million in common stock offering costs related to restricted common stock issued to employees. We also paid \$3.4 million to repurchase common stock to satisfy the tax obligations in connection with the vesting of restricted common stock issued to employees, \$11.1 million in dividends and distributions to our preferred and common stockholders and \$5.5 million in distributions to our former joint venture partner. In July 2022, we entered into the Amended Credit Agreement and received \$243.6 million in proceeds associated with additional borrowing on our two term loans. We utilized the proceeds received from the incremental borrowing on the term loans to fully repay the \$230.0 million we drew on our credit facility in the second quarter of 2022. In addition, we paid \$38.4 million in principal payments on our notes payable, including \$35.0 million to repay a portion of our senior notes, \$1.5 million in scheduled principal payments on our notes payable and \$1.9 million in principal payments associated with our Amended Credit Agreement, and we paid \$7.4 million in deferred financing costs related to the Amended Credit Agreement.

Future. We expect our primary sources of cash will continue to be our working capital, credit facility, additional issuances of notes payable, dispositions of hotel properties, including our sale of the Boston Park Plaza in October 2023 for gross proceeds of \$370.0 million, and proceeds from offerings of debt securities and common and preferred stock. However, there can be no assurance that our future asset sales will be successfully completed. As a result of rising inflation rates and interest rates, as well as a possible recession in 2024, certain sources of capital may not be as readily available to us as they have in the past or may only be available at higher costs.

We expect our primary uses of cash to be for operating expenses, capital investments in our hotels, repayment of principal on our notes payable and credit facility, interest expense, repurchases of our common stock, distributions on our common stock, dividends on our preferred stock and acquisitions of hotels or interests in hotels.

The recent increases in inflation and interest rates have had, and we expect will continue to have, a negative effect on our operations. We have experienced increases in wages, employee-related benefits, food costs, commodity costs, including those used to renovate or reposition our hotels, property taxes, property and liability insurance, utilities and borrowing costs. The ability of our hotel operators to adjust rates has mitigated the impact of increased operating costs on our financial position and results of operations. However, the increases in interest rates are negatively affecting our variable rate debt, resulting in increased interest payments.

Cash Balance. As of September 30, 2023, our unrestricted cash balance was \$113.8 million. We believe that our current unrestricted cash balance and our ability to draw the \$500.0 million capacity available for borrowing under the unsecured revolving credit facility will enable us to successfully manage our Company.

Debt. As of September 30, 2023, we had \$819.6 million of debt, \$185.0 million of cash and cash equivalents, including restricted cash, and total assets of \$3.1 billion. We believe that by maintaining appropriate debt levels, staggering maturity dates and maintaining a highly flexible structure, we will have lower capital costs than more highly leveraged companies, or companies with limited flexibility due to restrictive corporate-level financial covenants.

As of September 30, 2023, we had no amount outstanding under the revolving portion of our credit facility, with \$500.0 million of capacity available for additional borrowing under the facility. The Company's ability to draw on the credit facility is subject to the Company's compliance with various financial covenants.

As of September 30, 2023, 51.2% of our outstanding debt had fixed interest rates or had been swapped to fixed interest rates, including the loan secured by the JW Marriott New Orleans, unsecured corporate-level Term Loan 1 and two unsecured corporate-level senior notes. In March 2023, we entered into two interest rate swaps on Term Loan 1, the first of which was effective March 17, 2023, expires March 17, 2026, and fixes the SOFR rate on \$75.0 million of Term Loan 1 to 3.675%, and the second of which was effective September 14, 2023, expires September 14, 2026 and fixes the SOFR rate on the remaining \$100.0 million of Term Loan 1 to 3.931%.

The Company's floating rate debt as of September 30, 2023 included the \$175.0 million unsecured corporate-level Term Loan 2, which was subject to an interest rate swap derivative until the derivative matured in January 2023, and the \$225.0 million unsecured corporate-level Term Loan 3.

We may in the future seek to obtain mortgages on one or more of our 14 unencumbered hotels (subject to certain stipulations under our unsecured term loans and senior notes), all of which were held by subsidiaries whose interests were pledged to our credit facility as of September 30, 2023. Following the sale of the Boston Park Plaza in October 2023, we will have 13 unencumbered hotels. Should we obtain secured financing on any of our unencumbered hotels, the amount of capital available through our credit facility or future unsecured borrowings may be reduced.

Contractual Obligations. The following table summarizes our payment obligations and commitments as of September 30, 2023 (in thousands):

	Payment due by period				
	Total	Less Than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Notes payable (1)	\$ 819,582	\$ 2,145	\$ 362,437	\$ 455,000	\$ —
Interest obligations on notes payable (1) (2)	170,638	48,544	86,981	35,113	—
Operating lease obligations, including imputed interest (3) (4)	17,352	5,665	8,382	1,942	1,363
Construction commitments	40,424	40,424	—	—	—
Total	<u>\$ 1,047,996</u>	<u>\$ 96,778</u>	<u>\$ 457,800</u>	<u>\$ 492,055</u>	<u>\$ 1,363</u>

- (1) Notes payable and interest obligations on notes payable include the \$225.0 million unsecured Term Loan 3 assuming the Company has exercised its one-time option to extend the maturity of the loan from May 1, 2025 to May 1, 2026 upon payment of applicable fees and the satisfaction of certain customary conditions.
- (2) Interest is calculated based on the loan balances and variable rates, as applicable, at September 30, 2023, and includes the effect of our interest rate derivatives.
- (3) Operating lease obligations include the lease on our current corporate headquarters and the sublease on our previous corporate headquarters.
- (4) Operating lease obligations include a ground lease that expires in 2071 and requires a reassessment of rent payments due after 2025, agreed upon by both us and the lessor; therefore, no amounts are included in the above table for this ground lease after 2025.

Capital Expenditures and Reserve Funds

We believe we maintain each of our hotels in good repair and condition and in general conformity with applicable franchise and management agreements, ground lease, laws and regulations. Our capital expenditures primarily relate to the ongoing maintenance of our hotels and are budgeted in the reserve accounts described in the following paragraph. We also incur capital expenditures for cyclical renovations, hotel repositionings and development. We invested \$73.9 million in our portfolio and other assets during the first nine months of 2023. As of September 30, 2023, we have contractual construction commitments totaling \$40.4 million for ongoing renovations. During the remainder of 2023 and the majority of 2024, we will continue to incur significant capital expenditures as we complete a substantial renovation and rebranding of The Confidante Miami Beach to Andaz Miami Beach. If we renovate additional hotels in the future, our capital expenditures will likely increase.

With respect to our hotels that are operated under management or franchise agreements with major national hotel brands and our hotel subject to a first mortgage lien, we are obligated to maintain an FF&E reserve account for future planned and emergency-related capital expenditures at these hotels. The amount funded into each of these reserve accounts is determined pursuant to the management, franchise and loan agreements for each of the respective hotels, ranging between 1.0% and 5.0% of the respective hotel's applicable annual revenue. As of September 30, 2023, our balance sheet includes restricted cash of \$60.9 million, which was held in FF&E reserve accounts for future capital expenditures at the majority of our hotels. According to certain loan agreements, reserve funds are to be held by the lenders or managers in restricted cash accounts, and we are not required to spend the entire amount in such reserve accounts each year.

Seasonality and Volatility

As is typical of the lodging industry, we experience some seasonality in our business. Revenue for certain of our hotels is generally affected by seasonal business patterns (*e.g.*, the first quarter is strong in Florida, Hawaii and New Orleans, the second quarter is strong for the Mid-Atlantic business hotels, both the second and third quarters are strong for the Northern California counties of Napa and Sonoma and the fourth quarter is strong for Hawaii and Key West). Quarterly revenue also may be adversely affected by renovations and repositionings, our managers' effectiveness in generating business and by events beyond our control, such as economic and business conditions, including a U.S. recession or increased inflation, trade conflicts and tariffs, changes impacting global travel, regional or global economic slowdowns, any flu or disease-related pandemic that impacts travel or the ability to travel, the adverse effects of climate change, the threat of terrorism, terrorist events, civil unrest, government shutdowns, events that reduce the capacity or availability of air travel, increased competition from other hotels in our markets, new hotel supply or alternative lodging options and unexpected changes in business, commercial travel, leisure travel and tourism.

Inflation

Inflation affects our expenses, including, without limitation, by increasing such costs as wages, employee-related benefits, food costs, commodity costs, including those used to renovate or reposition our hotels, property taxes, property and liability insurance, utilities and borrowing costs. We rely on our hotel operators to adjust room rates and pricing for hotel services to reflect the effects of inflation. However, previously contracted rates, competitive pressures or other factors may limit the ability of our operators to respond to inflation. As a result, our hotel expenses may increase at higher rates than hotel revenue.

Critical Accounting Estimates

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

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

- ***Impairment of investments in hotel properties.*** Impairment losses are recorded on investments in hotel properties to be held and used by us when indicators of impairment are present and the future undiscounted net cash flows, including potential sale proceeds, expected to be generated by those assets, based on our anticipated investment horizon, are less than the assets' carrying amount. We evaluate our investments in hotel properties to determine if there are indicators of impairment on a quarterly basis. No single indicator would necessarily result in us preparing an estimate to determine if a hotel's future undiscounted cash flows are less than the carrying value of the hotel. We use judgment to determine if the severity of any single indicator, or the fact there are a number of indicators of less severity that when combined, would result in an indication that a hotel requires an estimate of the undiscounted cash flows to determine if an impairment has occurred. The Company considers indicators of impairment such as, but not limited to, hotel disposition strategy and hold

period, a significant decline in operating results not related to renovations or repositioning, physical damage to the property due to unforeseen events such as natural disasters, and other market and economic conditions. If the Company determines that an indicator of impairment is present, the Company performs an analysis to determine the recoverability of the hotel by comparing the future undiscounted cash flows expected to be generated by the hotel to the hotel's carrying amount.

If a hotel is considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment loss is recognized. We perform a fair value assessment using valuation techniques such as discounted cash flows and comparable sales transactions in the market to estimate the fair value of the hotel and, if appropriate and available, current estimated net sales proceeds from pending offers. Our judgment is required in determining the discount rate, terminal capitalization rate, the estimated growth of revenues and expenses, revenue per available room and margins, as well as specific market and economic conditions.

- **Acquisition related assets and liabilities.** The acquisition of a hotel property or other entity requires an analysis of the transaction to determine if it qualifies as the purchase of a business or an asset. If the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the transaction is an asset acquisition. Transaction costs associated with asset acquisitions are capitalized and subsequently depreciated over the life of the related asset, while the same costs associated with a business combination are expensed as incurred and included in corporate overhead on our consolidated statements of operations. Also, given the subjectivity, business combinations are provided a one-year measurement period to adjust the provisional amounts recognized if the necessary information is not available by the end of the reporting period in which the acquisition occurs; whereas asset acquisitions are not subject to a measurement period.

Accounting for the acquisition of a hotel property or other entity requires either allocating the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective relative fair values for an asset acquisition or recording the assets and liabilities at their estimated fair values with any excess consideration above net assets going to goodwill for a business combination. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment and intangible assets, together with any finance or operating lease right-of-use assets and their related obligations. When we acquire a hotel property or other entity, we use all available information to make these fair value determinations, including discounted cash flow analyses, market comparable data and replacement cost data. In addition, we make significant estimations regarding capitalization rates, discount rates, average daily rates, revenue growth rates and occupancy. We also engage independent valuation specialists to assist in the fair value determinations of the long-lived assets acquired and the liabilities assumed. The determination of fair value is subjective and is based in part on assumptions and estimates that could differ materially from actual results in future periods.

- **Depreciation and amortization expense.** Depreciation expense is based on the estimated useful life of our assets. The life of the assets is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish our hotels, as well as specific market and economic conditions. Hotel properties are depreciated using the straight-line method over estimated useful lives primarily ranging from five years to forty years for buildings and improvements and three years to twelve years for FF&E. Intangible assets are amortized using the straight-line method over the shorter of their estimated useful life or the length of the related agreement. While we believe our estimates are reasonable, a change in the estimated lives could affect depreciation expense and net income or the gain or loss on the sale of any of our hotels. We have not changed the useful lives of any of our assets during the periods discussed.
- **Income Taxes.** To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we currently distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and excluding net capital gains) to our stockholders. As a REIT, we generally will not be subject to federal corporate income tax on that portion of our taxable income that is currently distributed to stockholders. We are subject to certain state and local taxes on our income and property, and to federal income and excise taxes on our undistributed taxable income. In addition, our wholly owned TRS, which leases our hotels from the Operating Partnership, is subject to federal and state income taxes. We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and for net operating loss, capital loss and tax credit carryforwards. The deferred tax assets and liabilities are measured using the enacted income tax rates in effect for the year in which those temporary differences are expected to be realized or settled. The effect on the deferred tax assets and liabilities from a change in tax rates is recognized in earnings in the period when the new rate is enacted. 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 all available evidence, including the future reversals of existing taxable temporary differences, future projected taxable income and tax planning strategies. Valuation allowances

are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

We review any uncertain tax positions and, if necessary, we will record the expected future tax consequences of uncertain tax positions in the consolidated financial statements. Tax positions not deemed to meet the “more-likely-than-not” threshold are recorded as a tax benefit or expense in the current year. We are required to analyze all open tax years, as defined by the statute of limitations, for all major jurisdictions, which includes federal and certain states.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

As of September 30, 2023, 51.2% of our debt obligations were fixed in nature or were subject to interest rate swap derivatives, which mitigates the effect of changes in interest rates on our cash interest payments. If the market rate of interest on our variable rate debt increases or decreases by 50 basis points, annual interest expense would increase or decrease, respectively, our future consolidated earnings and cash flows by approximately \$2.0 million based on the variable rates at September 30, 2023.

Item 4. Controls and Procedures

Attached as exhibits to this Form 10-Q are the certifications required by Rule 13a-14 of the Securities Exchange Act of 1934, as amended. This section includes information concerning the controls and control evaluations referred to in the certifications.

Evaluation of Disclosure Controls and Procedures. Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the Securities and Exchange Commission and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. During our fiscal quarter to which this Quarterly Report on Form 10-Q relates, there has not occurred any change in our internal control over financial reporting 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, Use of Proceeds and Issuer Purchases of Equity Securities

(c) Issuer Purchases of Equity Securities

In February 2023, the Company's board of directors reauthorized the existing stock repurchase program and restored the \$500.0 million amount of aggregate common and preferred stock allowed to be repurchased under the program. During the three months ended September 30, 2023, the Company repurchased 1,561,375 shares of its common stock for a total purchase price of \$14.0 million, including fees and commissions, leaving \$475.5 million remaining under the stock repurchase program. The stock repurchase program has no stated expiration date. Future repurchases will depend on various factors, including the Company's capital needs and restrictions under its various financing agreements, as well as the price of the Company's common and preferred stock.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 1, 2023 - July 31, 2023	—		—	\$ 489,542,164
August 1, 2023 - August 31, 2023	1,079,762	\$ 8.96	1,079,762	\$ 479,868,577
September 1, 2023 - September 30, 2023	481,613	\$ 9.01	481,613	\$ 475,531,290
Total	1,561,375	\$ 8.97	1,561,375	\$ 475,531,290

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

- (a) None.
- (b) None.
- (c) During the quarter ended September 30, 2023, no director or officer of the Company adopted or terminated a "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement" as each such term is defined in Item 408(a) of Regulation S-K.

Item 6. Exhibits

The following Exhibits are filed as a part of this report:

Exhibit Number	Description
3.1	Articles of Amendment and Restatement of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 3.1 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
3.2	Third Amended and Restated Bylaws of Sunstone Hotel Investors, Inc. effective as of February 9, 2023 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed by the Company on February 10, 2023).
3.3	Articles Supplementary Prohibiting the Company From Electing to be Subject to Section 3-803 of the Maryland General Corporation Law Absent Shareholder Approval (incorporated by reference to Exhibit 3.1 to Form 8-K, filed by the Company on April 29, 2013).
3.4	Articles Supplementary for Series G preferred stock (incorporated by reference to Exhibit 3.1 to Form 8-K, filed by the Company on April 28, 2021).
3.5	Articles Supplementary for Series H preferred stock (incorporated by reference to Exhibit 3.3 to the registration statement on Form 8-A, filed by the Company on May 20, 2021).
3.6	Articles Supplementary for Series I preferred stock (incorporated by reference to Exhibit 3.3 to the registration statement on Form 8-A, filed by the company on July 15, 2021).
3.7	Eighth Amended and Restated Limited Liability Agreement of Sunstone Hotel Partnership LLC (incorporated by reference to Exhibit 3.2 to Form 8-K, filed by the Company on July 16, 2021).
31.1	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
31.2	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
32.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
101.INS	XBRL Instance Document - The instance document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL document.*
101.SCH	Inline XBRL Taxonomy Extension Schema Document. *
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document. *
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document. *
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document. *
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document. *
104	Cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2023 formatted in Inline XBRL (included in Exhibit 101).

* Filed herewith.

Management contract or compensatory plan or arrangement.

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.

Sunstone Hotel Investors, Inc.

Date: November 7, 2023

By: /s/ Aaron R. Reyes
Aaron R. Reyes
(Chief Financial Officer and Duly Authorized Officer)