

TWO-THOUSAND AND TWELVE
ANNUAL REPORT



SUNSTONE
HOTEL INVESTORS

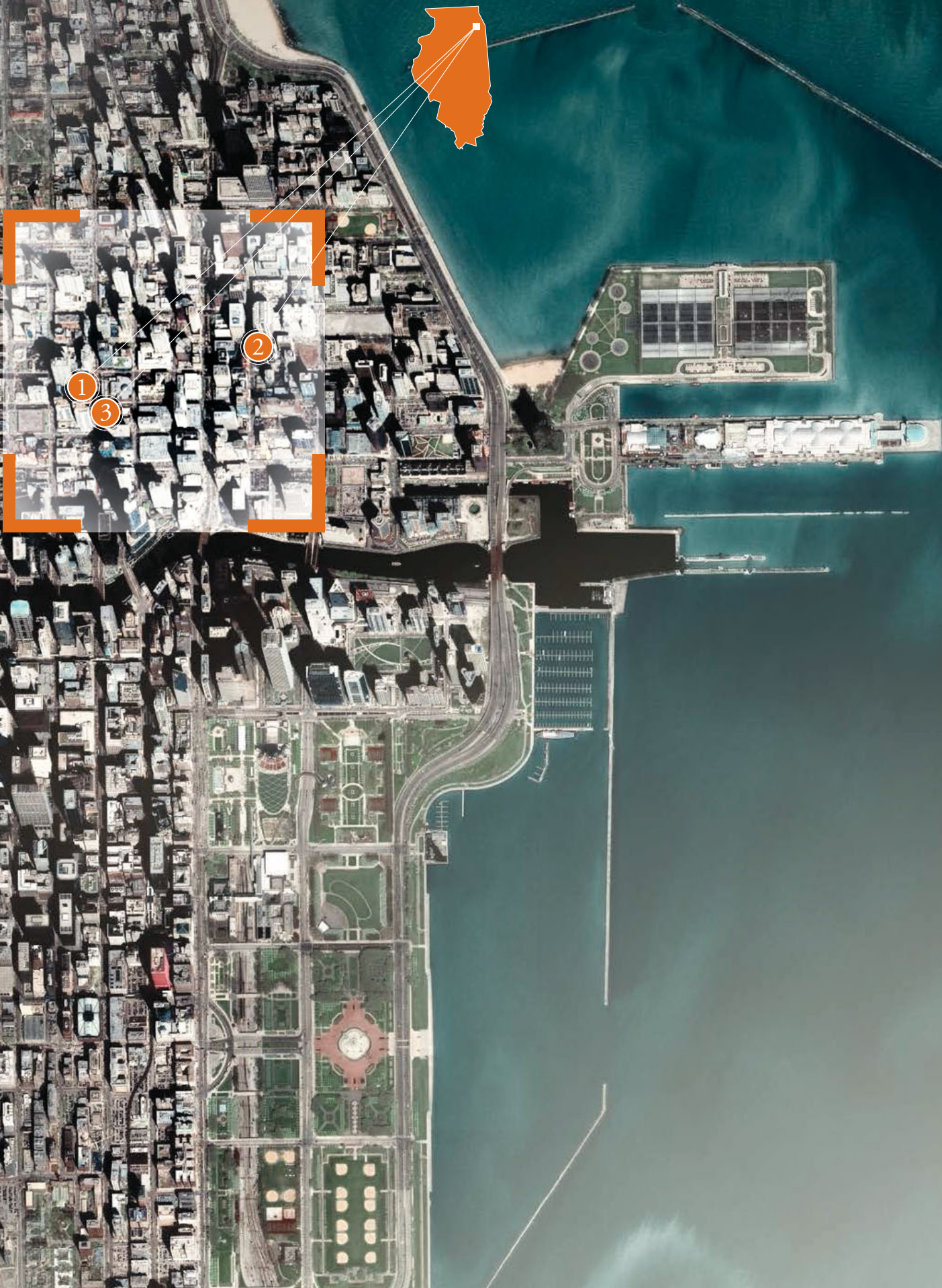
In 2012, we assembled a strategic concentration
of hotels within Chicago's Magnificent Mile district
by acquiring the Hyatt Chicago Magnificent Mile and
the Hilton Garden Inn Chicago Magnificent Mile.

① ② ③

Embassy Suites Chicago

Hyatt Chicago Magnificent Mile—Acquired June 4, 2012

Hilton Garden Inn Chicago Magnificent Mile—Acquired July 19, 2012







① EMBASSY SUITES Chicago

Located blocks from the Navy Pier and the Magnificent Mile shops along Michigan Avenue, the 368-room Embassy Suites Chicago is steps away from many of downtown Chicago's tourist attractions, theaters, parks, museums and restaurants.

① *EMBASSY SUITES Chicago*

Following a comprehensive \$12 million renovation, the Embassy Suites Chicago has all new suites, lobby and public areas. The all-suite hotel offers food & beverage options ranging from Italian specialties at Osteria Via Stato to custom burgers at MBurger to coffee & drinks at Starbucks.



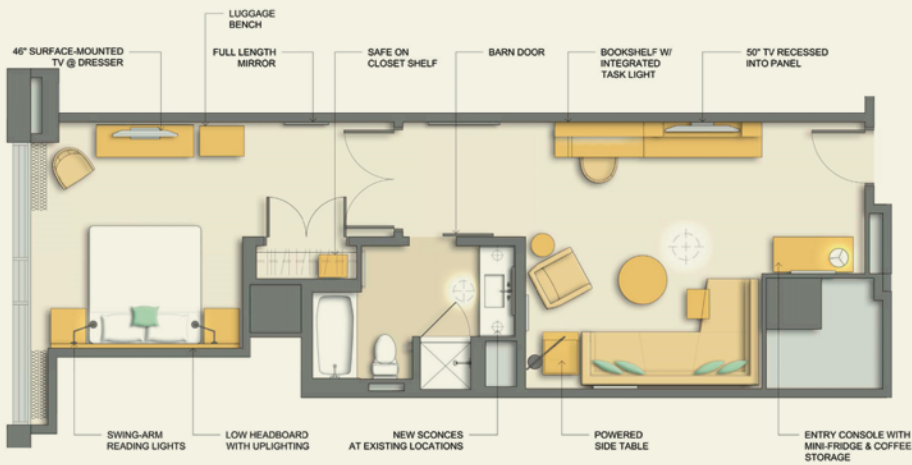


DISCIPLINED EXTERNAL GROWTH

During 2012 we took several steps to improve the quality and scale of our portfolio.

② HYATT Chicago Magnificent Mile

We acquired the 417-room Hyatt Chicago Magnificent Mile on June 4, 2012, and we are currently underway with a comprehensive \$25 million renovation which will transform the entire hotel into a showcase of modern design with inviting public spaces, contemporary rooms and exceptional food & beverage.



② *HYATT Chicago Magnificent Mile*

Upon completion in late spring 2013, we will have transformed the Hyatt Chicago Magnificent Mile within the first nine months of our ownership.







Our portfolio is comprised of 26 institutional-quality, primarily upper-upscale hotels with 11,632 rooms with concentrations in the top lodging markets across the country.

CALIFORNIA

Courtyard by Marriott Los Angeles
Embassy Suites La Jolla
Fairmont Newport Beach
Hilton San Diego Bayfront
Hyatt Regency Newport Beach
Renaissance Long Beach
Renaissance Los Angeles Airport
Sheraton Cerritos

OREGON

Marriott Portland

UTAH

Marriott Park City

ILLINOIS

Embassy Suites Chicago
Hilton Garden Inn Chicago
Magnificent Mile
Hyatt Chicago Magnificent Mile

TEXAS

Hilton Houston—North
Marriott Houston

LOUISIANA

JW Marriott New Orleans

MASSACHUSETTS

Marriott Boston Long Wharf
Marriott Quincy

NEW YORK

Doubletree Guest Suites Times Square
Hilton Times Square
Renaissance Westchester

PENNSYLVANIA

Marriott Philadelphia

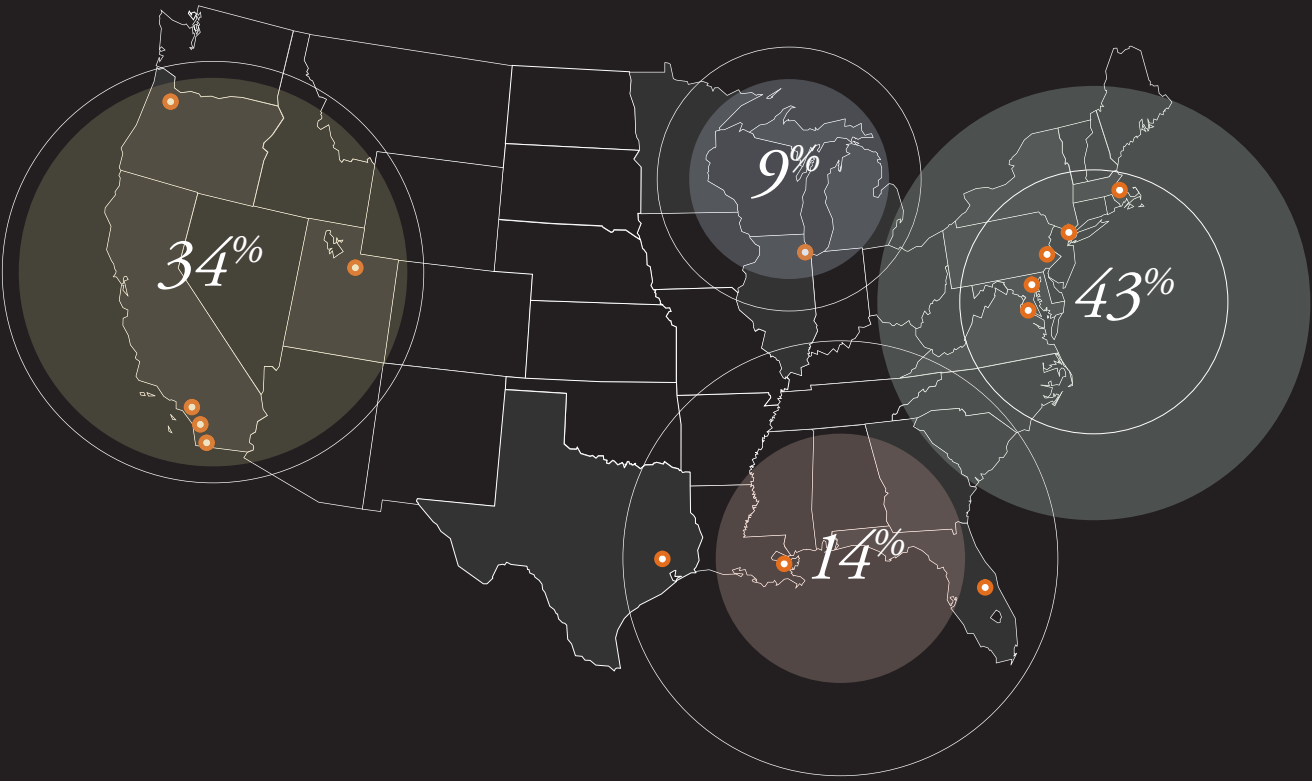
MD/DC/VA

Renaissance Baltimore—Harborplace
Renaissance Washington DC
Marriott Tysons Corner

FLORIDA

Renaissance Orlando at SeaWorld®

2012 EBITDA by Region*



③ *HILTON GARDEN INN Chicago Magnificent Mile*

We acquired the 357-room Hilton Garden Inn Chicago Magnificent Mile on July 19, 2012. Located across the street from our Embassy Suites Chicago, the 23-story hotel offers exceptional skyline views of downtown Chicago, as it neighbors Magnificent Mile and many of downtown Chicago’s attractions.

**Percentages reflect 100% ownership of the Hilton San Diego Bayfront.*









*PROACTIVE PORTFOLIO
MANAGEMENT*

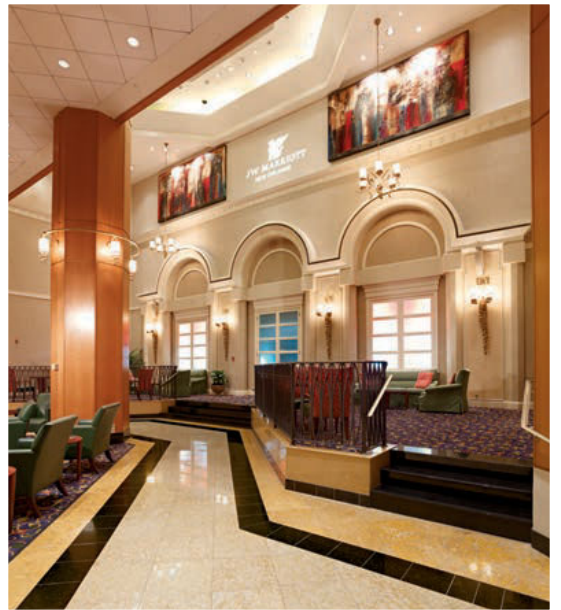
Renovation Plan for the JW Marriott New Orleans

HACKETT



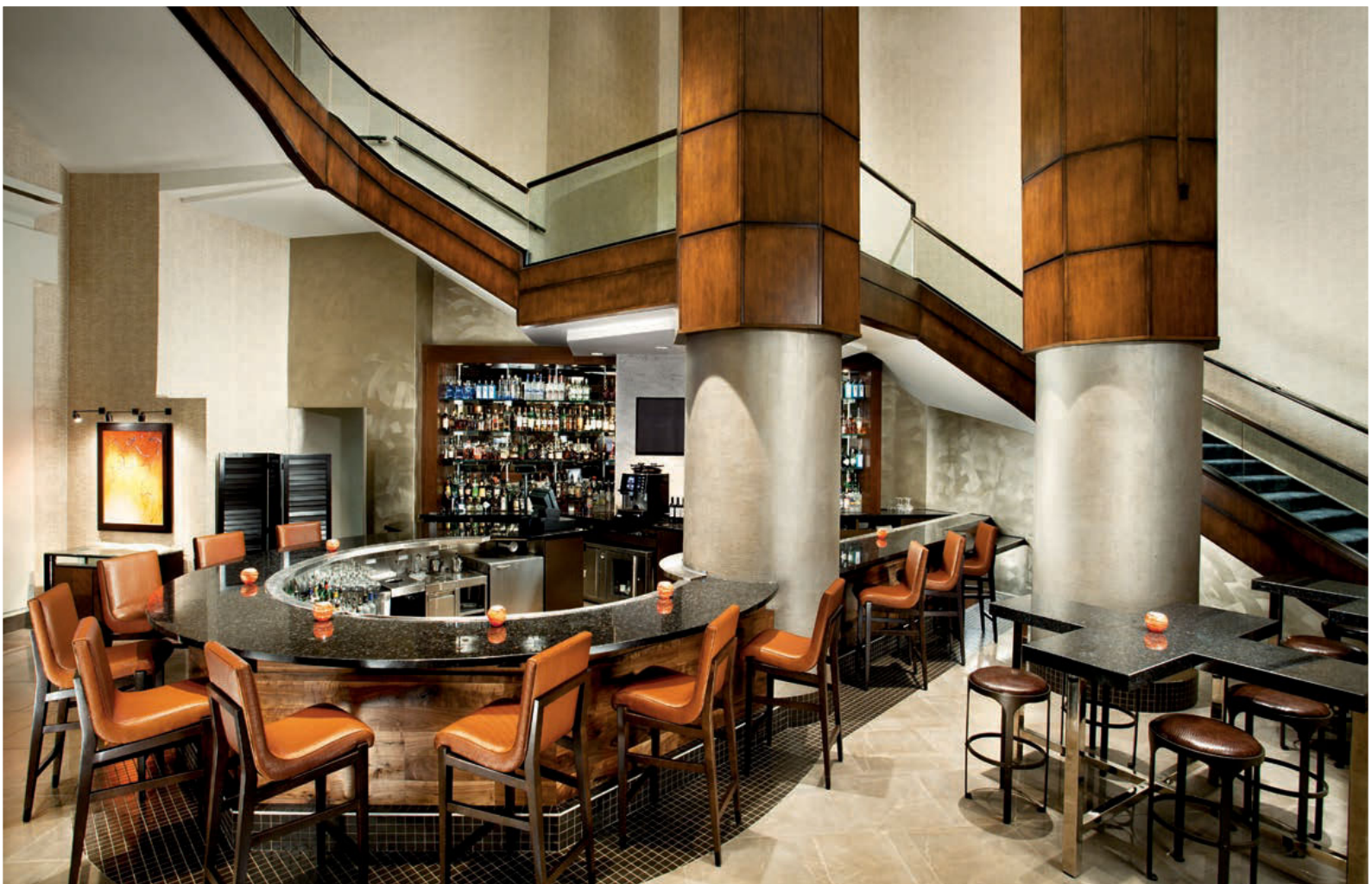
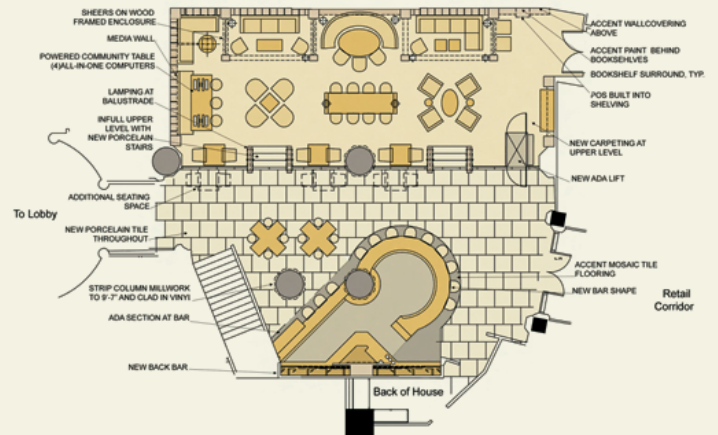
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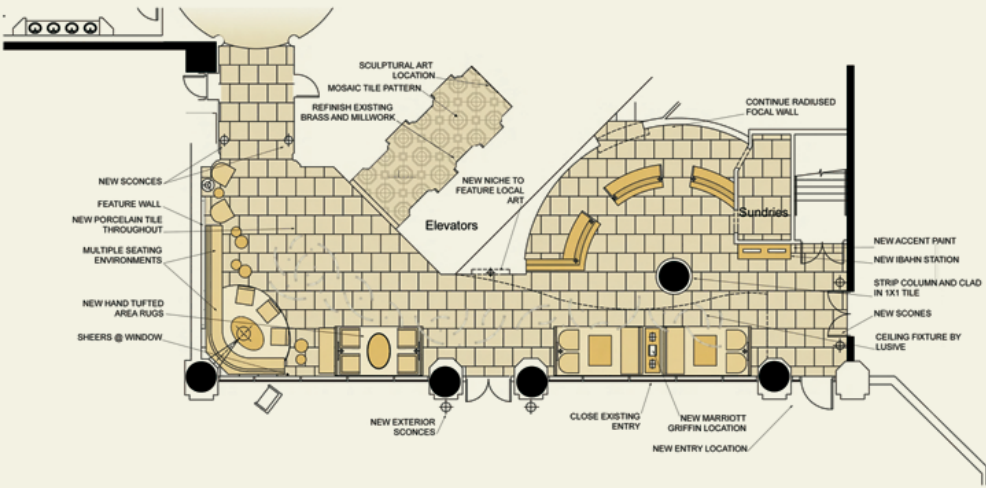
Prior to embarking on our \$5 million renovation of the JW Marriott New Orleans, the public spaces were dated and compartmentalized.



...TO here

With our renovation complete, the JW Marriott New Orleans provides guests with a welcoming environment to relax after spending time amidst the activity along Canal Street.





To Our
SUNSTONE Shareholders,

*We defined a new
Sunstone back in 2011.*

Looking back to 2011, we retooled our team, enhanced our corporate governance, established a new long-term vision, redefined our core values and developed a new, cycle-appropriate strategy aimed at creating significant shareholder value while improving the quality and scale of our portfolio and gradually deleveraging our balance sheet. Our strategy would be predicated on the following:

- *Proactive portfolio management;*
- *Intensive asset management;*
- *Disciplined external growth; and*
- *Measured balance sheet improvement.*

*The new Sunstone delivered strong
returns in its first year—2012.*

By remaining focused on our long-term vision, embracing our core values and adhering to our balanced strategy, we delivered total shareholder returns of greater than 31% in 2012, more than double the average returns generated by other comparable upper-upscale lodging REIT peers. At the same time, we materially improved our portfolio quality and deleveraged our balance sheet through a series of value-creating transactions. In short, during 2012 we advanced a number of our key corporate objectives through solid execution on each of Sunstone's disciplines.

First, with respect to *proactive portfolio management*, during 2012 we made in excess of \$109 million of value-adding investments throughout our portfolio. For example, we

completed a \$23 million full guestroom and bathroom renovation of our 807-room Renaissance Washington DC. Although the renovation resulted in short-term displacement while the work was underway, the renovation is already driving material outperformance at this hotel in 2013. We expect to see similarly strong year-over-year performance among all the other hotels we renovated in 2012.

In addition to our capital investment program, during 2012 we also divested of four legacy hotels that no longer fit our investment parameters, based on the hotels' market locations, relatively small scale and low average RevPAR. 2012 dispositions included the 284-room Marriott Del Mar, the 229-room Doubletree Guest Suites Minneapolis, the 257-room Hilton Del Mar and the 350-room Marriott Troy for a gross sale price of \$173.2 million, including the elimination of approximately \$122.7 million in mortgage debt.

Second, with respect to *intensive asset management*, our team continued to execute on a wide array of initiatives designed to improve the competitiveness and long-term value of our individual hotels. During the year we initiated a comprehensive, portfolio-wide energy management program to materially improve the efficiency of our portfolio. Additionally, we continued to streamline our food and beverage operations by redefining restaurant concepts and consolidating outlets into seamless lobby, bar, restaurant venues. We also made solid inroads in terms of refining our housekeeping and laundry functions. All of these initiatives have helped to make our hotels more efficient, which we expect will lead to significant margin improvement for years to come.

Third, with respect to *disciplined external growth*, during 2012 we took several steps to improve the quality and scale of our portfolio. First, we acquired the 417-room Hyatt Chicago Magnificent Mile for a contractual purchase price of \$88.4 million. We are in the process of investing approximately \$25 million on a complete repositioning of this well-located hotel aimed at elevating the physical appearance and amenities of the hotel to a sophisticated destination catering to high-rated business transient and group travelers. Additionally, we acquired the 357-room Hilton Garden Inn Chicago Downtown/Magnificent Mile for a gross purchase price of \$91.8 million.

Finally, with respect to *measured balance sheet improvement*, we reduced our indebtedness by over \$180 million and reduced our net debt 11 points from 53.6% to 42.8%. Additionally, we completed a favorable amendment and extension of our \$150 million credit facility.

As a result of the concerted execution of our strategy by each of our core disciplines, strengthening industry-wide demand trends and below-average supply growth, we achieved strong outputs, including:

- *comparable RevPAR improved by 5.6% to \$139.22,*
- *comparable hotel EBITDA margins improved by 110 basis points to 28.9%,*
- *adjusted Corporate EBITDA improved by 14.1% to \$242.5 million,*
- *adjusted FFO/diluted share improved by approximately 16.1% to \$1.01, and*
- *consolidated debt to total book capitalization improved by over 13 points from 53.6% to 42.8%.*

In short, 2012 marked the first of what we expect to be many years of solid execution of our strategy and strong returns for our shareholders, and through March 1, 2013, we've continued on this path. To date in 2013, we've eliminated \$27 million of debt through the sale of four non-core hotels and a commercial laundry facility at an attractive valuation, and we've continued to reduce our financial leverage through the repayment of the remaining \$58 million of exchangeable Senior Notes and the full redemption of our 8% Series A preferred security totaling \$176 million.

We will build value in 2013 and beyond.

We believe that equal measures of *vision*, *strategic focus*, *discipline* and *drive* are the keys to sustained business success.

We as a team are aligned around our *vision* to become the premier hotel investor. While that may seem like a lofty goal, we believe that without high aspirations, nothing of significance can be accomplished. I am confident that we have the team, the tools and the plan to accomplish our vision. This won't happen overnight—we will achieve our vision by adhering to our plan and by taking one smart, shareholder-friendly step at a time.

Our *strategic focus* remains on creating significant shareholder value while improving the quality and scale of our portfolio and gradually deleveraging our balance sheet through proactive portfolio management, intensive asset management, disciplined external growth and measured balance sheet improvement.

The lodging industry is cyclical. We are now entering the fourth year of what we believe will be a prolonged, albeit moderate growth recovery phase for the lodging industry. Value in our business is primarily created during the peaks and troughs of the lodging cycle. Our mid-term objective is to approach the next cyclical peak with significant liquidity and a materially improved balance sheet, so that we may enter the next cyclical trough in a position of strength with the capacity to capitalize on opportunities. Accordingly, we will continue to adjust the prominence of each of our strategic pillars based on our assessment of where we are in the lodging cycle. For example, we will be more focused on acquisitions during the first half of the lodging cycle and more focused on harvesting gains through the sale of non-strategic assets during the late phase of the cycle.

We are building a corporate-wide *discipline* based on rigorous quantitative analysis, cross-departmental communication and accountability. We have an abiding commitment to learn from the mistakes that we and others in our industry have made in the past. We will continue to monitor external factors and make course corrections based on changes in market dynamics in order to maximize value through all phases of the lodging cycle. Our goal is to make decisions and structure transactions based on what we fear could happen, rather than what we hope will happen.

While we are proud of the progress we made during 2012, we understand that positive track records are not built over the course of just one year. We are *driven* to unlock Sunstone's considerable potential by adhering to our stated strategy and building a

reputation of outperformance. Accordingly, we as a team remain focused on the daily execution of our long-term strategy in order to create lasting value and to earn your ongoing support and commitment.

Our team, vision and strategic plan are fully in place, and in connection with the continued development of our senior leadership team, we announced a number of highly deserved promotions earlier in 2013 which largely cements the leadership structure of the new Sunstone. Continued strength in business trends throughout our portfolio, especially among the hotels we recently renovated, is driving meaningful growth in hotel revenues and profitability. Looking ahead, fundamentals for Sunstone's portfolio are compelling: we now hold focused investments in key growth markets, and we continue to improve our portfolio's competitiveness through high-quality renovations. With the U.S. demand-to-supply ratio well above historical norms and our portfolio running at nearly 80% occupancy, our pricing power continues to improve. Accordingly, we expect our portfolio's profitability to accelerate over the next several years. We could not be more enthusiastic about Sunstone's future.

Thank you again for your commitment to Sunstone.

Sincerely,



Ken Cruse
Chief Executive Officer

 FINANCIAL Review

Selected Financial Data	25
Management’s Discussion and Analysis of Financial Condition and Results of Operations	26
Reports of Independent Registered Public Accounting Firm	52
Consolidated Balance Sheets	54
Consolidated Statements of Operations and Comprehensive Income	55
Consolidated Statements of Equity	56
Consolidated Statements of Cash Flows	57
Notes to Consolidated Financial Statements	59
Stock Information	85
Corporate Information	86

SELECTED
Financial Data

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
(\$ in thousands)					
OPERATING DATA:					
REVENUES:					
Room	\$ 576,146	\$ 501,183	\$ 351,039	\$ 336,981	\$ 417,785
Food and beverage	200,810	175,103	138,188	134,319	167,549
Other operating	52,128	45,508	26,373	30,241	34,825
Total revenues	829,084	721,794	515,600	501,541	620,159
OPERATING EXPENSES:					
Room	147,932	128,225	92,101	85,879	98,606
Food and beverage	139,106	126,139	98,889	96,755	119,310
Other operating	16,162	14,004	11,535	11,786	14,217
Advertising and promotion	42,474	37,226	27,326	26,404	27,550
Repairs and maintenance	32,042	29,067	22,608	22,437	24,353
Utilities	25,596	25,537	19,117	18,879	21,890
Franchise costs	30,067	25,595	18,032	17,435	20,520
Property tax, ground lease and insurance	66,830	58,010	35,280	37,058	38,976
Property general and administrative	94,642	85,293	61,753	58,675	70,439
Corporate overhead	24,316	25,453	21,751	25,072	21,346
Depreciation and amortization	130,907	113,708	79,633	78,790	78,503
Impairment loss	—	10,862	—	2,823	57
Total operating expenses	750,074	679,119	488,025	481,993	535,767
Operating income	79,010	42,675	27,575	19,548	84,392
Equity in net earnings (losses) of unconsolidated joint ventures	—	21	555	(27,801)	(1,445)
Interest and other income	297	3,115	112	1,378	3,590
Interest expense	(76,821)	(74,195)	(58,931)	(62,137)	(69,203)
Gain (loss) on extinguishment of debt	(191)	—	—	54,506	—
Gain on remeasurement of equity interests	—	69,230	—	—	—
Income (loss) before income taxes and discontinued operations	2,295	40,846	(30,689)	(14,506)	17,334
Income tax provision	(1,148)	—	—	—	—
Income (loss) from continuing operations	1,147	40,846	(30,689)	(14,506)	17,334
Income (loss) from discontinued operations	48,410	40,453	69,231	(255,102)	53,904
Net income (loss)	49,557	81,299	38,542	(269,608)	71,238
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	—	—	—
Distributions to non-controlling interest	(31)	(30)	—	—	—
Dividends paid on unvested restricted stock compensation	—	—	—	(447)	(814)
Preferred stock dividends and accretion	(29,748)	(27,321)	(20,652)	(20,749)	(20,884)
Undistributed income allocated to unvested restricted stock compensation	(203)	(636)	(102)	—	—
Income available (loss attributable) to common stockholders	\$ 17,814	\$ 53,000	\$ 17,788	\$ (290,804)	\$ 49,540
Income (loss) from continuing operations available (attributable) to common stockholders per diluted common share	\$ (0.24)	\$ 0.11	\$ (0.52)	\$ (0.51)	\$ (0.08)
Cash dividends declared per common share ⁽¹⁾	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 1.20
BALANCE SHEET DATA:					
Investment in hotel properties, net ⁽²⁾	\$2,681,877	\$2,532,232	\$1,666,180	\$1,670,164	\$1,716,814
Total assets	\$3,136,675	\$3,101,240	\$2,436,106	\$2,513,530	\$2,805,611
Total debt ⁽²⁾	\$1,363,389	\$1,416,890	\$ 973,810	\$ 968,816	\$1,150,837
Total liabilities	\$1,517,362	\$1,675,946	\$1,236,807	\$1,526,867	\$1,791,103
Equity	\$1,519,313	\$1,325,294	\$1,099,299	\$ 886,767	\$ 914,812

(1) Does not include non-cash common stock dividend of \$0.60 per share declared in 2008.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS of Financial Condition and Results of Operations

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

OVERVIEW

Sunstone Hotel Investors, Inc. is a Maryland corporation. We operate as a self-managed and self-administered real estate investment trust, or REIT. A REIT is a legal entity that directly or indirectly owns real estate assets. REITs generally are not subject to federal income taxes at the corporate level as long as they pay stockholder dividends equivalent to 100% of their taxable income. REITs are required to distribute to stockholders at least 90% of their taxable income. We own, directly or indirectly, 100% of the interests of Sunstone Hotel Partnership, LLC (the "Operating Partnership"), which is the entity that directly or indirectly owns our hotel properties. We also own 100% of the interests of our taxable REIT subsidiary, Sunstone Hotel TRS Lessee, Inc., which leases all of our hotels from the Operating Partnership, and engages independent third-parties to manage our hotels. In addition, we own 100% of BuyEfficient, LLC ("BuyEfficient"), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment. As of December 31, 2012, we also owned 100% of a commercial laundry facility located in Rochester, Minnesota, which we have classified as held for sale as of December 31, 2012 and included in discontinued operations due to its sale in January 2013.

We own primarily upper upscale hotels in the United States. As of December 31, 2012, we had interests in 30 hotels, including four hotels which we have classified as held for sale and included in discontinued operations due to their sale in January 2013, leaving 26 hotels currently held for investment (the "26 hotels"). Of the 26 hotels, we classify 24 as upscale or upper upscale and two as luxury as defined by Smith Travel Research, Inc. All of our 26 hotels are operated under nationally recognized brands such as Marriott, Hilton, Hyatt, Fairmont and Sheraton, which are among the most respected and widely recognized brands in the lodging industry. We believe the largest and most stable segment of travelers prefer the consistent service and quality associated with nationally recognized brands.

We seek to own hotels in urban locations that benefit from significant barriers to entry by competitors. All of our 26 hotels are considered business, convention, or airport hotels, as opposed to resort or leisure hotels. The hotels comprising our 26 hotel portfolio average 447 rooms in size.

Our mission is to create meaningful value for our stockholders by becoming the premier hotel owner. Our values include transparency, trust, ethical conduct, communication and discipline. Our goal is to improve the quality and scale of our portfolio while deleveraging our balance sheet. As demand for lodging generally fluctuates with the overall economy (we refer to these changes in demand as the lodging cycle), we seek to employ a balanced, cycle-appropriate corporate strategy that encompasses proactive portfolio management, intensive asset management, disciplined external growth and measured balance sheet improvement as detailed below:

- ***Proactive Portfolio Management.*** The leaders of each of our core disciplines function as a portfolio management team. The portfolio management team's purpose is to strategically maximize the long-term value of our assets by enhancing our portfolio quality and scale, optimizing our exposure to key markets, and improving the effectiveness and efficiency of our decision making. Accordingly, the team is responsible for developing a portfolio-wide strategy related to brand and operator relationships, asset quality and scale, target markets, capital investments, and portfolio capitalizations. Our portfolio strategy may also include the disposition of certain hotels.
- ***Intensive Asset Management.*** Through all phases of the lodging cycle, our strategy emphasizes internal growth and value enhancements through proactive asset management, which entails working closely with our third-party hotel operators to develop and implement long-term strategic plans for each hotel designed to enhance revenues, minimize operational expenses and asset risk, maximize the appeal of our hotels to travelers and maximize our return on invested capital. We also focus on improving the appeal and growth potential of our existing hotels through internally-managed hotel renovations.
- ***Disciplined External Growth.*** By gradually increasing the scale and quality of our portfolio, we may provide our stockholders with greater exposure to key growth markets, improved liquidity and broader access to value-adding transactions. Accordingly, our strategy emphasizes disciplined external growth during the recovery phase of the lodging cycle. Our external growth plan is oriented around investing in institutional-quality hotels that generate returns in excess of our cost of capital, that are additive to the quality of our portfolio, that have attractive growth potential and that may benefit from our asset management competencies. We endeavor to structure our acquisitions in ways that will not only increase the value of our shares of common stock, but also will advance our other corporate objectives, such as improving our financial flexibility and reducing our leverage. During periods of cyclical decline, our strategy may emphasize opportunistically investing in distressed assets and the repurchase of our equity or debt securities. In addition to hotel acquisitions, we may seek to grow our portfolio by making investments in defaulted and/or distressed debt positions in loan-to-own hotel transactions, utilizing our REIT structure to effect strategic combinations with select property owners, effecting portfolio purchases from institutional and other owners seeking portfolio liquidity, and by providing capital solutions to illiquid owners facing debt maturities or capital requirements.

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

During the past three years and continuing into 2013, demand for lodging in the U.S. has increased, which has resulted in improved hotel revenues and profits. In light of increasing demand for lodging and generally muted supply of new hotel development, we believe we are currently in the first half of a recovery phase of the lodging cycle. Hotels acquired during the early stages of past cyclical recoveries have benefited from multi-year increases in profitability, which in many cases created long-term value in excess of investment hurdles. Accordingly, during 2011 and 2012 we made selective acquisitions including: the purchase of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture in January 2011; the purchase of the outside 50.0% equity interest in our BuyEfficient joint venture in January 2011; the purchase of the JW Marriott New Orleans in February 2011; the purchase of a 75.0% majority interest in a joint venture that owns the Hilton San Diego Bayfront in April 2011; the purchase of the Wyndham Chicago in June 2012 (which we immediately rebranded the Hyatt Chicago Magnificent Mile); and the purchase of the Hilton Garden Inn Downtown/Magnificent Mile in July 2012. Our acquisition program is aimed at generating attractive risk-adjusted returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. We intend to select the brands and operators for our hotels that we believe will lead to the highest returns.

On June 4, 2012, we purchased the leasehold interest in the 417-room Wyndham Chicago located in Chicago, Illinois for a contractual purchase price of \$88.425 million. The acquisition was funded with \$29.7 million of cash on hand (including \$0.3 million of proration credits) and the issuance of 5,454,164 shares of our common stock, the "Wyndham stock consideration." The Wyndham stock consideration was determined by dividing \$58.425 million by the product of (1) the closing price of \$10.40 on the NYSE of our common stock on May 2, 2012 and (2) 1.03. In connection with this acquisition, we entered into a registration rights agreement requiring us to register the Wyndham stock consideration. We prepared the registration statement on Form S-3, which we filed with the SEC as required on June 4, 2012. Based on the \$9.38 closing price of the Company's common stock on the NYSE on June 4, 2012, the date the acquisition closed, the total purchase price of the Wyndham Chicago hotel for accounting purposes was \$81.16 million, excluding proration adjustments and closing costs. Upon closing, we terminated the existing management agreement and entered into a new management agreement with Davidson Hotels & Resorts. We rebranded the hotel the Hyatt Chicago Magnificent Mile and have commenced planning for a \$25.0 million renovation program. As an incentive to rebrand the hotel, Hyatt Franchising, L.L.C. will reimburse us for \$6.5 million of our renovation costs once the renovation is complete. We expect to receive the \$6.5 million during the third quarter of 2013, and will amortize the \$6.5 million once received on a straight line basis over the remaining term of our franchise agreement with Hyatt, which term ends in 2039.

On July 19, 2012, we purchased the 357-room Hilton Garden Inn Chicago Downtown/Magnificent Mile located in Chicago, Illinois for a net purchase price of \$90.3 million. The acquisition was funded with a portion of the \$126.2 million net proceeds we received from the issuance of 12,143,273 shares of our common stock on June 25, 2012.

The scope of our acquisitions program may include large hotel portfolios or hotel loans. Future acquisitions may be funded by our issuance of additional debt or equity securities, including our common and preferred OP units, or by draws on our \$150.0 million senior corporate credit facility entered into in November 2010 and amended in September 2012. However, in light of our current financial objectives, we expect to fund the majority of our near term acquisitions with a greater proportion of equity capital than debt capital.

We have from time to time divested of assets that no longer fit our target profile, will not offer long-term returns in excess of our cost of capital, or that have a high risk profile relative to their anticipated return expectations. In connection with this strategy, during 2011 and 2012 we sold the following: the Royal Palm Miami Beach in April 2011; the Valley River Inn located in Eugene, Oregon in October 2011; the Marriott Del Mar in August 2012; and the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and an office building adjacent to the Marriott Troy in September 2012.

In August 2012, we completed the sale of the Marriott Del Mar for a gross sales price of \$66.0 million, and recognized a gain on the sale of \$25.5 million. The buyer of the hotel assumed the \$47.1 million mortgage secured by the hotel, resulting in our receipt of net proceeds totaling \$17.7 million after proration adjustments and closing costs. In addition, we wrote off \$48,000 in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the Marriott Del Mar.

In September 2012, we completed the portfolio sale of the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and an office building adjacent to the Marriott Troy for a gross sales price of \$105.0 million, and recognized a \$12.7 million gain on the sale. The buyer of the portfolio assumed three separate mortgages secured by the hotels totaling \$75.6 million, including: \$16.9 million on the Doubletree Guest Suites Minneapolis; \$24.4 million on the Hilton Del Mar; and \$34.3 million on the Marriott Troy. In addition, the buyer of the portfolio assumed a \$2.2 million liability for deferred management fees payable to the Marriott Troy's independent third-party manager. We received net proceeds on the portfolio sale of \$28.6 million after proration adjustments, closing costs and the debt and deferred management fee assumptions. In addition, we wrote off \$0.1 million in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the three hotels.

The mortgages secured by the Marriott Del Mar, Hilton Del Mar and Marriott Troy contain "cash trap" provisions that were triggered in prior years due to the decline in the performance of these hotels. Once triggered, substantially all of the excess cash flow from operations generated by the three hotels was deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lenders. As of December 31, 2012, a total of \$8.2 million of our cash was held by the lenders of these three hotels. The cash will be returned to us once the lenders release the cash to the buyers according to the terms of the respective loan agreements, which is expected to occur within the near term.

In January 2013, we sold the Kahler Grand, the Kahler Inn & Suites, the Marriott Rochester, and the Residence Inn by Marriott Rochester in a portfolio sale that also included our commercial laundry facility in Rochester, Minnesota for a gross sales price of \$230.0 million. We retained a \$25.0 million preferred equity investment in the four-hotel portfolio that yields an 11% dividend. In addition, we retained a \$14.0 million liability related to the portfolio's pension plan, which could be triggered in certain circumstances, including termination of the pension plan. We also provided a \$3.7 million working cash advance to the buyer that will be repaid to us from the portfolio's available cash flow. In conjunction with the sale, we defeased the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of approximately \$30.0 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and wrote off \$51,000 in deferred financing fees. We have classified the four hotels and commercial laundry facility as held for sale as of December 31, 2012, and reclassified the results of operations for these assets to discontinued operations for all periods presented.

In February 2012, we repurchased \$4.5 million in aggregate principal amount of our Senior Notes for \$4.57 million, including \$13,000 in interest, using our existing cash. After the repurchase, such Senior Notes were cancelled. We wrote off \$47,000 in deferred financing fees and \$0.1 million of the Senior Notes discount, and recognized a loss of \$0.2 million on this early extinguishment of debt. We repurchased the remaining \$58.0 million balance of the Senior Notes at the first put date in January 2013 for \$58.0 million plus approximately \$23,000 in accrued interest using our existing cash. After the repurchase, such Senior Notes were cancelled, leaving no amounts outstanding for the Senior Notes.

In April 2012, we used our existing cash to repay the remaining balance on the \$32.2 million non-recourse mortgage secured by the Renaissance Long Beach, which was originally scheduled to mature in July 2012.

In September 2012, we amended and restated our \$150.0 million senior unsecured revolving credit facility, which was scheduled to mature in November 2013. The pricing on the amended revolving credit facility was reduced and the 1% LIBOR floor was eliminated. The maturity of the credit facility was extended to November 2015 with an option to extend to November 2016. The amended credit facility's interest rate is based on a pricing grid with a range of 175 to 350 basis points, which represents a reduction from the previous grid that ranged from 325 to 425 basis points over LIBOR depending on our leverage ratio. The credit facility also includes an accordion option that allows us to request additional lender commitments up to a total of \$350.0 million. We paid \$1.3 million in deferred financing fees in conjunction with this amendment, which will be amortized over the term of the amended credit facility. The credit facility currently has no outstanding borrowings; however, as of December 31, 2012, we have \$3.8 million in outstanding irrevocable letters of credit backed by the credit facility.

Of our total debt outstanding as of December 31, 2012, approximately \$605.6 million matures over the next four years (\$58.0 million in 2013, none in 2014, \$136.9 million in 2015 and \$410.7 million in 2016). In January 2013, we repurchased the remaining \$58.0 million balance of our Senior Notes for a price of \$58.0 million plus accrued interest of approximately \$23,000, leaving approximately \$547.6 million of our debt maturing over the next four years. The \$547.6 million does not include \$18.7 million of scheduled loan amortization payments due in 2013, \$22.3 million due in 2014, \$21.3 million due in 2015, or \$12.9 million due in 2016.

As of December 31, 2012, the weighted average term to maturity of our debt is approximately five years, and 70.2% of our debt is fixed rate with a weighted average interest rate of 5.5%. The weighted average interest rate on all of our debt, which includes our variable-rate debt obligations based on variable rates at December 31, 2012, is 4.9%. After our repurchase of the Senior Notes and the repayment of debt included in discontinued operations in January 2013, the weighted average term to maturity of our debt continues to be approximately five years, and 68.2% of our debt is fixed rate with a weighted average interest rate of 5.6%. The weighted average interest rate on all of our debt, which includes our variable-rate obligations based on variable rates at December 31, 2012, continues to be 4.9%.

OPERATING ACTIVITIES

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

- *Occupancy*;
- *Average daily room rate*, or ADR;
- *Revenue per available room*, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;
- *Comparable RevPAR*, which we define as the RevPAR generated by hotels we owned as of the end of the reporting period, but excluding those hotels that we classified as held for sale. For hotels that were not owned for the entirety of the comparison periods, comparable RevPAR is calculated using RevPAR generated during periods of prior ownership. We refer to this subset of our hotels used to calculate comparable RevPAR as our “Comparable Portfolio.” Currently our Comparable Portfolio includes all 26 hotels in which we have interests as of December 31, 2012. In addition, our Comparable Portfolio includes prior ownership results for the Doubletree Guest Suites Times Square, the JW Marriott New Orleans, the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile, as well as operating results for the Renaissance Westchester during the period in 2010 while it was held in receivership;
- *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 its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;
- *Operating flow through*, which is the quotient of operating income divided by revenues;
- *EBITDA*, which is net income (loss) excluding: non-controlling interests; interest expense; provision for income taxes, including income taxes applicable to sale of assets; and depreciation and amortization;
- *Adjusted EBITDA*, which includes EBITDA but excludes: amortization of deferred stock compensation; the impact of any gain or loss from asset sales; impairment charges; prior year property tax and other adjustments; and any other identified adjustments;
- *Funds from operations*, or FFO, which includes net income (loss), excluding non-controlling interests, gains and losses from sales of property, plus real estate-related depreciation and amortization (excluding amortization of deferred financing costs) and real estate-related impairment losses, and after adjustment for unconsolidated partnerships and joint ventures; and
- *Adjusted FFO*, which includes FFO but excludes penalties, written-off deferred financing costs, non-real estate-related impairment losses, income tax provisions, and any other identified adjustments.

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

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

Expenses. Our expenses consist of the following:

- *Room expense*, which is primarily driven by occupancy and, therefore, has a significant correlation with room revenue;
- *Food and beverage expense*, which is primarily driven by food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenue;
- *Other operating expense*, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities, and franchise costs;
- *Property tax, ground lease and insurance expense*, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense, but property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality;
- *Property general and administrative expense*, which includes our property-level general and administrative expenses, such as payroll and related costs, contract and professional fees, credit and collection expenses, employee recruitment, relocation and training expenses, travel expenses, and management fees. Additionally, this category includes general and administrative expense from BuyEfficient (subsequent to our purchase of the outside 50.0% equity interest in January 2011);
- *Corporate overhead expense*, which includes our corporate-level expenses, such as payroll and related costs, amortization of deferred stock compensation, acquisition and due diligence costs, legal expenses, contract and professional fees, bad debt, relocation, entity level state franchise and minimum tax payments, travel expenses and office rent;
- *Depreciation and amortization expense*, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment, along with amortization on our franchise fees and certain intangibles. Additionally, this category includes depreciation and amortization related to both our corporate office and BuyEfficient’s fixtures, equipment and intangibles (subsequent to our purchase of the outside 50.0% equity interest in January 2011); and
- *Impairment loss*, which includes the charges we have recognized to reduce the carrying value of assets on our balance sheets to their fair value.

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

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

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

- *Demand.* The demand for lodging generally fluctuates with the overall economy. In 2010, following a two-year cyclical trough, we began to see signs of improving demand trends, and Comparable Portfolio RevPAR increased 5.5% as compared to 2009, with a 230 basis point increase in portfolio occupancy. These improving demand trends continued in 2011 and 2012. As a result, our Comparable Portfolio RevPAR increased 7.4% in 2011 as compared to 2010, and 5.6% in 2012 as compared to 2011. Comparable Portfolio occupancy increased 280 basis points in 2011 as compared to 2010, and increased an additional 280 basis points in 2012 as compared to 2011. Consistent with prior trends, we anticipate that lodging demand will continue to improve as the U.S. economy continues to strengthen. Historically, cyclical troughs are followed by extended periods of relatively strong demand, resulting in a cyclical lodging growth phase. While growth is not expected to be uniform, we expect hotel demand to remain strong over the next several quarters if the U.S. economy continues to grow and employment levels improve.
- *Supply.* The addition of new competitive hotels affects the ability of existing hotels to drive RevPAR and profits. The development of new hotels is largely driven by construction costs and expected performance of existing hotels. The recession and credit crisis which occurred in 2008 and 2009, served to restrict credit and tighten lending standards, which resulted in a curtailment of funding for new hotel construction projects. Moreover, with same-property hotel profitability still below peak levels and hotel trading values generally well below replacement cost, new supply in many markets is difficult to justify economically. Accordingly, we believe hotel development will be constrained until such time as the construction financing markets recover, and operating trends and trading values of existing hotels improve to levels where developer return targets can be achieved. Given the one-to-three-year timeline needed to construct a typical hotel that would compete with our hotels, we expect a window of at least two to four years during which aggregate U.S. hotel supply, as indicated by the number of new hotel openings, will be below historical levels. On a market-by-market basis, some markets may experience new hotel room openings at or greater than historic levels, including in New York City where there is currently a higher-than-average supply of new hotel room openings. In addition, lenders are seeking higher yielding instruments, which may lead to riskier lending practices, including lending on new hotel construction.
- *Revenues and expenses.* We believe that marginal improvements in RevPAR index, even in the face of declining revenues, are a good indicator of the relative quality and appeal of our hotels, and our operators' effectiveness in maximizing revenues. Similarly, we also evaluate our operators' effectiveness in minimizing incremental operating expenses in the context of increasing revenues or, conversely, in reducing operating expenses in the context of declining revenues.

With respect to improving RevPAR index, we continue to work with our hotel operators to optimize revenue management initiatives while taking into consideration market demand trends and the pricing strategies of competitor hotels in our markets. We also develop capital investment programs designed to ensure each of our hotels is well renovated and positioned to appeal to groups and individual travelers fitting target guest profiles. Increased capital investment in our properties may lead to short-term revenue disruption and negatively impact RevPAR index. Our revenue management initiatives are generally oriented towards maximizing ADR even if the result may be lower

occupancy than may be achieved through lower ADR. Increases in RevPAR attributable to increases in ADR may be accompanied by minimal additional expenses, while increases in RevPAR attributable to higher occupancy may result in higher variable expenses such as housekeeping, labor and utilities expense. Thus, increases in RevPAR associated with higher ADR may result in higher hotel EBITDA margins. Increases in RevPAR associated with higher occupancy may result in more muted hotel EBITDA margin improvement. Our Comparable Portfolio RevPAR index was 110.7 in 2010, improving approximately 80 basis points in 2011 to 111.5. Our Comparable Portfolio RevPAR index, which was negatively impacted by several capital investment programs at our hotels, decreased 20 basis points in 2012 to 111.3.

With respect to maximizing operating flow through, we continue to work with our operators to identify operational efficiencies designed to reduce expenses while minimally affecting guest experience. Key asset management initiatives include optimizing hotel staffing levels, increasing the efficiency of the hotels, such as installing energy efficient management and inventory control systems, and selectively combining food and beverage outlets. Our operational efficiency initiatives may be difficult to implement, as most categories of variable operating expenses, such as utilities and housekeeping labor costs, fluctuate with changes in occupancy. Furthermore, our hotels operate with significant fixed costs, such as general and administrative expense, insurance, property taxes, and other expenses associated with owning hotels, over which our operators have little control. We have experienced either currently or in the past, increases in hourly wages, employee benefits (especially health insurance), utility costs and property insurance, which have negatively affected our operating margins. Moreover, there are limits to how far our operators can reduce expenses without affecting brand standards or the competitiveness of our hotels. Our Comparable Portfolio operating flow through was 33% in 2011 as compared to 2010, and 50% in 2012 as compared to 2011.

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

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

The following table presents our operating results for our total portfolio for 2011 and 2010, including the amount and percentage change in the results between the two periods. The table presents the results of operations included in the consolidated statements of operations, and includes continuing operations for 24 hotels (10,857 rooms) as of December 31, 2011 and 21 hotels (8,705 rooms) as of December 31, 2010, as well as discontinued operations for 10 hotels (3,017 rooms) as of December 31, 2011 and 20 hotels (5,508 rooms) as of December 31, 2010. An additional 347 rooms are included in discontinued operations for the first six months of 2010 due to our disposal and subsequent reacquisition of the Renaissance Westchester in June 2010. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report.

	2011	2010	Change \$	Change %
<i>(dollars in thousands, except statistical data)</i>				
REVENUES				
Room	\$501,183	\$351,039	\$150,144	42.8%
Food and beverage	175,103	138,188	36,915	26.7%
Other operating	45,508	26,373	19,135	72.6%
Total revenues	721,794	515,600	206,194	40.0%
OPERATING EXPENSES				
Hotel operating	443,803	324,888	118,915	36.6%
Property general and administrative	85,293	61,753	23,540	38.1%
Corporate overhead	25,453	21,751	3,702	17.0%
Depreciation and amortization	113,708	79,633	34,075	42.8%
Impairment loss	10,862	—	10,862	100.0%
Total operating expenses	679,119	488,025	191,094	39.2%
OPERATING INCOME	42,675	27,575	15,100	54.8%
Equity in earnings of unconsolidated joint ventures	21	555	(534)	(96.2)%
Interest and other income	3,115	112	3,003	2,681.3%
Interest expense	(74,195)	(58,931)	(15,264)	(25.9)%
Gain on remeasurement of equity interests	69,230	—	69,230	100.0%
INCOME (LOSS) FROM CONTINUING OPERATIONS	40,846	(30,689)	71,535	233.1%
Income from discontinued operations	40,453	69,231	(28,778)	(41.6)%
NET INCOME	81,299	38,542	42,757	110.9%
Income from consolidated joint venture attributable to non-controlling interest	(312)	—	(312)	(100.0)%
Distributions to non-controlling interest	(30)	—	(30)	(100.0)%
Preferred stock dividends and accretion	(27,321)	(20,652)	(6,669)	(32.3)%
Undistributed income allocated to unvested restricted stock compensation	(636)	(102)	(534)	(523.5)%
INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 53,000	\$ 17,788	\$ 35,212	198.0%

Operating Statistics. Included in the following tables are comparisons of the key operating metrics for our 26 hotel Comparable Portfolio, which includes prior ownership results for the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront, as well as operating results for the Renaissance Westchester during the periods in 2010 while it was held in receivership.

2012			2011			Change		
Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
79.2%	\$175.78	\$139.22	76.4%	\$172.63	\$131.89	280 bps	1.8%	5.6%

2011			2010			Change		
Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
76.4%	\$172.63	\$131.89	73.6%	\$166.84	\$122.79	280 bps	3.5%	7.4%

Non-GAAP Financial Measures. The following table reconciles net income to EBITDA and Adjusted EBITDA for our hotel portfolio for the years ended December 31, 2012, 2011 and 2010. We believe EBITDA and Adjusted EBITDA are useful to investors in evaluating our operating performance because these measures help investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization) from our operating results. We also use EBITDA and Adjusted EBITDA as measures in determining the value of hotel acquisitions and dispositions. We caution investors that amounts presented in accordance with our definitions of EBITDA and Adjusted EBITDA may not be comparable to similar measures disclosed by other companies, because not all companies calculate these non-GAAP measures in the same manner. EBITDA and Adjusted EBITDA should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. EBITDA and Adjusted EBITDA may include funds that may not be available for our discretionary use

to fund interest expense, capital expenditures or general corporate purposes. Although we believe that EBITDA and Adjusted EBITDA can enhance an investor’s understanding of our results of operations, these non-GAAP financial measures, when viewed individually, are not necessarily a better indicator of any trend as compared to GAAP measures such as net income (loss) or cash flow from operations. In addition, you should be aware that adverse economic and market conditions may harm our cash flow.

	2012	2011	2010
<i>(in thousands)</i>			
Net income	\$ 49,557	\$ 81,299	\$ 38,542
Operations held for investment:			
Depreciation and amortization	130,907	113,708	79,633
Amortization of lease intangibles	4,319	3,979	254
Interest expense	71,664	67,319	54,839
Amortization of deferred financing fees	3,690	3,138	1,457
Write-off of deferred financing fees	3	21	1,462
Loan penalties and fees	—	—	177
Non-cash interest related to discount on Senior Notes	1,058	1,062	996
Non-cash interest related to loss on derivatives	406	2,655	—
Income tax provision	1,148	—	—
Non-controlling interests:			
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	—
Depreciation and amortization	(5,685)	(4,014)	—
Interest expense	(2,252)	(1,562)	—
Amortization of deferred financing fees	(224)	(160)	—
Non-cash interest related to loss on derivative	(1)	(31)	—
Unconsolidated joint ventures:			
Depreciation and amortization	—	3	52
Discontinued operations:			
Depreciation and amortization	13,164	16,188	21,299
Amortization of lease intangibles	14	28	27
Interest expense	6,231	9,191	19,257
Interest expense—default rate	—	—	7,955
Amortization of deferred financing fees	74	104	581
Write-off of deferred financing fees	185	42	123
Loan penalties and fees	—	—	1,155
EBITDA	272,497	292,658	227,809
Operations held for investment:			
Amortization of deferred stock compensation	3,466	2,745	3,942
Non-cash straight-line lease expense	2,777	2,398	944
Capital lease obligation interest—cash ground rent	(819)	—	—
(Gain) loss on sale of assets	18	(83)	382
Gain on remeasurement of equity interests	—	(69,230)	—
Loss on extinguishment of debt	191	—	—
Closing costs—completed acquisitions	1,965	3,403	—
Due diligence costs—abandoned project	—	—	959
Impairment loss	—	10,862	—
Lawsuit settlement costs, net	158	1,553	—
Prior year property tax and CAM adjustments, net	621	—	—
Hotel laundry closing costs	623	—	—
Costs associated with CEO severance	—	—	2,242
Non-controlling interests:			
Non-cash straight-line lease expense	(450)	(354)	—
Prior year property tax adjustments, net	(202)	—	—
Unconsolidated joint ventures:			
Amortization of deferred stock compensation	—	2	32
Discontinued operations:			
Gain on sale of assets, net	(38,292)	(14,912)	—
Impairment loss	—	1,495	1,943
Gain on extinguishment of debt	—	(18,145)	(86,235)
Lawsuit settlement (reversal) costs	(48)	67	—
Closing costs—completed acquisition	—	—	6,796
	(29,992)	(80,199)	(68,995)
Adjusted EBITDA	\$242,505	\$212,459	\$158,814

Adjusted EBITDA was \$242.5 million in 2012 as compared to \$212.5 million in 2011 and \$158.8 million in 2010. Adjusted EBITDA increased \$30.0 million in 2012 as compared to 2011 due to additional earnings generated by the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Downtown/Magnificent Mile), and the three hotels we acquired or purchased interests in during 2011 (the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront), combined with increased earnings at our other hotels. Adjusted EBITDA increased \$53.6 million in 2011 as compared to 2010 due to additional earnings generated by the three hotels we acquired or purchased interests in during 2011 and by the Renaissance Westchester, which we reacquired from a court-appointed receiver in June 2010, combined with increased earnings at our other hotels.

The following table reconciles net income to FFO and Adjusted FFO for our hotel portfolio for the years ended December 31, 2012, 2011 and 2010. We believe that the presentation of FFO and Adjusted FFO provides useful information to investors regarding our operating performance because they are measures of our operations without regard to specified non-cash items such as real estate depreciation and amortization, any real estate impairment loss, gain or loss on sale of assets and certain other items which we believe are not indicative of the performance of our underlying hotel properties. We believe that these items are more representative of our asset base and our acquisition and disposition activities than our ongoing operations. We also use FFO as one measure in determining our results after taking into account the impact of our capital structure. We caution investors that amounts presented in accordance with our definitions of FFO and Adjusted FFO may not be comparable to similar measures disclosed by other companies, because not all companies calculate these non-GAAP measures in the same manner. FFO and Adjusted FFO should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. FFO and Adjusted FFO may include funds that may not be available for our discretionary use to fund interest expense, capital expenditures or general corporate purposes. Although we believe that FFO and Adjusted FFO can enhance an investor's understanding of our results of operations, these non-GAAP financial measures, when viewed individually, are not necessarily better indicators of any trend as compared to GAAP measures such as net income (loss) or cash flow from operations. In addition, you should be aware that adverse economic and market conditions may harm our cash flow.

	2012	2011	2010
<i>(in thousands)</i>			
Net income	\$ 49,557	\$ 81,299	\$ 38,542
Preferred stock dividends	(29,748)	(27,321)	(20,652)
Operations held for investment:			
Real estate depreciation and amortization	129,668	112,539	79,083
Amortization of lease intangibles	4,319	3,979	254
(Gain) loss on sale of other assets	18	(83)	382
Non-controlling interests:			
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	—
Real estate depreciation and amortization	(5,685)	(4,014)	—
Discontinued operations:			
Real estate depreciation and amortization	13,164	16,188	21,299
Amortization of lease intangibles	14	28	27
Real estate impairment loss	—	—	1,943
Gain on sale of assets, net	(38,292)	(14,912)	—
FFO	121,254	167,391	120,878
Operations held for investment:			
Non-cash straight-line lease expense	2,777	2,398	944
Write-off of deferred financing fees	3	21	1,462
Loan penalties and fees	—	—	177
Non-cash interest related to loss on derivatives	406	2,655	—
Gain on remeasurement of equity interests	—	(69,230)	—
Loss on extinguishment of debt	191	—	—
Closing costs—completed acquisitions	1,965	3,403	—
Due diligence costs—abandoned project	—	—	959
Prior year property tax and CAM adjustments, net	621	—	—
Hotel laundry closing costs	623	—	—
Impairment loss	—	10,862	—
Lawsuit settlement costs, net	158	1,553	—
Income tax provision	1,148	—	—
Costs associated with CEO severance	—	—	2,242
Amortization of deferred stock compensation associated with CEO severance	—	—	1,074
Non-controlling interests:			
Non-cash straight-line lease expense	(450)	(354)	—
Non-cash interest related to loss on derivative	(1)	(31)	—
Prior year property tax adjustments, net	(202)	—	—

(continued)

	2012	2011	2010
<i>(in thousands)</i>			
Discontinued operations:			
Write-off of deferred financing fees	\$ 185	\$ 42	\$ 123
Interest expense—default rate	—	—	7,955
Loan penalties and fees	—	—	1,155
Impairment loss	—	1,495	—
Gain on extinguishment of debt	—	(18,145)	(86,235)
Lawsuit settlement (reversal) costs	(48)	67	—
Closing costs—completed acquisition	—	—	6,796
	7,376	(65,264)	(63,348)
Adjusted FFO	\$128,630	\$102,127	\$ 57,530

Adjusted FFO was \$128.6 million in 2012 as compared to \$102.1 million in 2011 and \$57.5 million in 2010. Adjusted FFO increased \$26.5 million in 2012 as compared to 2011 due to additional earnings generated by the two hotels we acquired in 2012 (the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Downtown/Magnificent Mile), and the three hotels we acquired or purchased interests in during 2011 (the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront), combined with increased earnings at our other hotels. Adjusted EBITDA increased \$44.6 million in 2011 as compared to 2010 due to additional earnings generated by the three hotels we acquired or purchased interests in during 2011 and by the Renaissance Westchester, which we reacquired from a court-appointed receiver in June 2010, combined with increased earnings at our other hotels.

Room revenue. Room revenue increased \$75.0 million, or 15.0%, for the year ended December 31, 2012 as compared to the year ended December 31, 2011. We acquired the Hyatt Chicago Magnificent Mile in June 2012 and the Hilton Garden Inn Downtown/Magnificent Mile in July 2012. In addition, we acquired the outside 62.0% equity interests in the Doubletree Guest Suites Times Square in January 2011 (resulting in our 100% ownership of the hotel) and the JW Marriott New Orleans in February 2011. We also purchased a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront in April 2011. These five recently acquired hotels (the “five recently acquired hotels”) contributed additional room revenue of \$57.4 million during the year ended December 31, 2012. Room revenue in our five recently acquired hotels was negatively impacted in 2012 by Hurricane Sandy, which caused a loss in room revenue of approximately \$0.3 million. Room revenue generated by the 21 hotels we owned prior to January 1, 2011 (our “existing portfolio”) increased \$17.6 million during 2012 as compared to 2011 due to an increase in occupancy (\$14.8 million) combined with an increase in ADR (\$2.8 million). The increase in occupancy was driven by an additional 22,641 group room nights sold combined with an additional 72,391 transient room nights sold. Room revenue in our existing portfolio was impacted during 2012 by major room renovations at both the Renaissance Washington DC and the Hyatt Regency Newport Beach. The major room renovation at the Renaissance Washington DC caused 13,656 room nights to be out of service during the last six months of 2012, displacing approximately \$2.9 million in room revenue based on the hotel achieving a potential 72.7% occupancy rate and RevPAR of \$148.24 without the renovation. The major room renovation at the Hyatt Regency Newport Beach caused 4,333 room nights to be out of service during the last two months of 2012, displacing approximately \$0.5 million in room revenue based on the hotel achieving a potential 85.0% occupancy rate and RevPAR of \$110.96 without the renovation. Room revenue in our existing portfolio was also negatively impacted in 2012 by Hurricane Sandy, which caused a loss in room revenue of approximately \$1.4 million.

Room revenue increased \$150.1 million, or 42.8%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. We acquired the outside 62.0% equity interests in the Doubletree Guest Suites Times Square in January 2011 (resulting in our 100% ownership of the hotel) and the JW Marriott New Orleans in February 2011. We also purchased a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront in April 2011, and reacquired possession and control of the Renaissance Westchester in June 2010 from a court-appointed receiver. These three hotels acquired in 2011 (the “three hotels acquired in 2011”) and the Renaissance Westchester contributed additional room revenue of \$127.1 million. Room revenue generated by the 20 hotels we acquired prior to January 1, 2010 (our “2011 existing portfolio”) increased \$23.0 million in 2011 as compared to 2010 due to an increase in occupancy (\$13.4 million) combined with an increase in ADR (\$9.6 million). The increase in occupancy was driven by an additional 28,089 group room nights sold combined with an additional 57,518 transient room nights sold. Room revenue at some of our northeast hotels was negatively impacted in 2011 by Hurricane Irene, which caused a loss in room revenue of approximately \$0.9 million.

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

Food and beverage revenue increased \$36.9 million, or 26.7%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The three hotels acquired in 2011 and the Renaissance Westchester contributed an additional \$38.2 million. Food and beverage revenue in our 2011 existing portfolio decreased \$1.3 million during 2011 as compared to 2010. This decrease is primarily due to a reduction in business at one of our Houston, Texas hotels with a customer who was operating under a contract with the United States government. In addition, our 2011 existing portfolio lost approximately \$0.1 million during 2011 due to Hurricane Irene. Banquet revenue also decreased in our 2011 existing portfolio during 2011 as compared to 2010 as a few of our larger group-oriented hotels experienced higher traffic from transient demand than from group demand. These decreases were slightly offset by an increase in food and beverage revenue generated by our outlets due to increased transient occupancy at several of our hotels, as well as to increased volume from local businesses and residents at several of our recently renovated restaurants and lounges.

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

Other operating revenue increased \$19.1 million, or 72.6%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The three hotels acquired in 2011 and the Renaissance Westchester contributed an additional \$12.8 million to other operating revenue during 2011. Other operating revenue also increased \$5.4 million in 2011 as compared to 2010 due to the consolidation of BuyEfficient with our operations due to the purchase of the outside 50.0% equity interest in the joint venture in January 2011. Previously, our 50.0% portion of BuyEfficient's net income was included in equity in earnings of unconsolidated joint ventures. Other operating revenue in our 2011 existing portfolio increased \$0.9 million in 2011 as compared to 2010, as increased parking and lease rent revenue was slightly offset by decreased telephone, cancellation, attrition, guest movies, lift ticket, spa and retail revenue.

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

Hotel operating expenses increased \$118.9 million, or 36.6%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The three hotels acquired in 2011 and the Renaissance Westchester contributed an additional \$109.3 million to hotel operating expenses during 2011. Hotel operating expenses in our 2011 existing portfolio increased \$9.6 million during 2011 as compared to 2010. This increase in hotel operating expenses is primarily related to increased room expense, corresponding to the increased room revenue. In addition, hotel operating expenses in our 2011 existing portfolio increased in 2011 as compared to 2010 due to increases in the following expenses: advertising and repairs and maintenance as the hotels increased spending due to the improved economy; franchise fees and assessments due to the increased revenue; and property taxes due to increased assessments. In addition, hotel operating expenses increased in our 2011 existing portfolio during 2011 as compared to 2010 due to increased food and beverage expense, as many of our outlets which were under renovation during 2011 continued to incur labor expenses, including training on new menus and restaurant concepts, along with pre-opening costs. These increases were partially offset by decreased utilities due to reductions in gas rates and usage at several of our hotels and by decreased property and liability insurance due to an actuarial adjustment.

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

Property general and administrative expense increased \$23.5 million, or 38.1%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The three hotels acquired in 2011 and the Renaissance Westchester contributed an additional \$16.8 million to hotel operating expenses during 2011. Property general and administrative expense also increased \$3.7 million in 2011 as compared to 2010 due to the consolidation of BuyEfficient with our operations due to the purchase of the outside 50.0% equity interest in the joint venture in January 2011. Property general and administrative expense in our 2011 existing portfolio increased \$3.0 million during the year ended December 31, 2011 as compared to the year ended December 31, 2010, primarily due to increased payroll, management fees and credit and collection expenses due to the increase in revenue, combined with increased legal expenses, travel, training and sales tax audit expense, partially offset by decreased contract and professional fees, employee recruitment expenses and computer hardware/software costs.

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

Corporate overhead expense increased \$3.7 million, or 17.0%, during the year ended December 31, 2011 as compared to the year ended December 31, 2010, primarily due to increases of \$0.4 million related to payroll and related costs, \$0.3 million related to contract and professional fees, \$0.2 million related to relocation, \$0.2 million related to travel, \$0.1 million related to bad debt, \$1.5 million related to legal expenses and \$2.4 million related to due diligence costs. In September 2011, we accrued \$1.6 million in settlement costs related to litigation involving three separate claims by certain employees at three of the 24 hotels included in continuing operations. As of December 31, 2012, we have reached court-approved settlements on all three claims. During 2011 we incurred due diligence costs of \$3.4 million related to our completed acquisitions, and an additional \$0.3 million related to in-process or abandoned projects. During 2010, we incurred due diligence costs of \$1.3 million related to in-process or abandoned projects. These increases in corporate overhead expense in 2011 as compared to 2010 were partially offset by decreases of \$1.1 million related to deferred stock compensation, \$0.1 million related to corporate office rent and maintenance, and \$0.2 million related to sales tax audit expenses.

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

Depreciation and amortization expense increased \$34.1 million, or 42.8%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010. The three hotels acquired in 2011 and the Renaissance Westchester contributed an additional \$31.0 million to depreciation and amortization expense during 2011. Depreciation and amortization in our 2011 existing portfolio increased \$3.1 million during 2011 as compared to 2010 due to additional depreciation recognized on hotel renovations and purchases of FF&E for our hotel properties.

Impairment loss. Impairment loss totaled zero for the year ended December 31, 2012, \$10.9 million for the year ended December 31, 2011, and zero for the year ended December 31, 2010. During 2011, we recognized an impairment loss of \$10.9 million on our Royal Palm note due to its sale in October 2011.

Equity in earnings of unconsolidated joint ventures. Equity in earnings of unconsolidated joint ventures totaled zero for the year ended December 31, 2012, \$21,000 for the year ended December 31, 2011, and \$0.6 million for the year ended December 31, 2010. In January 2011, we acquired 100% interests in both the Doubletree Guest Suites Times Square and BuyEfficient joint ventures. Post-acquisition, therefore, we present both of these investments on a consolidated basis. Prior to our January 14, 2011 acquisition date, we did not recognize any earnings on our Doubletree Guest Suites Times Square joint venture during either 2011 or 2010 because the joint venture had cumulative losses in excess of our investment, and we reduced our interest in this partnership to zero at December 31, 2009. The excess cumulative losses resulted primarily from the hotel's fourth quarter 2009 impairment charge. Prior to our purchase of the outside 50.0% equity interest in the BuyEfficient joint venture on January 21, 2011, we recognized income of \$21,000 in 2011 and \$0.6 million in 2010 on our BuyEfficient joint venture.

Interest and other income. Interest and other income totaled \$0.3 million for the year ended December 31, 2012, \$3.1 million for the year ended December 31, 2011 and \$0.1 million for the year ended December 31, 2010. In 2012, we recognized \$0.2 million in interest income, and \$0.1 million in other miscellaneous income. In 2011, we recognized \$2.9 million in interest income, including \$2.7 million related to the Royal Palm note. We sold this Royal Palm note in October 2011 for net proceeds of approximately \$79.2 million. In anticipation of this sale, we recorded an impairment loss of \$10.9 million in September 2011. In addition, during 2011, we recognized income of \$0.1 million on sales and dispositions of surplus FF&E located in several of our hotels and \$0.1 million in other miscellaneous income. In 2010, we recognized \$0.3 million in interest income and \$0.1 million in other miscellaneous income, partially offset by a loss of \$0.3 million on sales and dispositions of surplus FF&E located in several of our hotels and in our corporate office.

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Interest expense	\$71,664	\$67,319	\$54,839
Loss on derivatives	406	2,655	—
Accretion of Senior Notes	1,058	1,062	996
Amortization of deferred financing fees	3,690	3,138	1,457
Write-off of deferred financing fees	3	21	1,462
Loan penalties and fees	—	—	177
	<u>\$76,821</u>	<u>\$74,195</u>	<u>\$58,931</u>

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

Interest expense increased \$15.3 million, or 25.9%, during the year ended December 31, 2011 as compared to the year ended December 31, 2010. Mortgage interest expense increased \$12.5 million during 2011 as compared to 2010 due to increased loan balances as we assumed \$270.0 million of non-recourse senior mortgage and mezzanine debt in connection with our acquisition of the outside 62.0% equity interests in our Doubletree Guest Suites Times Square joint venture in January 2011 (which loan we refinanced in October 2011 with a new \$180.0 million non-recourse mortgage), and a \$42.2 million loan in connection with our acquisition of the JW Marriott New Orleans in February 2011. Our loan balances also increased during 2011 as compared to 2010 due to a \$240.0 million loan entered into by our Hilton San Diego Bayfront joint venture in April 2011. In addition, interest expense increased \$2.7 million during 2011 as compared to 2010 related to losses recognized on interest rate cap agreements on the Doubletree Guest Suites Times Square and Hilton San Diego Bayfront loans, combined with a loss on an interest rate swap agreement on the JW Marriott New Orleans loan. Interest expense also increased during 2011 as compared to 2010 due to a \$1.7 million increase in amortization of deferred financing fees related to additional fees paid in association with our Doubletree Guest Suites Times Square, JW Marriott New Orleans and Hilton San Diego Bayfront acquisitions, as well as to fees incurred on our line of credit and on our refinancing of the Doubletree Guest Suites Times Square in October 2011 and the Hilton Times Square in November 2010. Accretion of Senior Notes also caused interest expense to increase by \$0.1 million in 2011 as compared to 2010. These increases were partially offset by additional interest expenses incurred in 2010 related to the termination of our credit facility in February 2010 and to our refinancing of the Hilton Times Square in November 2010, which caused an additional \$0.2 million in penalties and fees during 2010. In addition, interest expense for 2011 decreased as compared to 2010 as we incurred \$1.5 million in 2010 related to the write-off of deferred financing fees in conjunction with the termination of our credit facility in February 2010.

Our weighted average interest rate per annum on debt included in our continuing operations, including our variable-rate debt obligations, was approximately 4.9% at December 31, 2012, 5.0% at December 31, 2011 and 5.5% at December 31, 2010. At December 31, 2012, approximately 69.6% of the outstanding notes payable included in our continuing operations had fixed interest rates. At December 31, 2011,

approximately 70.5% of the outstanding notes payable included in our continuing operations had fixed interest rates. At December 31, 2010, all of the outstanding notes payable included in our continuing operations had fixed interest rates.

Loss on extinguishment of debt. Loss on extinguishment of debt totaled \$0.2 million for the year ended December 31, 2012, and zero for both the years ended December 31, 2011 and 2010. During 2012, we recognized a loss of \$0.2 million due to the repurchase and cancellation of \$4.5 million in aggregate principal amount of the Senior Notes.

Gain on remeasurement of equity interests. Gain on remeasurement of equity interests totaled zero for the year ended December 31, 2012, \$69.2 million for the year ended December 31, 2011, and zero for the year ended December 31, 2010. In January 2011, we purchased the outside interests in both our Doubletree Guest Suites Times Square joint venture and our BuyEfficient joint venture, and became the sole owner of both entities. Previously, our investment in the Doubletree Guest Suites Times Square joint venture consisted of a 38.0% equity interest in the hotel and a \$30.0 million, 8.5% mezzanine loan maturing in January 2017 secured by the equity interests in the hotel. During the fourth quarter of 2009, the Doubletree Guest Suites Times Square recorded an impairment loss, effectively reducing our investment in the partnership to zero as of December 31, 2009. In conjunction with the acquisition of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square in January 2011, we adjusted both our investment in the Doubletree Guest Suites Times Square joint venture and the mezzanine loan to their fair market values, and recorded gains totaling \$60.5 million on the remeasurement. In addition, in conjunction with the acquisition of the outside 50.0% equity interest in the BuyEfficient joint venture in January 2011, we adjusted our investment up to its fair market value, and recorded a gain of \$8.7 million on the remeasurement.

Income tax provision. Income tax provision totaled \$1.1 million for the year ended December 31, 2012, and zero for both the years ended December 31, 2011 and 2010. During 2012, our use of net operating loss carryforwards resulted in federal and state income tax expense totaling \$1.1 million.

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

Properties:	Rooms:	Disposition Date:
<i>2012:</i>		
Kahler Grand ⁽¹⁾	660	Held for sale as of December 31, 2012
Kahler Inn & Suites	271	Held for sale as of December 31, 2012
Marriott Rochester ⁽¹⁾	202	Held for sale as of December 31, 2012
Residence Inn by Marriott Rochester	89	Held for sale as of December 31, 2012
Textile Care Services Rochester	—	Held for sale as of December 31, 2012
Doubletree Guest Suites Minneapolis	229	September 2012
Hilton Del Mar	257	September 2012
Marriott Troy	350	September 2012
Office building adjacent to the Marriott Troy	—	September 2012
Marriott Del Mar	284	August 2012
<i>2011:</i>		
Valley River Inn	257	October 2011
Textile Care Services Salt Lake City	—	July 2011
Royal Palm Miami Beach	409	April 2011
<i>2010⁽²⁾:</i>		
Courtyard by Marriott, San Diego (Old Town)	176	November 2010
Hilton Huntington	302	November 2010
Holiday Inn Downtown San Diego	220	November 2010
Holiday Inn Express, San Diego (Old Town)	125	November 2010
Marriott Provo	330	November 2010
Marriott Salt Lake City (University Park)	218	November 2010
Renaissance Atlanta Concourse	387	November 2010
Residence Inn by Marriott Manhattan Beach	176	November 2010
Marriott Ontario Airport	299	August 2010
W Hotel San Diego	258	July 2010
Renaissance Westchester ⁽³⁾	347	June 2010
Total rooms	5,846	

(1) During 2011, the Company subtracted eight rooms from the Kahler Grand and one room from the Marriott Rochester, bringing the hotel room counts to 660 and 202, respectively.
(2) Hotels deeded back to the lenders, or sold by the receiver, pursuant to our 2009 secured debt restructuring program.
(3) Hotel reacquired by the Company in June 2010.

Income from discontinued operations for the year ended December 31, 2012 includes activity for the four hotels and one office building sold during 2012 and the four hotels and one commercial laundry facility classified as held for sale as of December 31, 2012 due to their sale in January 2013. Income from discontinued operations for the year ended December 31, 2011 includes activity for the four hotels and one office building sold during 2012, the four hotels and one commercial laundry facility classified as held for sale as of December 31, 2012 and the two hotels and one commercial laundry facility sold in 2011. Income from discontinued operations for the year ended December 31, 2010 includes activity for the four hotels and one office building sold during 2012, the four hotels and one commercial laundry facility held for sale as of December 31, 2012, the two hotels and one commercial laundry facility sold in 2011, and the 11 hotels disposed of during 2010 pursuant to our 2009 secured debt restructuring program. Income from discontinued operations for the years ended December 31, 2012, 2011 and 2010 is as follows (in thousands):

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Operating revenues	\$100,861	\$130,997	\$ 198,595
Operating expenses	(71,089)	(96,581)	(163,286)
Interest expense	(6,490)	(9,337)	(29,071)
Depreciation and amortization expense	(13,164)	(16,188)	(21,299)
Impairment loss	—	(1,495)	(1,943)
Gain on extinguishment of debt	—	18,145	86,235
Gain on sale of hotels and other assets, net	38,292	14,912	—
Income from discontinued operations	\$ 48,410	\$ 40,453	\$ 69,231

Income from consolidated joint venture attributable to non-controlling interest. Income from consolidated joint venture attributable to non-controlling interest totaled \$1.8 million for the year ended December 31, 2012, \$0.3 million for the year ended December 31, 2011, and zero for the year ended December 31, 2010. In April 2011 we purchased a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. Consistent with the Presentation Topic of the FASB ASC, our net income for the years ended December 31, 2012 and 2011 includes 100% of the net income generated during our ownership period by the entity that owns the Hilton San Diego Bayfront. The outside 25.0% interest in the entity that owns the Hilton San Diego Bayfront earned net income of \$1.8 million and \$0.3 million for the years ended December 31, 2012 and 2011, respectively.

Distributions to non-controlling interest. Distributions to non-controlling interest totaled \$31,000 for the year ended December 31, 2012, \$30,000 for the year ended December 31, 2011, and zero for the year ended December 31, 2010. We purchased the outside 62.0% common stock equity interest in our Doubletree Guest Suites Times Square joint venture in January 2011, and, as a result, we became the sole common stockholder of the captive REIT that owns the hotel. Preferred dividends earned by investors from the entity that owns the Doubletree Guest Suites Times Square, net of related administrative fees totaled \$31,000 and \$30,000 for the years ended December 31, 2012 and 2011, respectively.

Preferred stock dividends and accretion. Preferred stock dividends and accretion totaled \$29.7 million for the year ended December 31, 2012, \$27.3 million for the year ended December 31, 2011, and \$20.7 million for the year ended December 31, 2010. In April 2011, we issued 4,600,000 shares of Series D preferred stock, causing us to incur an additional \$2.4 million in dividends during 2012 as compared to 2011, and an additional \$6.8 million in dividends during 2011 as compared to 2010. This increase in 2011 was slightly offset by a reduction in preferred stock accretion due to the initial carrying value of our Series C preferred stock being fully accreted to its redemption value during the third quarter of 2010.

Undistributed income allocated to unvested restricted stock compensation. In accordance with the Earnings Per Share Topic of the FASB ASC, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. As such, undistributed income of \$0.2 million for 2012, \$0.6 million for 2011 and \$0.1 million for 2010 were allocated to the participating securities.

INVESTING ACTIVITIES

Acquisitions. We believe we are in the first half of a potentially prolonged cyclical lodging industry recovery. Accordingly, we further believe that hotels acquired over the next several quarters are likely to benefit from a multi-year recovery in hotel profitability, and may create long-term value in excess of our investment hurdles. During 2010, 2011 and 2012, we made several selective acquisitions. The following table sets forth the hotels we have acquired or reacquired since January 1, 2010:

Hotels	Rooms	Acquisition Date
2012:		
Hyatt Chicago Magnificent Mile, Chicago, Illinois	417	June 4, 2012
Hilton Garden Inn Chicago Downtown/Magnificent Mile, Chicago, Illinois	357	July 19, 2012
2011:		
Doubletree Guest Suites Times Square, New York City, New York	460	January 14, 2011
JW Marriott New Orleans, New Orleans, Louisiana ⁽¹⁾	494	February 15, 2011
Hilton San Diego Bayfront, San Diego, California	1,190	April 15, 2011
2010:		
Renaissance Westchester, White Plains, New York ⁽²⁾	347	June 14, 2010
Royal Palm Miami Beach, Miami Beach, Florida ⁽³⁾	409	August 27, 2010
Total January 1, 2010 to December 31, 2012	3,674	

(1) Subsequent to this acquisition, the Company added two additional rooms to this hotel, increasing the room count to 496.

(2) Hotel deeded back to the lender and reacquired by the Company on June 14, 2010.

(3) Hotel sold by the Company on April 8, 2011.

The total cost for these seven hotel acquisitions was approximately \$585.5 million, including shares of the Company’s common stock valued at \$51.2 million for accounting purposes, or \$159,400 per room. Each of these acquisitions is discussed below.

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

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

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

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

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

In June 2010, we reacquired the 347-room Renaissance Westchester in White Plains, New York. In 2009, we transferred possession and control of the hotel to a court-appointed receiver pursuant to our 2009 secured debt restructuring program. In connection with this transfer, we deconsolidated this hotel and reclassified the assets and liabilities, including the \$25.2 million hotel net asset and the hotel's \$29.2 million 4.98% non-recourse mortgage, to discontinued operations on our balance sheets. Additionally, we reclassified the Renaissance Westchester's results of operations and cash flows to discontinued operations on our statements of operations and cash flows. We reacquired the Renaissance Westchester in June 2010 for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled. We recorded a \$6.7 million gain on extinguishment of debt to discontinued operations in June 2010.

In August 2010, we used available cash on hand to acquire the Royal Palm hotel in Miami Beach, Florida at a foreclosure auction for a gross purchase price of \$126.1 million excluding transaction costs. Prior to the auction, we purchased a portion of the hotel's outstanding debt at a discount to par resulting in a net purchase price of the Royal Palm hotel of approximately \$117.6 million.

In addition to the above noted hotels, we deployed a portion of our excess cash in 2011 and 2010 towards non-hotel investments. Each of these non-hotel investments is discussed below.

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

In April 2010, we purchased two hotel loans with a combined principal amount of \$32.5 million for a total purchase price of \$3.7 million. The loans included (i) a \$30.0 million, 8.5% mezzanine loan maturing in January 2017 secured by the equity interests in our Doubletree Guest Suites Times Square joint venture, and (ii) one-half of a \$5.0 million, 8.075% subordinate note maturing in November 2010 secured by the 101-room boutique hotel known as Twelve Atlantic Station in Atlanta, Georgia. We purchased the mezzanine loan for \$3.45 million and half of the subordinate note for \$250,000. After our acquisition of the remaining interests in the Doubletree Guest Suites Times Square joint venture in January 2011, the mezzanine loan was eliminated in consolidation on our balance sheet until the mezzanine loan was satisfied in conjunction with our refinancing of the debt secured by the Doubletree Guest Suites Times Square in October 2011.

In November 2010, we purchased the remaining half of the Twelve Atlantic Station subordinate note for an additional \$250,000. In November 2010, the subordinate note was modified to provide for monthly interest only payments of 3.5%, with the remaining interest due at maturity, and the maturity date was extended to November 2012. As the subordinate note was in default, the borrower was required to bring the subordinate note current. During 2012, we continued to account for the subordinate note using the cost recovery method as we did not consider the expected cash flows from the loan to be reasonably probable and estimable. As of December 31, 2012, the subordinate note secured by the Twelve Atlantic Station was again in default, and we recorded a reserve for the remaining \$0.2 million balance to bad debt expense, which is included in corporate overhead on our consolidated statements of operations and comprehensive income. We are currently working with the borrower and the special servicer to bring the note current, at which time we may reverse the bad debt expense we recorded in 2012.

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

Dispositions. We have from time to time divested of assets that no longer fit our target profile, will not offer long-term returns in excess of our cost of capital, or that have high risk relative to their anticipated returns. The following table sets forth the hotels we have sold or disposed of since January 1, 2010:

Hotels	Rooms	Disposition Date
2012:		
Marriott Del Mar, San Diego, California	284	August 23, 2012
Doubletree Guest Suites, Minneapolis, Minnesota ⁽¹⁾	229	September 14, 2012
Hilton Del Mar, San Diego, California ⁽¹⁾	257	September 14, 2012
Marriott, Troy, Michigan ⁽¹⁾	350	September 14, 2012
2011:		
Royal Palm Miami Beach, Miami Beach, Florida	409	April 8, 2011
Valley River Inn, Eugene, Oregon	257	October 26, 2011
2010:		
Renaissance Westchester, White Plains, New York ⁽²⁾⁽³⁾	347	June 14, 2010
W Hotel, San Diego, California ⁽²⁾	258	July 2, 2010
Marriott, Ontario (Airport), California ⁽²⁾	299	August 12, 2010
Courtyard by Marriott, San Diego (Old Town), California ⁽²⁾	176	November 1, 2010
Hilton, Huntington, New York ⁽²⁾	302	November 1, 2010
Holiday Inn Downtown, San Diego, California ⁽²⁾	220	November 1, 2010
Holiday Inn Express, San Diego (Old Town), California ⁽²⁾	125	November 1, 2010
Marriott, Provo, Utah ⁽²⁾	330	November 1, 2010
Marriott, Salt Lake City (University Park), Utah ⁽²⁾	218	November 1, 2010
Renaissance Atlanta Concourse, Atlanta, Georgia ⁽²⁾	387	November 1, 2010
Residence Inn by Marriott, Manhattan Beach, California ⁽²⁾	176	November 1, 2010
Total January 1, 2010 to December 31, 2012	4,624	

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

(2) Hotels deeded back to the lenders, or sold by the receiver, pursuant to our 2009 secured debt restructuring program.

(3) Hotel reacquired by the Company on June 14, 2010.

The aggregate net sale proceeds for the four hotels and office building sold in 2012 and the two hotels sold in 2011 was \$192.2 million, including the Royal Palm note, or \$107,600 per room. The 11 hotels disposed of in 2010 pursuant to our secured debt restructuring program eliminated \$282.7 million of debt from our balance sheet. The results of operations of all of the properties identified above and the gains or losses on dispositions and extinguishments of debt through December 31, 2012 are included in discontinued operations for all periods presented through the time of sale. The cash proceeds from the sales are included in our cash flows from investing activities for the respective periods. Each of these dispositions is discussed below.

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

The mortgages secured by the Marriott Del Mar, Hilton Del Mar and Marriott Troy contain “cash trap” provisions that were triggered in prior years due to the decline in the performance of these hotels. Once triggered, substantially all of the excess cash flow from operations generated by the three hotels was deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lenders. Cash was distributed to us only after certain items were paid, including deposits into leasing and maintenance reserve accounts and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and leasing expenses. As of December 31, 2012, a total of \$8.2 million of our cash was held by the lenders of these three hotels. The cash will be returned to us once the lenders release the cash to the buyers, which is expected to occur within the near term.

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

We did not sell any hotels during 2010. We did, however, complete the disposal of 11 hotels pursuant to our secured debt restructuring program, which we initiated in 2009. In June 2010, we disposed of the Renaissance Westchester, and subsequently reacquired the hotel from the lender during the same month. We completed the deed back of the W San Diego in July 2010, and title to the hotel was transferred to the lender. In August 2010, the Marriott Ontario Airport was sold by the receiver, and title to the hotel was transferred to the third party purchaser. In November 2010, we completed the deed back of eight hotels which secured a non-recourse mortgage, and titles to the hotels were transferred to the lender. As of December 31, 2010, five of the eight hotels remained subject to franchise agreements which contained corporate guaranties. If the franchise agreements on these five hotels were to be terminated, we were potentially liable for up to \$19.6 million in termination fees. In June 2011, we paid termination fees of \$1.5 million related to one of these five hotels, and the franchise agreements on the remaining four hotels were transferred to new owners, resulting in our recording \$18.1 million to gain on extinguishment of debt in June 2011, which is included in discontinued operations.

The following table summarizes our portfolio and room data from January 1, 2010 through December 31, 2012, adjusted for the hotels acquired, reacquired, disposed through non-sale disposition and sold during the respective periods.

	2012	2011	2010
<i>PORTFOLIO DATA—HOTELS</i>			
Number of hotels—beginning of period	32	31	40
Add: Acquisitions	2	3	1
Add: Reacquisitions	—	—	1
Less: Dispositions	(4)	(2)	—
Less: Non-sale dispositions	—	—	(11)
Number of hotels—end of period ⁽¹⁾	30	32	31
	2012	2011	2010
<i>PORTFOLIO DATA—ROOMS</i>			
Number of rooms—beginning of period	13,208	11,722	13,804
Add: Acquisitions	774	2,144	409
Add: Reacquisitions	—	—	347
Add: Room (conversions) expansions	(8)	8	—
Less: Dispositions	(1,120)	(666)	—
Less: Non-sale dispositions	—	—	(2,838)
Number of rooms—end of period ⁽¹⁾	12,854	13,208	11,722
Average rooms per hotel—end of period ⁽¹⁾	428	413	378

(1) Both the number of hotels and number of rooms as of December 31, 2012 include four hotels which we have classified as held for sale as of December 31, 2012 due to their sale in January 2013: the Kahler Grand; the Kahler Inn & Suites; the Marriott Rochester; and the Residence Inn by Marriott Rochester. Without these four hotels, we had 26 hotels held for investment as of December 31, 2012, comprised of 11,632 rooms for an average of 447 rooms per hotel. The details of this sale are discussed below.

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

In January 2013, we sold the Kahler Grand, the Kahler Inn & Suites, the Marriott Rochester, and the Residence Inn by Marriott Rochester in a portfolio sale that also included our commercial laundry facility in Rochester, Minnesota for a gross sales price of \$230.0 million. In conjunction with the sale, we defeased the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of approximately \$30.0 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and wrote off \$51,000 in deferred financing fees.

Renovations. During 2012, we invested \$109.3 million in capital improvements to our hotel and other real estate portfolio. Consistent with our cycle-appropriate strategy, this investment in capital improvements to our portfolio was \$8.9 million more than the amount we invested in 2011 and \$52.3 million more than the amount we invested in 2010.

LIQUIDITY AND CAPITAL RESOURCES

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

Operating activities. Our net cash provided by or used in operating activities fluctuates primarily as a result of changes in RevPAR and operating cash flow of our hotels. Our net cash provided by or used in operating activities may also be affected by changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. Net cash provided by operating activities was \$171.5 million for 2012 compared to \$155.2 million for 2011, and \$44.3 million for 2010. The increases in 2012 as compared to 2011 and 2011 as compared to 2010 were primarily due to our acquisitions of new hotels, combined with increased earnings at our existing hotels.

Investing activities. Our net cash provided by or used in investing activities fluctuates primarily as a result of acquisitions, dispositions and renovations of hotels. Net cash used in investing activities in 2012, 2011 and 2010 was as follows (in thousands):

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Proceeds from sales of hotel properties and other assets	\$ 46,367	\$ 44,576	\$ 63
Cash received from unconsolidated joint venture	—	—	900
Restricted cash—replacement reserve	(10,743)	(8,143)	(931)
Acquisitions of notes receivable	—	—	(3,950)
Proceeds received from sale of note receivable	—	79,194	—
Acquisitions of hotel properties and other assets	(120,003)	(263,264)	(142,410)
Renovations and additions to hotel properties and other real estate	(109,321)	(100,400)	(56,984)
Payments for interest rate derivatives	—	(1,082)	—
Net cash used in investing activities	<u><u>\$(193,700)</u></u>	<u><u>\$(249,119)</u></u>	<u><u>\$(203,312)</u></u>

Net cash used in investing activities was \$193.7 million in 2012, as compared to \$249.1 million in 2011, and \$203.3 million in 2010. During 2012, we received total proceeds of \$46.4 million from the sales of four hotels and an office building adjacent to one of the sold hotels, including \$17.7 million for the Marriott Del Mar, \$28.6 million from the portfolio sale of the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy, and an office building adjacent to the Marriott Troy, and an additional \$37,000 from the sale of surplus FF&E. This cash inflow was offset by the following cash outflows: \$10.7 million as we increased the balance in our restricted cash replacement reserve accounts; \$120.0 million to acquire two hotels, including \$29.7 million paid to acquire the Hyatt Chicago Magnificent Mile, partially offset by \$21,000 of unrestricted cash received upon acquisition and \$90.3 million paid to acquire the Hilton Garden Inn Downtown/Magnificent Mile, partially offset by \$11,000 of unrestricted cash received upon acquisition; and \$109.3 million for renovations and additions to our portfolio.

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

During 2010, we paid \$117.6 million to acquire the Royal Palm Miami Beach and \$24.8 million to reacquire the Renaissance Westchester, for a total cash outlay of \$142.4 million. In addition, we increased the balance in our restricted cash replacement reserve accounts by \$0.9 million, and we paid \$4.0 million for the purchase of two notes receivable and \$57.0 million for renovations and additions to our portfolio. These cash outflows were partially offset by \$0.1 million of proceeds received from the sale of surplus FF&E at several of our hotels and our corporate office and distributions of \$0.9 million received from our BuyEfficient joint venture.

Financing activities. Our net cash provided by or used in financing activities fluctuates primarily as a result of our issuance of common stock and our issuance and repayment of notes payable (including the repurchase of Senior Notes) and our credit facility, and our issuance and repurchase of other forms of capital, including preferred equity. Net cash provided by financing activities was \$30.2 million in 2012, as compared to net cash used of \$32.8 million in 2011, and net cash provided of \$82.6 million in 2010. Net cash provided by financing activities for 2012 consisted of \$126.1 million in net proceeds received from the issuance of common stock, including \$126.2 million in net proceeds received from our common stock offering offset by \$0.1 million in fees related to shares issued to the seller of the Hyatt Chicago Magnificent Mile, and \$15.0 million in proceeds received from a draw on our credit facility. These cash inflows were partially offset by \$68.8 million in principal payments on our notes payable and credit facility, including \$32.2 million to repay the existing mortgage secured by the Renaissance Long Beach, \$15.0 million to repay a draw on our credit facility and \$21.6 million of principal payments on our notes payable. In addition, we paid \$4.6 million to repurchase a portion of our Senior Notes, \$1.3 million in deferred financing costs to amend our credit facility, \$29.7 million in preferred dividends to our stockholders, and \$6.4 million in distributions to the non-controlling interests in our hotels.

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

Net cash provided by financing activities for 2010 consisted primarily of \$190.6 million in net proceeds received from the issuance of common stock and \$92.5 million in proceeds received from the new loan on the Hilton Times Square. These cash inflows were partially offset by \$175.2 million of principal payments on our notes payable, including \$83.0 million paid to release three hotels from a loan, \$81.0 million to pay off the loan on the Hilton Times Square in connection with the refinance of the loan and \$11.2 million of principal amortization. In addition, net cash provided by financing activities for 2010 includes \$20.5 million of dividends paid to our stockholders, and \$4.8 million in deferred financing costs paid in connection with our new credit facility and the refinancing of the Hilton Times Square loan.

Future. We expect our primary uses of cash to be for acquisitions of hotels, including possibly hotel portfolios, capital investments in our hotels, operating expenses, repayment of principal on our notes payable and credit facility, interest expense and dividends. We expect our primary sources of cash will continue to be our operating activities, working capital, notes payable, dispositions of hotel properties, and proceeds from public and private offerings of debt securities and common and preferred stock. Our financial objectives include the measured improvement of our credit ratios, maintenance of appropriate levels of liquidity, and a gradual reduction in our financial leverage. In light of our leverage objectives, in the near-term, we expect to fund acquisitions largely through the issuance of equity in order to grow the quality and scale of our portfolio while reducing our leverage. Our acquisitions of the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile in June 2012 and July 2012, respectively, were consistent with this strategy. Our ability to raise funds through the issuance of equity securities depends on, among other things, general market conditions for hotel companies and REITs and market perceptions about us. We will continue to analyze alternate sources of capital in an effort to minimize our capital costs and maximize our financial flexibility. However, when needed, the capital markets may not be available to us on favorable terms or at all.

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

Debt. In February 2012, we repurchased \$4.5 million in aggregate principal amount of our Senior Notes for \$4.57 million, including \$13,000 in interest, using our existing cash. After the repurchase, such Senior Notes were cancelled. We wrote off \$47,000 in deferred financing fees and \$0.1 million of the Senior Notes discount, and recognized a loss of \$0.2 million on this early extinguishment of debt. We repurchased the remaining \$58.0 million balance of the Senior Notes at the first put date in January 2013 for \$58.0 million plus \$23,000 in accrued interest using our existing cash. After the repurchase, such Senior Notes were cancelled, leaving no amounts outstanding for the Senior Notes.

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

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

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

In September 2012, we amended and restated our \$150.0 million senior unsecured revolving credit facility, which was scheduled to mature in November 2013. The pricing on the amended revolving credit facility was reduced and the 1% LIBOR floor was eliminated. The maturity of the credit facility was extended to November 2015 with an option to extend to November 2016. The amended credit facility's interest rate is based on a pricing grid with a range of 175 to 350 basis points, which represents a reduction from the previous grid that ranged from 325 to 425 basis points over LIBOR depending on our leverage ratio. The credit facility also includes an accordion option that allows us to request additional lender commitments up to a total of \$350.0 million. We paid \$1.3 million in deferred financing fees in conjunction with this amendment, which will be amortized over the term of the amended credit facility. The credit facility currently has no outstanding borrowings; however, as of December 31, 2012, we have \$3.8 million in outstanding irrevocable letters of credit backed by the credit facility.

In January 2013, we completed the portfolio sale of the Kahler Grand, the Kahler Inn & Suites, the Marriott Rochester, the Residence Inn by Marriott Rochester and a commercial laundry facility located in Rochester, Minnesota for a gross sales price of \$230.0 million. Concurrent with the portfolio sale, we defeased the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of approximately \$30.0 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and wrote off \$51,000 in related deferred financing fees.

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

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

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

Regarding our 2010 debt activities, in February 2010, we elected to terminate our existing \$80.0 million credit facility, and we wrote off \$1.5 million in related deferred financing costs. The termination of the facility eliminated approximately \$0.6 million in fees and associated costs per annum. In November 2010, we entered into a new \$150.0 million senior corporate credit facility, which we later amended in September 2012.

In November 2010, we entered into a new \$92.5 million non-recourse mortgage on our Hilton Times Square. The new mortgage matures in 2020 and bears a fixed interest rate of 4.97%, with scheduled monthly principal and interest amounts based on a 30-year amortization. The proceeds from the new mortgage were used in part to repay the maturing \$81.0 million mortgage on our Hilton Times Square, which bore an interest rate of 5.915%. Excess proceeds were retained for general corporate purposes. The new mortgage contains customary events of default relating to payments and breaches of representations and warranties.

As of December 31, 2012, we had \$1.4 billion of debt, including \$27.3 million in debt associated with our held for sale properties, \$235.6 million of cash and cash equivalents, including restricted cash, and total assets of \$3.1 billion. We believe that by controlling debt levels, staggering maturity dates and maintaining a highly flexible capital structure, we can maintain lower capital costs than more highly leveraged companies, or companies with limited flexibility due to restrictive corporate-level financial covenants.

As of December 31, 2012, all of our outstanding debt had fixed interest rates, except the \$234.7 million non-recourse mortgage on the Hilton San Diego Bayfront and the \$180.0 million non-recourse mortgage on the Doubletree Guest Suites Times Square, both of which are subject to interest rate cap agreements. The interest rate cap agreement on the Hilton San Diego Bayfront mortgage matures in April 2013, and caps the 3-month LIBOR rate at 3.75%. We plan to purchase a new interest rate cap agreement on the Hilton San Diego Bayfront mortgage in April upon the expiration of the current agreement. The interest rate cap agreement on the Doubletree Guest Suites Times Square mortgage matures in October 2015, and caps the 3-month LIBOR rate at 4.0%. The majority of our mortgage debt is in the form of single asset loans. We currently believe this structure is appropriate for the operating characteristics of our business and provides flexibility for assets to be sold subject to the existing debt, and as evidenced by our 2009 secured debt restructuring program, in instances where asset values have declined to levels below the principal amount of the associated mortgage, non-recourse single asset mortgages may limit the degradation in value experienced by our stockholders by shifting a portion of asset risk to our secured lenders.

As of December 31, 2012, excluding debt on assets held for sale and the Senior Notes which were repurchased in January 2013, the weighted average term to maturity of our debt is approximately 5 years, and 68.2% of this debt is fixed rate with a weighted average interest rate of 5.6%. Including our variable-rate debt obligations based on the variable rates at December 31, 2012, the weighted average interest rate on this debt is 4.9%.

Financial Covenants. We are subject to compliance with various covenants under the Series C preferred stock and the Senior Notes. With respect to our Series C preferred stock, if we fail to meet certain financial ratios for four consecutive quarters, a financial ratio violation will occur. During the continuation of a financial ratio violation, among other things, we would be restricted from paying dividends on our common stock, and may incur a 50 basis point per quarter dividend increase on the Series C preferred stock. Additionally, the Series C preferred stockholders would gain the right to appoint one board member. We do not currently expect to incur a financial ratio violation.

With respect to our Senior Notes, if the maturity dates of more than \$300.0 million of our indebtedness were to be accelerated as the result of uncured defaults, either the trustee or the holders of not less than 25% in principal amount of the outstanding Senior Notes would have the right to declare the Senior Notes and any unpaid interest immediately due and payable. As of December 31, 2012, none of the maturity dates have been accelerated for any of our indebtedness. In January 2013, we repurchased the remaining \$58.0 million balance of the Senior Notes at the first put date in January 2013. After the repurchase, such Senior Notes were cancelled, leaving no amounts outstanding for the Senior Notes.

Additionally, we may in the future seek to obtain mortgages on one or all of our unencumbered hotels which totaled 11 as of January 31, 2013 after our portfolio sale of four hotels in January 2013. All but two of the 11 unencumbered hotels are currently held by subsidiaries whose interests are pledged to our credit facility at December 31, 2012: Courtyard by Marriott Los Angeles, Fairmont Newport Beach, Hilton Garden Inn Chicago Downtown/Magnificent Mile (not pledged to our credit facility), Hyatt Chicago Magnificent Mile (not pledged to our credit facility), Hyatt Regency Newport Beach, Marriott Quincy, Marriott Portland, Renaissance Long Beach, Renaissance Los Angeles Airport, Renaissance Westchester and Sheraton Cerritos. These 11 hotels had an aggregate of 4,299 rooms as of December 31, 2012, and generated \$247.1 million in revenue during 2012, including revenue generated prior to our ownership as applicable. Should we obtain secured financing on any or all of our 11 unencumbered hotels, the amount of capital available through our credit facility may be reduced.

Cash Balance. As of December 31, 2012, our unrestricted cash balance of \$157.2 million exceeds all of our pending maturities through April 2015. By minimizing our need to access external capital by maintaining higher than typical cash balances, our financial security and flexibility are meaningfully enhanced because we are able to fund our business needs and debt maturities partially with our cash. As we believe the lodging cycle is in the first half of a potentially prolonged cyclical recovery, we may deploy a portion of our excess cash balance in 2013 towards debt repayments and repurchases, selective acquisitions and capital investments in our portfolio. Our repurchase of the remaining \$58.0 million balance of our Senior Notes in January 2013 is consistent with this strategy. While our primary focus is on acquiring branded, urban, upper upscale hotels, our acquisition program is aimed at generating attractive risk-adjusted returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans.

CONTRACTUAL OBLIGATIONS

The following table summarizes our payment obligations and commitments as of December 31, 2012 (in thousands):

	Payment Due by Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
(in thousands)					
Notes payable	\$1,363,392	\$ 76,726	\$180,538	\$673,809	\$ 432,319
Notes payable on assets held for sale ⁽¹⁾	27,270	27,270	—	—	—
Interest obligations on notes payable ⁽²⁾	302,238	64,801	123,530	68,120	45,787
Interest obligations on notes payable of assets held for sale ⁽³⁾	127	127	—	—	—
Capital lease obligations	15,656	35	45	3	15,573
Interest obligations on capital leases	103,655	1,402	2,804	2,803	96,646
Operating lease obligations	547,340	10,105	20,383	23,587	493,265
Construction commitments	43,604	43,604	—	—	—
Employment obligations	1,008	914	94	—	—
Total	\$2,404,290	\$224,984	\$327,394	\$768,322	\$1,083,590

(1) Notes payable on assets held for sale includes debt secured by the Kabler Grand and the commercial laundry facility located in Rochester, Minnesota, which we have classified as held for sale as of December 31, 2012 and included in discontinued operations due to their sale in January 2013.

(2) Interest on variable-rate debt obligations is calculated based on the variable rates at December 31, 2012 and includes the effect of our interest rate derivative agreements.

(3) Due to the January 2013 sale of the Kabler Grand and the commercial laundry facility located in Rochester, Minnesota, interest obligations on notes payable of assets held for sale includes interest obligations only through January 31, 2013.

CAPITAL EXPENDITURES AND RESERVE FUNDS

We believe we maintain each of our hotels in good repair and condition and in general conformity with applicable franchise and management agreements, ground, building and air leases, laws and regulations. Our capital expenditures primarily relate to the ongoing maintenance of our hotels and are budgeted in the reserve accounts described in the following paragraph. We also incur capital expenditures for renovation and development. We invested \$109.3 million in our portfolio during 2012. As of December 31, 2012, we have contractual construction commitments totaling \$43.6 million. If we acquire, renovate or develop additional hotels in the future, our capital expenditures will increase.

With respect to our hotels that are operated under management or franchise agreements with major national hotel brands and for all of our hotels subject to first mortgage liens, we are obligated to maintain an FF&E reserve account for future planned and emergency-related capital expenditures at these hotels. The amount funded into each of these reserve accounts is determined pursuant to the management, franchise and loan agreements for each of the respective hotels, ranging between zero and 5.0% of the respective hotel's total annual revenue. As of December 31, 2012, \$47.2 million was held in FF&E reserve accounts for future capital expenditures at the 26 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 as indicated in the table below. Revenue for certain of our hotels is generally affected by seasonal business patterns (e.g., the first quarter is strong in Orlando, the second quarter is strong for the Mid-Atlantic business hotels, and the fourth quarter is strong for New York City). Quarterly revenue also may be adversely affected by renovations, our managers' effectiveness in generating business and by events beyond our control, such as extreme weather conditions, terrorist attacks or alerts, public health concerns, airline strikes or reduced airline capacity, economic factors and other considerations affecting travel. Quarterly revenue is also impacted by the 13-fiscal period accounting calendar used by one of our third-party managers, subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, "Marriott"). Beginning in 2013, Marriott, the third-party manager of 10 of our hotels will switch to a standard 12-month fiscal calendar, which will impact our seasonality by shifting the operating results for approximately 20 calendar days from the fourth quarter to the first three quarters. Revenues for our 26 hotel Comparable Portfolio by quarter for 2010, 2011 and 2012 were as follows (dollars in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
REVENUES					
2010 Comparable Portfolio ⁽¹⁾	\$163,897	\$191,288	\$179,349	\$211,674	\$746,208
2010 Revenues as a percentage of total	22.0%	25.6%	24.0%	28.4%	100.0%
2011 Comparable Portfolio ⁽¹⁾	\$174,034	\$205,817	\$192,283	\$225,322	\$797,456
2011 Revenues as a percentage of total	21.8%	25.8%	24.1%	28.3%	100.0%
2012 Comparable Portfolio ⁽¹⁾	\$183,805	\$221,829	\$204,361	\$231,494	\$841,489
2012 Revenues as a percentage of total	21.8%	26.4%	24.3%	27.5%	100.0%

(1) Includes all 26 hotel properties in which we have interests as of December 31, 2012. Also includes the following prior ownership results: the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile for all of 2010 and 2011, and during the periods in 2012 before our acquisitions of the hotels; the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the Hilton San Diego Bayfront for all of 2010 and during the periods in 2011 before our acquisitions of the hotels; and the Renaissance Westchester while it was held in receivership and reclassified to discontinued operations, prior to the Company's reacquisition of the hotel in June 2010.

INFLATION

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

- **Acquisition related assets and liabilities.** Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment, intangible assets and capital lease obligations that are assumed as part of the acquisition of a leasehold interest. During 2011 and 2012, we used all available information to make these fair value determinations, and engaged an independent valuation specialist to assist in the fair value determination of the long-lived assets acquired in our purchases of Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/ Magnificent Mile, the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture, the outside 50.0% equity interests in the BuyEfficient joint venture, the JW Marriott New Orleans and the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. Due to the inherent subjectivity in determining the estimated fair value of long-lived assets, we believe that the recording of acquired assets and liabilities is a critical accounting policy.
- **Depreciation and amortization expense.** Depreciation expense is based on the estimated useful life of our assets. The life of the assets is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish our hotels, as well as specific market and economic conditions. Hotel properties and other investments are depreciated using the straight line method over

estimated useful lives primarily ranging from five to 35 years for buildings and improvements and three to 12 years for furniture, fixtures and equipment. While we believe our estimates are reasonable, a change in the estimated lives could affect depreciation expense and net income or the gain or loss on the sale of any of our hotels. We have not changed the estimated useful lives of any of our assets during the periods discussed.

NEW ACCOUNTING STANDARDS AND ACCOUNTING CHANGES

In December 2011, the FASB issued Accounting Standards Update No. 2011-10, “*Property, Plant and Equipment: Derecognition of in Substance Real Estate—a Scope Clarification*” (“ASU No. 2011-10”). Under the amendments in ASU No. 2011-10, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary’s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. ASU No. 2011-10 is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. We do not believe the adoption of ASU No. 2011-10 will have an effect on our historical financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

As of December 31, 2012, excluding debt on assets held for sale and the Senior Notes which were repurchased in January 2013, interest payments on 68.2% of our debt are fixed in nature, which largely mitigates the effect of changes in interest rates on our cash interest payments. If market rates of interest on our variable rate debt increase or decrease by 100 basis points, interest expense would increase or decrease, respectively, our future earnings and cash flows by approximately \$4.3 million based on the variable rates at December 31, 2012. However, increases and decreases in LIBOR rates are sometimes correlated with increases and decreases in lodging operations, which may mean that any increases in our interest expense due to higher variable rates may coincide with increases in our revenue due to higher lodging demand.

CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

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

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

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

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

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework. Based on its evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2012.

Ernst & Young LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report and, as part of its audit, has issued its report, included herein at page 52, on the effectiveness of our internal control over financial reporting.

(c) Changes in Internal Control over Financial Reporting

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

*REPORT OF INDEPENDENT
Registered Public Accounting Firm*

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

We have audited Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Sunstone Hotel Investors, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Sunstone Hotel Investors, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sunstone Hotel Investors, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income, equity, and cash flows for each of the years in the three-year period ended December 31, 2012 of Sunstone Hotel Investors, Inc. and our report dated February 25, 2013 expressed an unqualified opinion thereon.

Irvine, California
February 25, 2013

Ernst + Young LLP

*REPORT OF INDEPENDENT
Registered Public Accounting Firm*

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

We have audited the accompanying consolidated balance sheets of Sunstone Hotel Investors, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sunstone Hotel Investors, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2013 expressed an unqualified opinion thereon.

Irvine, California
February 25, 2013

Ernst & Young LLP

CONSOLIDATED
Balance Sheets

	December 31, 2012	December 31, 2011
<i>(in thousands, except share data)</i>		
ASSETS		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 157,217	\$ 149,198
Restricted cash	78,394	55,359
Accounts receivable, net	27,498	29,677
Inventories	1,377	1,210
Prepaid expenses	10,739	9,834
Assets held for sale, net	132,335	279,945
Total current assets	407,560	525,223
Investment in hotel properties, net	2,681,877	2,532,232
Deferred financing fees, net	11,931	14,340
Goodwill	9,405	9,405
Other assets, net	25,902	20,040
Total assets	\$3,136,675	\$ 3,101,240
LIABILITIES AND EQUITY		
<i>Current liabilities:</i>		
Accounts payable and accrued expenses	\$ 22,646	\$ 24,848
Accrued payroll and employee benefits	23,734	20,727
Due to Third-Party Managers	3,663	3,378
Dividends payable	7,437	7,437
Other current liabilities	30,304	25,392
Current portion of notes payable	76,723	49,505
Notes payable of assets held for sale	27,270	153,587
Liabilities of assets held for sale	8,228	11,064
Total current liabilities	200,005	295,938
Notes payable, less current portion	1,286,666	1,367,385
Capital lease obligations, less current portion	15,621	—
Other liabilities	15,070	12,623
Total liabilities	1,517,362	1,675,946
Commitments and contingencies <i>(Note 14)</i>		
Preferred stock, Series C Cumulative Convertible Redeemable Preferred Stock, \$0.01 par value, 4,102,564 shares authorized, issued and outstanding at December 31, 2012 and 2011, liquidation preference of \$24.375 per share	100,000	100,000
<i>Equity:</i>		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized.		
8.0% Series A Cumulative Redeemable Preferred Stock, 7,050,000 shares issued and outstanding at December 31, 2012 and 2011, stated at liquidation preference of \$25.00 per share	176,250	176,250
8.0% Series D Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at December 31, 2012 and 2011, stated at liquidation preference of \$25.00 per share	115,000	115,000
Common stock, \$0.01 par value, 500,000,000 shares authorized, 135,237,438 shares issued and outstanding at December 31, 2012 and 117,265,090 shares issued and outstanding at December 31, 2011	1,352	1,173
Additional paid in capital	1,493,397	1,312,566
Retained earnings	158,376	110,580
Cumulative dividends	(475,144)	(445,396)
Accumulated other comprehensive loss	(5,335)	(4,916)
Total stockholders' equity	1,463,896	1,265,257
Non-controlling interest in consolidated joint ventures	55,417	60,037
Total equity	1,519,313	1,325,294
Total liabilities and equity	\$3,136,675	\$ 3,101,240

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS
of Operations and Comprehensive Income

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
<i>(in thousands, except per share data)</i>			
REVENUES			
Room	\$576,146	\$501,183	\$351,039
Food and beverage	200,810	175,103	138,188
Other operating	52,128	45,508	26,373
Total revenues	829,084	721,794	515,600
OPERATING EXPENSES			
Room	147,932	128,225	92,101
Food and beverage	139,106	126,139	98,889
Other operating	16,162	14,004	11,535
Advertising and promotion	42,474	37,226	27,326
Repairs and maintenance	32,042	29,067	22,608
Utilities	25,596	25,537	19,117
Franchise costs	30,067	25,595	18,032
Property tax, ground lease and insurance	66,830	58,010	35,280
Property general and administrative	94,642	85,293	61,753
Corporate overhead	24,316	25,453	21,751
Depreciation and amortization	130,907	113,708	79,633
Impairment loss	—	10,862	—
Total operating expenses	750,074	679,119	488,025
Operating income	79,010	42,675	27,575
Equity in earnings of unconsolidated joint ventures	—	21	555
Interest and other income	297	3,115	112
Interest expense	(76,821)	(74,195)	(58,931)
Loss on extinguishment of debt	(191)	—	—
Gain on remeasurement of equity interests	—	69,230	—
Income (loss) before income taxes and discontinued operations	2,295	40,846	(30,689)
Income tax provision	(1,148)	—	—
Income (loss) from continuing operations	1,147	40,846	(30,689)
Income from discontinued operations	48,410	40,453	69,231
NET INCOME	49,557	81,299	38,542
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	—
Distributions to non-controlling interest	(31)	(30)	—
Preferred stock dividends and accretion	(29,748)	(27,321)	(20,652)
Undistributed income allocated to unvested restricted stock compensation	(203)	(636)	(102)
INCOME AVAILABLE TO COMMON STOCKHOLDERS	17,814	53,000	17,788
Basic and diluted per share amounts:			
Income (loss) from continuing operations available (attributable) to common stockholders	\$ (0.24)	\$ 0.11	\$ (0.52)
Income from discontinued operations	0.38	0.34	0.70
Basic and diluted income available to common stockholders per common share	\$ 0.14	\$ 0.45	\$ 0.18
Basic and diluted weighted average common shares outstanding	127,027	117,206	99,709
Other comprehensive income (loss):			
Pension liability adjustment	(419)	(1,779)	(156)
Comprehensive income available to common stockholders	\$ 17,395	\$ 51,221	\$ 17,632

See accompanying notes to consolidated financial statements.

CONSOLIDATED
Statements of Equity

	Preferred Stock						Additional Paid in Capital	Retained Earnings (Deficit)	Cumulative Dividends	Accumulated Other Compre- hensive Loss	Non- Controlling Interest in Consolidated Joint Ventures	Total
	Series A		Series D		Common Stock							
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount						
<i>(in thousands, except per share data)</i>												
Balance at December 31, 2009	7,050,000	\$176,250	—	\$ —	96,904,075	\$ 969	\$1,119,005	\$ (8,949)	\$(397,527)	\$(2,981)	\$ —	\$ 886,767
Net proceeds from sale of common stock	—	—	—	—	19,500,000	195	190,447	—	—	—	—	190,642
Vesting of restricted common stock	—	—	—	—	546,429	6	4,150	—	—	—	—	4,156
Series A preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(14,100)	—	—	(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share	—	—	—	—	—	—	—	—	(6,448)	—	—	(6,448)
Accretion of discount on Series C preferred stock	—	—	—	—	—	—	(104)	—	—	—	—	(104)
Net income	—	—	—	—	—	—	—	38,542	—	—	—	38,542
Pension liability adjustment	—	—	—	—	—	—	—	—	—	(156)	—	(156)
Balance at December 31, 2010	7,050,000	176,250	—	—	116,950,504	1,170	1,313,498	29,593	(418,075)	(3,137)	—	1,099,299
Net proceeds from sale of preferred stock	—	—	4,600,000	115,000	—	—	(4,052)	—	—	—	—	110,948
Vesting of restricted common stock	—	—	—	—	314,586	3	3,120	—	—	—	—	3,123
Non-controlling interest assumed at acquisition	—	—	—	—	—	—	—	—	—	—	61,067	61,067
Distributions to non-controlling interests	—	—	—	—	—	—	—	—	—	—	(1,342)	(1,342)
Series A preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(14,100)	—	—	(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share	—	—	—	—	—	—	—	—	(6,448)	—	—	(6,448)
Series D preferred dividends and dividends payable at \$1.472222 per share	—	—	—	—	—	—	—	—	(6,773)	—	—	(6,773)
Net income	—	—	—	—	—	—	—	80,987	—	—	312	81,299
Pension liability adjustment	—	—	—	—	—	—	—	—	—	(1,779)	—	(1,779)
Balance at December 31, 2011	7,050,000	176,250	4,600,000	115,000	117,265,090	1,173	1,312,566	110,580	(445,396)	(4,916)	60,037	1,325,294
Net proceeds from sale of common stock	—	—	—	—	12,143,273	121	126,058	—	—	—	—	126,179
Issuance of common stock in con- nection with hotel acquisition, net	—	—	—	—	5,454,164	55	51,008	—	—	—	—	51,063
Vesting of restricted common stock	—	—	—	—	374,911	3	3,765	—	—	—	—	3,768
Distributions to non-controlling interests	—	—	—	—	—	—	—	—	—	—	(6,381)	(6,381)
Series A preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(14,100)	—	—	(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share	—	—	—	—	—	—	—	—	(6,448)	—	—	(6,448)
Series D preferred dividends and dividends payable at \$2.00 per share	—	—	—	—	—	—	—	—	(9,200)	—	—	(9,200)
Net income	—	—	—	—	—	—	—	47,796	—	—	1,761	49,557
Pension liability adjustment	—	—	—	—	—	—	—	—	—	(419)	—	(419)
Balance at December 31, 2012	7,050,000	\$176,250	4,600,000	\$115,000	135,237,438	\$1,352	\$1,493,397	\$158,376	\$(475,144)	\$(5,335)	\$55,417	\$1,519,313

See accompanying notes to consolidated financial statements.

CONSOLIDATED
Statements of Cash Flows

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
<i>(in thousands)</i>			
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 49,557	\$ 81,299	\$ 38,542
Adjustments to reconcile net income to net cash provided by operating activities:			
Bad debt expense	410	630	89
(Gain) loss on sales of hotel properties and other assets, net	(38,274)	(14,995)	382
(Gain) loss on extinguishment of debt	191	(18,145)	(86,235)
Gain on remeasurement of equity interests	—	(69,230)	—
Loss on derivatives	406	2,655	—
Depreciation	128,206	118,834	100,670
Amortization of franchise fees and other intangibles	20,198	15,069	543
Amortization and write-off of deferred financing fees	3,952	3,305	3,623
Amortization of loan discounts	1,058	1,062	996
Amortization of deferred stock compensation	3,466	2,745	3,942
Impairment loss	—	12,357	1,943
Equity in earnings of unconsolidated joint ventures	—	(21)	(555)
Changes in operating assets and liabilities:			
Restricted cash	(249)	13,322	(19,234)
Accounts receivable	4,587	(4,123)	4,287
Inventories	(271)	(316)	(163)
Prepaid expenses and other assets	(7,906)	2,558	(4,494)
Accounts payable and other liabilities	2,279	5,422	(1,301)
Accrued payroll and employee benefits	2,683	2,424	3,829
Due to Third-Party Managers	300	(404)	(2,449)
Discontinued operations	903	730	(78)
Net cash provided by operating activities	171,496	155,178	44,337
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of hotel properties and other assets	46,367	44,576	63
Cash received from unconsolidated joint venture	—	—	900
Restricted cash—replacement reserve	(10,743)	(8,143)	(931)
Acquisitions of notes receivable	—	—	(3,950)
Proceeds received from sale of note receivable	—	79,194	—
Acquisitions of hotel properties and other assets	(120,003)	(263,264)	(142,410)
Renovations and additions to hotel properties and other real estate	(109,321)	(100,400)	(56,984)
Payments for interest rate derivatives	—	(1,082)	—
Net cash used in investing activities	(193,700)	(249,119)	(203,312)

(continued)

CONSOLIDATED
Statements of Cash Flows

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
<i>(in thousands)</i>			
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from preferred stock offering	\$ —	\$ 115,000	\$ —
Payment of preferred stock offering costs	—	(4,052)	—
Proceeds from common stock offering	126,533	—	199,875
Payment of common stock offering costs	(451)	—	(9,233)
Proceeds from notes payable and credit facility	15,000	460,000	92,500
Payments on notes payable and credit facility	(68,828)	(568,308)	(175,175)
Payments for repurchases of notes payable and related costs	(4,570)	—	—
Payments of deferred financing costs	(1,332)	(9,049)	(4,788)
Dividends paid	(29,748)	(25,021)	(20,548)
Distributions to non-controlling interests	(6,381)	(1,342)	—
Net cash provided by (used in) financing activities	30,223	(32,772)	82,631
Net increase (decrease) in cash and cash equivalents	8,019	(126,713)	(76,344)
Cash and cash equivalents, beginning of year	149,198	275,911	352,255
Cash and cash equivalents, end of year	\$ 157,217	\$ 149,198	\$ 275,911
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid for interest	\$ 78,234	\$ 76,015	\$ 65,780
Cash paid for income taxes	\$ 1,023	\$ —	\$ —
NONCASH INVESTING ACTIVITY			
Accounts payable related to renovations and additions to hotel properties and other real estate	\$ 5,897	\$ 8,304	\$ 8,739
Amortization of deferred stock compensation—construction activities	\$ 302	\$ 376	\$ 182
Amortization of deferred stock compensation—unconsolidated joint venture	\$ —	\$ 2	\$ 32
NONCASH FINANCING ACTIVITY			
Issuance of note receivable	\$ —	\$ 90,000	\$ —
Issuance of common stock in connection with acquisition of hotel property	\$ 51,160	\$ —	\$ —
Assignment of debt in connection with dispositions of hotel properties	\$(122,622)	\$ (11,532)	\$ —
Assumption of debt in connection with acquisitions of hotel properties	\$ —	\$ 545,952	\$ —
Dividends payable	\$ 7,437	\$ 7,437	\$ 5,137

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED Financial Statements

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

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

As a REIT, certain tax laws limit the amount of “non-qualifying” income the Company can earn, including income derived directly from the operation of hotels. As a result, the Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company’s hotels. As of December 31, 2012, the Company had interests in 30 hotels, including four hotels classified as held for sale and included in discontinued operations due to their sale in January 2013, leaving 26 hotels held for investment (the “26 hotels”). The Company’s third-party managers included subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”), managers of 10 of the Company’s 26 hotels; a subsidiary of Interstate Hotels & Resorts, Inc., manager of six of the Company’s 26 hotels; Highgate Hotels L.P. and an affiliate, manager of three of the Company’s 26 hotels; Davidson Hotels & Resorts and Hilton Worldwide, each a manager of two of the Company’s 26 hotels; and Crestline Hotels & Resorts, Fairmont Hotels & Resorts (U.S.) and Hyatt Corporation each a manager of one of the Company’s 26 hotels. In addition, as of December 31, 2012 the Company owned BuyEfficient, LLC (“BuyEfficient”), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment, and a commercial laundry facility located in Rochester, Minnesota. The Company has classified the commercial laundry facility as held for sale and included the property in discontinued operations as of December 31, 2012 due to its sale in January 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES BASIS OF PRESENTATION

The accompanying consolidated financial statements as of December 31, 2012 and 2011, and for the years ended December 31, 2012, 2011 and 2010, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company consolidates subsidiaries when it has the ability to direct the activities that most significantly impact the economic performance of the entity. The Company also evaluates its subsidiaries to determine if they should be considered variable interest entities (“VIEs”). Typically, the entity that has the power to direct the activities that most significantly impact economic performance would consolidate the VIE. The Company considers an entity a VIE if equity investors own an interest therein that does not have the characteristics of a controlling financial interest or if such investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. In accordance with the Consolidation Topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), the Company reviewed its subsidiaries to determine if (i) they should be considered VIEs, and (ii) whether the Company should change its consolidation determination based on changes in the characteristics of these entities.

Non-controlling interests at both December 31, 2012 and 2011 represent the outside equity interests in various consolidated affiliates of the Company.

Certain prior year amounts have been reclassified in the consolidated financial statements in order to conform to the current year 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 accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

REPORTING PERIODS

The results the Company reports in its consolidated statements of operations and comprehensive income are based on results reported to the Company by its hotel managers. These hotel managers use different reporting periods. Marriott uses a fiscal year ending on the Friday closest to December 31, and reports twelve weeks of operations each for the first three quarters of the year, and sixteen or seventeen weeks of operations for the fourth quarter of the year. The Company’s other hotel managers report operations on a standard monthly calendar. The Company has elected to adopt quarterly close periods of March 31, June 30 and September 30, and an annual year end of December 31. As a result, the Company’s 2012 results of operations for the Marriott-managed hotels include results from December 31 through March 23 for the first quarter, March 24 through June 15 for the second quarter, June 16 through September 7 for the third quarter, and September 8 through December 28 for the fourth quarter. The Company’s 2011 results of operations for the Marriott-managed hotels include results from January 1 through March 25 for the first quarter, March 26 through June 17 for the second quarter, June 18 through

September 9 for the third quarter, and September 10 through December 30 for the fourth quarter. The Company's 2010 results of operations for the Marriott-managed hotels include results from January 2 through March 26 for the first quarter, March 27 through June 18 for the second quarter, June 19 through September 10 for the third quarter, and September 11 through December 31 for the fourth quarter. Beginning in 2013, Marriott will report operations on a standard monthly calendar basis.

The Company estimates that Marriott's fiscal calendar had the following effects on the Company's total revenue and net income based on the average daily revenues and income generated by its Marriott hotels during the years ended December 31, 2012, 2011 and 2010 as follows (in thousands):

	2012 ⁽¹⁾	2011 ⁽¹⁾	2010 ⁽¹⁾
Total revenue	<u><u>\$(1,251)</u></u>	<u><u>\$(1,048)</u></u>	<u><u>\$(495)</u></u>
Net income	<u><u>\$ (328)</u></u>	<u><u>\$ (273)</u></u>	<u><u>\$(126)</u></u>

(1) Reductions in total revenue and net income based on the Marriott fiscal calendars for 2012 (363 days), 2011 (364 days) and 2010 (364 days) versus a standard 365 day year.

CASH AND CASH EQUIVALENTS

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

The Company maintains cash and cash equivalents and certain other financial instruments with various financial institutions. These financial institutions are located throughout the country and the Company's policy is designed to limit exposure to any one institution. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company's investment strategy. At December 31, 2012 and 2011, the Company had amounts in banks that were in excess of federally insured amounts.

RESTRICTED CASH

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

ACCOUNTS RECEIVABLE

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes, among other things, receivables from customers who utilize purchase volume rebates through BuyEfficient, as well as tenants who lease space in the Company's hotels. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company's accounts receivable includes an allowance for doubtful accounts of \$0.2 million at both December 31, 2012 and 2011.

INVENTORIES

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

ACQUISITIONS OF HOTEL PROPERTIES AND OTHER ENTITIES

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

INVESTMENTS IN HOTEL PROPERTIES AND OTHER REAL ESTATE

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

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

The Company follows the requirements of the Property, Plant and Equipment Topic of the FASB ASC, which requires impairment losses to be recorded on long-lived assets to be held and used by the Company when indicators of impairment are present and the future undiscounted net cash flows expected to be generated by those assets are less than the assets' carrying amount. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment is recognized. The impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. In computing fair value, the Company uses a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets, taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. In 2012, the Company did not identify any properties or other assets with indicators of impairment. In 2011, the Company did not recognize any impairments on its hotel properties, but did recognize a \$1.5 million impairment on its commercial laundry facility located in Salt Lake City, Utah based on proceeds received from its sale in July 2011. In 2010, the Company recognized an impairment of \$1.9 million to impairment loss on an office building and land adjacent to one of its hotels based on estimated proceeds expected to be received from the possible sale of this property. This property was ultimately sold in September 2012. Based on the Company's review, management believes that there were no other impairments on its long-lived assets, and that the carrying values of its hotel properties and other real estate are recoverable at December 31, 2012.

When an impairment loss is required for assets held for sale, the related assets are adjusted to their estimated fair values, less costs to sell. Operating results of any long-lived assets with their own identifiable cash flows that are disposed of or held for sale are removed from income from continuing operations and reported as discontinued operations. Depreciation ceases when a property is held for sale. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations.

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

DEFERRED FINANCING FEES

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

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

During 2012, the Company wrote-off \$0.2 million in deferred financing fees related to its sales of the Marriott Del Mar, the Doubletree Guest Suites Minneapolis, the Hilton Del Mar and the Marriott Troy, along with its repayment of the non-recourse mortgage secured by the Renaissance Long Beach. During 2011, the Company wrote-off \$0.1 million in deferred financing fees related to its sale of the Valley River Inn, along with its refinancing of debt secured by the Doubletree Guest Suites Times Square. During 2010, the Company wrote-off \$1.5 million in deferred financing fees related to the termination of the Company's credit facility, and \$0.1 million related to the release of three hotels from a non-recourse mortgage.

Total amortization and write-off of deferred financing fees for 2012, 2011 and 2010 was as follows (in thousands):

	2012	2011	2010
Continuing operations:			
Amortization of deferred financing fees	\$3,690	\$3,138	\$1,457
Write-off of deferred financing fees	3	21	1,462
Total deferred financing fees—continuing operations	3,693	3,159	2,919
Discontinued operations:			
Amortization of deferred financing fees	74	104	581
Write-off of deferred financing fees	185	42	123
Total deferred financing fees—discontinued operations	259	146	704
Total amortization and write-off of deferred financing fees	\$3,952	\$3,305	\$3,623

GOODWILL AND BUYEFFICIENT INTANGIBLES

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

During 2011, the Company recorded goodwill of \$8.4 million related to its purchase of the outside 50.0% equity interest in its BuyEfficient joint venture.

Based on its annual impairment evaluations for both 2012 and 2011, the Company determined that no adjustments to its goodwill were required.

As of December 31, 2012 and 2011, goodwill consisted of the following (in thousands):

	2012	2011
Balance at beginning of year ⁽¹⁾	\$9,405	\$ 990
Purchase of outside 50.0% equity interest in BuyEfficient	—	8,415
Balance at end of year ⁽¹⁾	\$9,405	\$9,405

(1) Assets held for sale, net includes goodwill of \$3.7 million as of both December 31, 2012 and 2011 related to hotels that the Company sold in January 2013.

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

PROPERTY AND EQUIPMENT

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

FAIR VALUE OF FINANCIAL INSTRUMENTS

As of December 31, 2012 and 2011, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

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

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

As discussed in Note 6, during 2011, the Company entered into interest rate protection agreements to manage, or hedge, interest rate risks in conjunction with its acquisitions of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square, the JW Marriott New Orleans, a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront and the refinancing of the debt secured by the Doubletree Guest Suites Times Square. The Company records interest rate protection agreements on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in the consolidated statements of operations and comprehensive income as they are not designated as hedges. In accordance with the Fair Value Measurements and Disclosure Topic of the FASB ASC, the Company estimates the fair value of its interest rate protection agreements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. The Company has valued the derivative interest rate cap agreements related to the Doubletree Guest Suites Times Square and the Hilton San Diego Bayfront using Level 2 measurements as an asset of \$48,000 and \$0.4 million as of December 31, 2012 and 2011, respectively. The interest rate cap agreements are included in other assets, net, in the accompanying consolidated balance sheets. The Company has valued the derivative interest rate swap agreement related to the JW Marriott New Orleans using Level 2 measurements as a liability of \$1.6 million as of both December 31, 2012 and 2011. The interest rate swap agreement is included in other liabilities in the accompanying consolidated balance sheets.

The Company is responsible for paying the premiums, if any, for a \$5.0 million split life insurance policy for its former Chairman and Chief Executive Officer, Robert A. Alter. The Company has valued this policy using Level 2 measurements at \$1.5 million and \$1.9 million as of December 31, 2012 and 2011, respectively. These amounts are included in other assets, net on the accompanying consolidated balance sheets, and will be used to reimburse the Company for payments made to Mr. Alter associated with a Retirement Benefit Agreement. The Company has valued the Retirement Benefit Agreement using Level 2 measurements at \$1.5 million and \$1.7 million as of December 31, 2012 and 2011, respectively. The agreement calls for the balance of the Retirement Benefit Agreement to be paid out to Mr. Alter in 10 annual installments, beginning in 2011. As such, the Company has paid Mr. Alter a total of \$0.4 million through December 31, 2012, which was reimbursed to the Company using funds from the split life insurance policy. These amounts are included in accrued payroll and employee benefits in the accompanying consolidated balance sheets.

On an annual basis and periodically when indicators of impairment exist, the Company analyzes the carrying values of its hotel properties and other assets using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. The Company did not identify any properties or other assets with indicators of impairment during 2012. In 2011, the Company recognized a \$1.5 million impairment on its commercial laundry facility located in Salt Lake City, Utah based on proceeds received from its sale in July 2011. Also in 2011, the Company recognized a \$10.9 million impairment on the \$90.0 million mortgage-secured purchase money loan received from the buyer of the Royal Palm Miami Beach (the "Royal Palm note") due to its sale in October 2011. In 2010, the Company recognized a \$1.9 million impairment on an office building and land adjacent to one of its hotels based on estimated proceeds expected to be received from the potential sale of this property. The Company ultimately sold this property in September 2012.

On an annual basis and periodically when indicators of impairment exist, the Company also analyzes the carrying value of its goodwill using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its reporting units. The Company did not identify any properties with indicators of goodwill impairment in 2012, 2011 or 2010.

As of December 31, 2012 and 2011, 69.6% and 70.5%, respectively, of the Company's outstanding debt included in continuing operations had fixed interest rates, including the effect of an interest rate swap agreement. The Company's carrying value of its debt secured by properties not classified as discontinued operations totaled \$1.4 billion as of both December 31, 2012 and 2011. Using Level 3 measurements, including the Company's weighted average cost of debt of 5.5% as of December 31, 2012, and between 6.0% and 7.0% as of December 31, 2011, the Company estimates that the fair market value of its debt included in continuing operations totaled \$1.3 billion and \$1.4 billion as of December 31, 2012 and 2011, respectively.

The following table presents the Company’s assets measured at fair value on a recurring and non-recurring basis at December 31, 2012 and 2011 (in thousands):

	Fair Value Measurements at Reporting Date			
	Total	Level 1	Level 2	Level 3
<i>DECEMBER 31, 2012:</i>				
Interest rate cap derivative agreements	\$ 48	\$—	\$ 48	\$—
Life insurance policy	1,494	—	1,494	—
Total assets at December 31, 2012	\$1,542	\$—	\$1,542	\$—
<i>DECEMBER 31, 2011:</i>				
Interest rate cap derivative agreements	\$ 386	\$—	\$ 386	\$—
Life insurance policy	1,877	—	1,877	—
Total assets at December 31, 2011	\$2,263	\$—	\$2,263	\$—

The following table presents the Company’s liabilities measured at fair value on a recurring and non-recurring basis at December 31, 2012 and 2011 (in thousands):

	Fair Value Measurements at Reporting Date			
	Total	Level 1	Level 2	Level 3
<i>DECEMBER 31, 2012:</i>				
Interest rate swap derivative agreement	\$1,636	\$—	\$1,636	\$—
Retirement benefit agreement	1,494	—	1,494	—
Total liabilities at December 31, 2012	\$3,130	\$—	\$3,130	\$—
<i>DECEMBER 31, 2011:</i>				
Interest rate swap derivative agreement	\$1,567	\$—	\$1,567	\$—
Retirement benefit agreement	1,687	—	1,687	—
Total liabilities at December 31, 2011	\$3,254	\$—	\$3,254	\$—

The following table presents the gains and impairment charges included in earnings as a result of applying Level 3 measurements for the years ended December 31, 2012, 2011 and 2010 (in thousands):

	2012	2011	2010
Gains:			
Investment in unconsolidated joint ventures ⁽¹⁾	\$—	\$ 69,230	\$ —
Impairment charges:			
Other assets, net ⁽²⁾	—	(10,862)	—
Assets held for sale, net ⁽³⁾	—	(1,495)	(1,943)
Total impairment charges	—	(12,357)	(1,943)
Total Level 3 measurement charges included in earnings	\$—	\$ 56,873	\$(1,943)

(1) Includes the gains recorded by the Company on the remeasurements of the Company's equity interests in its Doubletree Guest Suites Times Square and BuyEfficient joint ventures.
(2) Includes the impairment loss recorded by the Company on the Royal Palm note due to the note's sale in October 2011.
(3) Includes the \$1.5 million impairment loss recorded on a commercial laundry facility in Salt Lake City, Utah which the Company sold in July 2011, and the \$1.9 million impairment loss on an office building and land adjacent to one of the Company's hotels, which the Company sold in September 2012.

REVENUE RECOGNITION

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

Other operating revenue consists of revenue derived from incidental hotel services such as telephone, transportation, parking, spa, entertainment and other guest services, along with sublease revenues relating to the restaurants and retail shops. Other operating revenue also includes revenue generated by BuyEfficient subsequent to the Company's acquisition of the outside 50.0% equity interest in BuyEfficient in January 2011. Revenues from incidental hotel services and BuyEfficient are recognized in the period the related services are provided or the revenue is earned.

ADVERTISING AND PROMOTION COSTS

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

INCOME TAXES

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

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

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

DIVIDENDS

The Company currently pays quarterly dividends to its Series A Cumulative Redeemable, Series D Cumulative Redeemable and Series C Cumulative Convertible Redeemable preferred stockholders as declared by the Board of Directors. The Company may also pay dividends on its common stock to the extent declared by the Board of Directors. The Company's ability to pay dividends is dependent on the receipt of distributions from the Operating Partnership.

EARNINGS PER SHARE

The Company applies the two-class method when computing its earnings per share as required by the Earnings Per Share Topic of the FASB ASC, which requires the net income per share for each class of stock (common stock and convertible preferred stock) to be calculated assuming 100% of the Company's net income is distributed as dividends to each class of stock based on their contractual rights. To the extent the Company has undistributed earnings in any calendar quarter, the Company will follow the two-class method of computing earnings per share.

The Company follows the requirements of the Earnings Per Share Topic of the FASB ASC, which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Undistributed earnings representing nonforfeitable dividends of \$0.2 million, \$0.6 million and \$0.1 million were allocated to the participating securities for the years ended December 31, 2012, 2011 and 2010, respectively.

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

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Numerator:			
Net income	\$ 49,557	\$ 81,299	\$ 38,542
Income from consolidated joint venture attributable to non-controlling interest	(1,761)	(312)	—
Distributions to non-controlling interest	(31)	(30)	—
Preferred stock dividends and accretion	(29,748)	(27,321)	(20,652)
Undistributed income allocated to unvested restricted stock compensation	(203)	(636)	(102)
Numerator for basic and diluted earnings available to common stockholders	\$ 17,814	\$ 53,000	\$ 17,788
Denominator:			
Weighted average basic and diluted common shares outstanding	127,027	117,206	99,709
Basic and diluted earnings available to common stockholders per common share	\$ 0.14	\$ 0.45	\$ 0.18

The Company’s shares of Series C preferred stock issuable upon conversion, unvested restricted shares associated with its long-term incentive plan and shares associated with common stock options have been excluded from the above calculation of earnings per share for the years ended December 31, 2012, 2011 and 2010, as their inclusion would have been anti-dilutive.

SEGMENT REPORTING

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

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued Accounting Standards Update No. 2011-10, “Property, Plant and Equipment: Derecognition of in Substance Real Estate—a Scope Clarification” (“ASU No. 2011-10”). Under the amendments in ASU No. 2011-10, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary’s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. ASU No. 2011-10 is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The Company does not believe the adoption of ASU No. 2011-10 will have an effect on its historical financial statements.

3. INVESTMENT IN HOTEL PROPERTIES

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

	December 31,	
	2012	2011
Land	\$ 260,939	\$ 246,900
Buildings and improvements	2,541,024	2,345,229
Furniture, fixtures and equipment	329,770	293,557
Intangibles	167,467	162,267
Franchise fees	1,261	878
Construction in process	48,388	16,418
	3,348,849	3,065,249
Accumulated depreciation and amortization	(666,972)	(533,017)
	\$2,681,877	\$2,532,232

ACQUISITIONS

On June 4, 2012, the Company purchased the leasehold interest in the 417-room Wyndham Chicago for a contractual purchase price of \$88.425 million. The Company funded the acquisition with \$29.7 million of cash on hand (including \$0.3 million of proration credits) and the issuance of 5,454,164 shares of the Company’s common stock, the “Wyndham stock consideration.” The Wyndham stock consideration was determined by dividing \$58.425 million by the product of (1) the closing price of \$10.40 on the NYSE of the Company’s common stock on May 2, 2012 and (2) 1.03. In connection with this acquisition, the Company entered into a registration rights agreement requiring the

Company to register the Wyndham stock consideration. The Company prepared the registration statement on Form S-3, which was filed with the SEC as required on June 4, 2012. Based on the \$9.38 closing price of the Company's common stock on the NYSE on June 4, 2012, the date the acquisition closed, the total purchase price of the Wyndham Chicago hotel for accounting purposes was \$81.16 million, excluding proration adjustments and closing costs. Immediately upon acquisition, the Company rebranded the hotel the Hyatt Chicago Magnificent Mile. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, hotel working capital assets and liabilities, obligations under capital lease and the Company's common stock. During 2012, the Company incurred acquisition-related costs of \$1.3 million, which are included in corporate overhead on the Company's consolidated statements of operations and comprehensive income. The results of operations for the Hyatt Chicago Magnificent Mile have been included in the Company's consolidated statements of operations and comprehensive income from the acquisition date of June 4, 2012 through the year ended December 31, 2012.

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

The fair values of the assets acquired and liabilities assumed at the dates of acquisition for the Hyatt Chicago Magnificent Mile and the Hilton Garden Inn Chicago Downtown/Magnificent Mile were allocated based on independent third-party analyses. The amounts allocated to both investment in hotel properties and other current liabilities have increased by \$1.2 million from the amounts disclosed in the Company's quarterly reports on Form 10-Q for the periods ended June 30, 2012 and September 30, 2012 due to additional information obtained by the Company related to prior year real estate taxes which the Company has agreed to pay on behalf of the seller of one of the hotels. The following table summarizes the fair values of assets acquired and liabilities assumed in both of these acquisitions (in thousands):

<i>ASSETS:</i>	
Investment in hotel properties ⁽¹⁾	\$189,912
Cash	32
Accounts receivable	1,190
Other assets	176
Total assets acquired	191,310
<i>LIABILITIES:</i>	
Capital lease obligation ⁽²⁾	15,579
Other current liabilities	4,536
Total liabilities acquired	20,115
Stockholders' equity ⁽³⁾	51,160
Total cash paid for acquisition	\$120,035

(1) Investment in hotel properties was allocated to land (\$14.0 million), buildings and improvements (\$158.3 million), furniture, fixtures and equipment (\$12.2 million), intangibles (\$5.2 million) related to advanced bookings, a below-market tenant lease and a below-market management agreement, and franchise fees (\$0.2 million) related to a franchise agreement. Details of the intangibles and the franchise agreement are as follows (in thousands):

	Value at Acquisition	Expected Life at Acquisition
		6 months to
Advanced bookings	\$ 2,630	17.5 months
Below-market tenant lease	(280)	20 years
Below-market management agreement	2,850	5 years–10.5 years
Franchise agreement	168	14.5 years
Total intangibles and franchise fees related to 2012 acquisitions	5,368	
Accumulated amortization	(2,222)	
	\$ 3,146	

The Hyatt Chicago Magnificent Mile is subject to a building lease, which the Company determined should be accounted for as a capital lease. Accordingly, at the date of acquisition in June 2012, the Company recorded a capital asset related to its leasehold interest of \$58.8 million which has been allocated to buildings and improvements, based upon the estimated fair value of the right to use the leased property for the then remaining term of 85.6 years. The capital asset, net of accumulated depreciation of \$0.9 million for the year ended December 31, 2012 is included in investment in hotel properties, net, in the accompanying consolidated balance sheet as of December 31, 2012.

- (2) *The Hyatt Chicago Magnificent Mile is subject to a building lease which expires in December 2097 (see Note 14). The Company evaluated the terms of the lease agreement and determined the lease to be a capital lease pursuant to the Leases Topic of the FASB ASC. At acquisition, the fair value of the remaining rent payments of \$15.6 million was recorded as a capital lease obligation. The current portion of this obligation is included in accounts payable and accrued expenses, and the long-term portion of this obligation, net of amortization, is included in capital lease obligations, less current portion in the accompanying consolidated balance sheet as of December 31, 2012.*
- (3) *In accordance with the Fair Value Measurements and Disclosure Topic of the FASB ASC, the Wyndham stock consideration was recorded by the Company based on the \$9.38 closing price of the Company's common stock on the NYSE on June 4, 2012.*

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

In February 2011, the Company purchased the 494-room JW Marriott New Orleans located in New Orleans, Louisiana for approximately \$51.6 million in cash and the assumption of a \$42.2 million floating-rate, non-recourse senior mortgage. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets. The Company recognized acquisition-related costs of \$0.4 million during the year ended December 31, 2011, which are included in corporate overhead on the Company's consolidated statements of operations and comprehensive income. The results of operations for the JW Marriott New Orleans have been included in the Company's consolidated statements of operations and comprehensive income from the acquisition date of February 15, 2011 through Marriott's year ended December 28, 2012.

In April 2011, the Company paid \$182.8 million to acquire a 75.0% majority interest in the joint venture that owns the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California, which implied a gross value of approximately \$475.0 million. The purchase price included \$3.7 million of unrestricted cash held on the joint venture's balance sheet. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets and liabilities. The Company recognized acquisition-related costs of \$0.5 million for the year ended December 31, 2011, which are included in corporate overhead on the Company's consolidated statements of operations and comprehensive income. The results of operations for the Hilton San Diego Bayfront have been included in the Company's consolidated statements of operations and comprehensive income from the acquisition date of April 15, 2011 through the year ended December 31, 2012. The remaining 25.0% interest in the joint venture continues to be owned by Hilton Worldwide, and is included in non-controlling interest in consolidated joint ventures on the Company's consolidated balance sheets and in income from consolidated joint venture attributable to non-controlling interest in the Company's consolidated statements of operations and comprehensive income.

Acquired properties are included in the Company's results of operations and comprehensive income from the date of acquisition. The following unaudited pro forma results of operations reflect the Company's results as if the acquisitions of the Hyatt Chicago Magnificent Mile in June 2012, the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012, the Doubletree Guest Suites Times Square in January 2011, the JW Marriott New Orleans in February 2011 and the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront in April 2011, along with the reacquisition of the Renaissance Westchester in June 2010, had occurred on January 1, 2010. In the Company's opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made (in thousands, except per share data):

	2012	2011	2010
Revenues	\$847,483	\$873,505	\$810,807
Income available (loss attributable) to common stockholders from continuing operations	\$ 635	\$ 50,824	\$ (12,294)
Income (loss) per diluted share available (attributable) to common stockholders from continuing operations	\$ (0.24)	\$ 0.19	\$ (0.33)

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

INTANGIBLE ASSETS

As of December 31, 2012 and 2011, intangible assets included in the Company's investment in hotel properties, net consisted of the following (in thousands):

	2012	2011
Contractual advance hotel bookings ⁽¹⁾	\$ 28,740	\$ 26,110
Easement agreement ⁽²⁾	9,727	9,727
Ground/air lease agreements ⁽³⁾	121,850	121,850
In-place lease agreements ⁽⁴⁾	4,300	4,580
Below-market management agreement ⁽⁵⁾	2,850	—
	167,467	162,267
Accumulated amortization	(34,978)	(15,487)
	\$132,489	\$146,780

Amortization expense on these intangible assets for the years ended December 31, 2012, 2011 and 2010 consisted of the following (in thousands):

	2012	2011	2010
Contractual advance hotel bookings ⁽¹⁾	\$14,824	\$ 9,988	\$ —
Ground/air lease agreements ⁽³⁾	4,113	3,978	255
In-place lease agreements ⁽⁴⁾	342	299	—
Below-market management agreement ⁽⁵⁾	212	—	—
	\$19,491	\$14,265	\$255

(1) Contractual advance hotel bookings consist of advance deposits related to the purchases of Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Downtown/Magnificent Mile, the Doubletree Guest Suites Times Square, the JW Marriott New Orleans & the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. The contractual advance hotel bookings were recorded at a discounted present value based on estimated collectability, and are amortized using the straight-line method based over the periods the amounts are expected to be collected. The contractual advance hotel bookings will be fully amortized by December 31, 2013.

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

(3) Ground/air lease agreements at the Hilton Times Square, the Doubletree Guest Suites Times Square and the JW Marriott New Orleans were valued at fair value at the dates of acquisition. The agreements are amortized using the straight-line method over the remaining non-cancelable terms of the related agreements, which range from between approximately 24 and 78 years as of December 31, 2012.

(4) In-place lease agreements at the Hilton Garden Inn Downtown/Magnificent Mile, Doubletree Guest Suites Times Square and the Hilton San Diego Bayfront were valued at fair value at the dates of acquisition. The agreements are amortized using the straight-line method over the remaining non-cancelable terms of the related agreements, which range from between approximately six and 19 years as of December 31, 2012.

(5) The below-market management agreement at the Hilton Garden Inn Downtown/Magnificent Mile was valued at fair value at the acquisition date. The agreement is comprised of two components, one for the management of the Hilton Garden Inn Downtown/Magnificent Mile, and the other for the potential management of a future hotel. The agreement is amortized using the straight-line method over the remaining non-cancelable terms of the two components, approximately 5 and 10 years each as of December 31, 2012.

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

2013	\$8,845
2014	\$4,917
2015	\$4,917
2016	\$4,917
2017	\$4,747

4. DISCONTINUED OPERATIONS

During 2012, the Company sold four hotels and an office building adjacent to one of the sold hotels. In addition, the Company classified four hotels and a commercial laundry facility as held for sale as of December 31, 2012 due to their sale in January 2013. In August 2012, the Company sold the Marriott Del Mar located in San Diego, California for net proceeds of \$17.7 million, including the assumption of the existing mortgage secured by the hotel which totaled \$47.1 million on the date of sale, and recognized a gain on the sale of \$25.5 million. In addition, the Company wrote off \$48,000 in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the hotel. The Company reclassified the hotel's results of operations for the first eight months of 2012, as well as for the years ended December 31, 2011 and 2010 to discontinued operations on its consolidated statements of operations and comprehensive income.

In September 2012, the Company sold a portfolio of assets that included the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy (located in Minneapolis, Minnesota, San Diego, California, and Troy, Michigan, respectively) and an office building adjacent to the Marriott Troy for net proceeds of \$28.6 million, including the assumptions of three separate mortgages secured by the hotels totaling \$75.6 million, as well as a \$2.2 million liability for deferred management fees payable to the Marriott Troy's third-party manager. The Company recognized a gain on the sale of \$12.7 million. In addition, the Company wrote off \$0.1 million in deferred financing fees in conjunction with the buyer's assumption of the debt secured by the three hotels. The Company reclassified the results of operations for the Doubletree Guest Suites Minneapolis, the Hilton Del Mar, the Marriott Troy and the office building to discontinued operations for the first nine months of 2012, as well as for the years ended December 31, 2011 and 2010 on its consolidated statements of operations and comprehensive income.

In December 2012, the Company classified the Kahler Grand, Kahler Inn & Suites, Marriott Rochester, Residence Inn by Marriott Rochester, and a commercial laundry facility, all located in Rochester, Minnesota, as held for sale due to their sale in January 2013. The Company expects no significant continuing involvement with any of the properties. As such, the Company reclassified the hotels' and laundry's assets and liabilities as of December 31, 2012 and 2011 (including debt secured by the Kahler Grand and the commercial laundry facility which totaled \$27.3 million and \$29.0 million as of December 31, 2012 and 2011, respectively) to discontinued operations on its consolidated balance sheets, and reclassified the hotels' and laundry's results of operations for the years ended December 31, 2012, 2011 and 2010 to discontinued operations on its consolidated statements of operations and comprehensive income.

During 2011, the Company sold two hotels and a commercial laundry facility. In April 2011, the Company sold the Royal Palm Miami Beach hotel for net proceeds of \$129.8 million, including \$39.8 million in cash and the \$90.0 million Royal Palm note, and recognized a gain on the sale of \$14.0 million. The Company reclassified the hotel's results of operations for the first four months of 2011, as well as for the period that it owned the hotel during 2010, to discontinued operations on its consolidated statements of operations and comprehensive income. The Company retained an earn-out right on the Royal Palm hotel which will enable it to receive future payments of up to \$20.0 million in the event the hotel achieves certain return hurdles.

In July 2011, the Company sold its commercial laundry facility located in Salt Lake City, Utah for net proceeds of \$0.1 million, and recognized a loss on the sale of \$0.1 million. In anticipation of this sale, the Company recorded an impairment loss of \$1.5 million to discontinued operations in June 2011. The Company reclassified the laundry's results of operations for the first seven months of 2011, as well as for the year ended December 31, 2010 to discontinued operations on its consolidated statements of operations and comprehensive income.

In October 2011, the Company sold the Valley River Inn located in Eugene, Oregon for net proceeds of \$16.1 million, including the assumption of the existing mortgage secured by the hotel which totaled \$11.5 million on the date of sale, and recognized a gain on the sale of \$0.9 million. The Company reclassified the hotel's results of operations for the first 10 months of 2011, as well as for the year ended December 31, 2010 to discontinued operations on its consolidated statements of operations and comprehensive income.

The Company did not sell any hotels during 2010, but did, however, complete the disposal of 11 hotels pursuant to its secured debt restructuring program, which the Company initiated in 2009: W San Diego; Renaissance Westchester; Marriott Ontario Airport; and the "Mass Mutual eight" (Renaissance Atlanta Concourse, Hilton Huntington, Residence Inn by Marriott Manhattan Beach, Marriott Provo, Courtyard by Marriott San Diego (Old Town), Holiday Inn Downtown San Diego, Holiday Inn Express San Diego (Old Town), and Marriott Salt Lake City (University Park)). The Company reclassified the results of operations for all 11 of these hotels beginning in 2009 to discontinued operations on its consolidated statements of operations and comprehensive income. During 2010, the Company deeded back or sold to the receiver 10 of these hotels, resulting in the cancellation of \$253.5 million in debt. The Company recorded a total of \$79.5 million to gain on extinguishment of debt, which was included in discontinued operations. Additional gain of \$18.1 million was deferred until 2011 when all significant contingencies related to the disposed hotels were resolved. In addition, during 2010 the Company deeded back the Renaissance Westchester, and subsequently reacquired the hotel from the lender during the same month. The \$29.2 million non-recourse mortgage secured by the Renaissance Westchester was cancelled, and the Company recorded a gain on extinguishment of debt of \$6.7 million to discontinued operations.

The following sets forth the discontinued operations for the years ended December 31, 2012, 2011 and 2010 for the four hotels and the commercial laundry facility held for sale as of December 31, 2012, the four hotels and the office building sold in 2012, the two hotel properties and the commercial laundry facility sold in 2011, the 10 hotel properties deeded back to lenders or sold by the receiver during 2010, and the Renaissance Westchester held in receivership until its reacquisition by the Company in June 2010, which all met the “held for sale” and “discontinued operations” criteria in accordance with the Property, Plant and Equipment Topic of the FASB ASC (in thousands):

	2012	2011	2010
Operating revenues	\$100,861	\$130,997	\$ 198,595
Operating expenses	(71,089)	(96,581)	(163,286)
Interest expense	(6,490)	(9,337)	(29,071)
Depreciation and amortization expense	(13,164)	(16,188)	(21,299)
Impairment loss	—	(1,495)	(1,943)
Gain on extinguishment of debt	—	18,145	86,235
Gain on sale of hotels and other assets, net	38,292	14,912	—
Income from discontinued operations	\$ 48,410	\$ 40,453	\$ 69,231

5. INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES

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

In December 2007, the Company entered into a joint venture agreement with Strategic Hotels & Resorts (“Strategic”) to own and operate BuyEfficient. Under the terms of the agreement, Strategic acquired a 50.0% interest in BuyEfficient from the Company. The Company accounted for its ownership interest in BuyEfficient using the equity method, and its accounting policies were consistent with those of the unconsolidated joint venture. During 2010, the Company received \$0.9 million in distributions from its BuyEfficient joint venture. In January 2011, the Company repurchased Strategic’s 50.0% share in BuyEfficient for \$9.0 million. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to intangibles (which are included in other assets, net on the Company’s consolidated balance sheets as of December 31, 2012 and 2011), goodwill and other working capital assets and liabilities. In conjunction with this purchase, the Company recognized a gain of \$8.7 million on the remeasurement of the Company’s equity interest in this joint venture to its fair market value. Subsequent to this acquisition, the Company is now the sole owner of BuyEfficient, and has consolidated BuyEfficient’s results of operations with its continuing operations.

6. INTEREST RATE DERIVATIVE AGREEMENTS

At December 31, 2012, the Company held two interest rate cap agreements and one interest rate swap agreement to manage its exposure to the interest rate risks related to its floating rate debt. The first interest rate cap agreement was purchased in connection with the Company’s acquisition of the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. Concurrent with the acquisition, the joint venture replaced the hotel’s existing construction loan (which was scheduled to mature in April 2011) with a new \$240.0 million mortgage secured by the hotel which bears a floating rate of interest of 3-month LIBOR plus 325 basis points. The Company paid \$0.1 million for this interest rate cap agreement. The notional amount of the related debt totaled \$120.0 million at December 31, 2012. The interest rate cap strike rate is 3.75%, and the maturity date is in April 2013. The second interest rate cap agreement was acquired in connection with the Company’s refinancing of debt secured by the Doubletree Guest Suites Times Square. The Company’s purchase of the outside 62.0% equity interests in its Doubletree Guest Suites Times Square joint venture in January 2011 included the assumption of \$270.0 million of non-recourse senior mortgage and mezzanine debt with a blended interest rate of 3-month LIBOR plus 115 basis points, along with an interest rate cap agreement which the Company valued at \$0.1 million at the acquisition date. The Company refinanced this debt in October 2011 with a new \$180.0 million non-recourse mortgage which matures in October 2018, and bears interest at a floating rate of 3-month LIBOR plus 325 basis points. In conjunction with this refinancing, the Company entered into an interest rate protection agreement which caps the 3-month LIBOR rate on the new mortgage at 4.0% until October 2015. The Company paid \$0.9 million for this interest rate cap agreement. The notional amount of the related debt totaled \$180.0 million at December 31, 2012.

The interest rate swap agreement was acquired in connection with the Company’s purchase of the JW Marriott New Orleans, which included the assumption of \$42.2 million of floating rate debt which was swapped to a fixed rate of 5.45%. The Company valued this interest rate swap agreement as an asset of \$0.3 million at the acquisition date. The notional amount of the related debt totaled \$40.7 million as of December 31, 2012. The interest rate swap agreement fixes the LIBOR interest rate on the underlying debt at a total interest rate of 5.45%, and the maturity date is in September 2015.

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

7. OTHER ASSETS

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

	December 31,	
	2012	2011
Property and equipment, net	\$ 2,529	\$ 2,318
Land held for development	188	188
Intangibles, net	7,877	8,476
Interest rate cap derivative agreements	48	386
Cash trap receivables	8,208	—
Notes receivable	—	394
Other receivables	4,130	4,931
Other	2,922	3,347
	<u>\$25,902</u>	<u>\$20,040</u>

As of December 31, 2012 and 2011, property and equipment, net consisted of the following (in thousands):

	2012	2011
Cost basis	\$10,153	\$ 9,380
Accumulated depreciation	(7,624)	(7,062)
Property and equipment, net	<u>\$ 2,529</u>	<u>\$ 2,318</u>

Due to the purchase of the outside 50.0% equity interest in its BuyEfficient joint venture (see Footnote 5), the Company’s other assets, net as of December 31, 2012 and 2011, include BuyEfficient’s intangible assets totaling \$7.9 million and \$8.5 million, respectively, net of accumulated amortization related to certain trademarks, customer and supplier relationships and intellectual property related to internally developed software. These intangibles are amortized using the straight-line method over the remaining useful lives, which range from between approximately five and 18 years as of December 31, 2012. Accumulated amortization totaled \$1.2 million and \$0.6 million at December 31, 2012 and 2011, respectively. Amortization expense totaled \$0.6 million for both of the years ended December 31, 2012 and 2011, and will total \$0.6 million for each of the next five years.

In conjunction with the Company’s 2012 sales of the Marriott Del Mar, the Hilton Del Mar and the Marriott Troy, the mortgages secured by these hotels were assumed by the buyers of the hotels. These mortgages contain “cash trap” provisions that were triggered in prior years due to the decline in the performance of the three hotels. Once triggered, substantially all of the excess cash flow from operations generated by the three hotels was deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lenders. Cash was distributed to the Company only after certain items were paid, including deposits into leasing and maintenance reserve accounts and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and leasing expenses. As of December 31, 2012, a total of \$8.2 million of the Company’s cash was held by the lenders of these three hotels. The cash will be returned to the Company once the lenders release the cash to the buyers, which is expected to occur within the near term.

In April 2010, the Company paid \$250,000 to purchase one-half of a \$5.0 million 8.075% subordinate note maturing in November 2010 secured by the 101-room boutique hotel known as Twelve Atlantic Station in Atlanta, Georgia. In November 2010, the Company purchased the remaining half of the Twelve Atlantic Station subordinate note for an additional \$250,000. In November 2010, the subordinate note was modified to provide for monthly interest only payments of 3.5%, with the remaining interest due at maturity, and the maturity date was extended to November 2012. As the subordinate note was in default, the borrower was required to bring the subordinate note current. Since the purchase date in April 2010, the Company has accounted for the subordinate note using the cost recovery method as the Company did not consider the expected cash flows from the loan to be reasonably probable and estimable. The Company received \$0.2 million and \$0.1 million during the years ended December 31, 2012 and 2011, respectively, which were applied to the subordinate note's principal balance in accordance with the cost recovery method. As of December 31, 2012, the subordinate note was again in default, and the Company recorded a reserve for the remaining \$0.2 million balance to bad debt expense, which is classified in corporate overhead on the Company's consolidated statements of operations and comprehensive income. The Company is currently working with the borrower and the special servicer to bring the note current, at which time the Company may reverse the bad debt expense recorded in 2012.

8. DUE TO THIRD-PARTY MANAGERS, OTHER CURRENT LIABILITIES
AND OTHER LIABILITIES

DUE TO THIRD-PARTY MANAGERS

IHR manages six of the Company's 26 hotels as of December 31, 2012. The following amounts make up the net liability owed to IHR in regards to these six hotels (in thousands):

	December 31,	
	2012	2011
Accrued payroll and employee benefits	\$ 3,004	\$ 2,367
Workers' compensation	530	896
Management fees payable	129	115
	<u>\$ 3,663</u>	<u>\$ 3,378</u>

Liabilities of assets held for sale includes \$6.3 million and \$5.8 million due to IHR as of December 31, 2012 and 2011, respectively.

OTHER CURRENT LIABILITIES

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

	December 31,	
	2012	2011
Property, sales, and use taxes payable	\$13,379	\$ 8,674
Accrued interest	4,901	4,885
Advance deposits	6,938	4,908
Management fees payable	2,217	2,976
Other	2,869	3,949
	<u>\$30,304</u>	<u>\$25,392</u>

OTHER LIABILITIES

Other liabilities consisted of the following (in thousands):

	December 31,	
	2012	2011
Interest rate swap derivative agreement	\$ 1,636	\$ 1,567
Deferred revenue	1,089	1,191
Deferred rent	9,459	6,684
Other	2,886	3,181
	<u>\$15,070</u>	<u>\$12,623</u>

9. NOTES PAYABLE

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

	2012	2011
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.97% to 6.60%; maturing at dates ranging from May 2015 through May 2021. The notes are collateralized by first deeds of trust on 13 and 14 hotel properties as of December 31, 2012 and 2011, respectively.	\$ 890,668	\$ 937,719
Note payable requiring payments of interest and principal, bearing a blended rate of 3-month LIBOR plus 325 basis points; maturing in April 2016. The note is collateralized by a first deed of trust on one hotel property.	234,724	237,806
Note payable requiring payments of interest only through October 2013, and interest and principal thereafter, with a blended interest rate of 3-month LIBOR plus 325 basis points; maturing in October 2018. The note is collateralized by a first deed of trust on one hotel property.	180,000	180,000
Senior Notes, with a fixed interest rate of 4.60%, maturing in July 2027. The notes are guaranteed by the Company and certain of its subsidiaries.	58,000	62,500
	1,363,392	1,418,025
Less: discount on Senior Notes	(3)	(1,135)
	1,363,389	1,416,890
Less: current portion	(76,723)	(49,505)
	\$1,286,666	\$1,367,385

In February 2012, the Company repurchased \$4.5 million in aggregate principal amount of the Senior Notes for \$4.57 million, including \$13,000 in interest, using its existing cash. After the repurchase, such Senior Notes were cancelled. The Company wrote off \$47,000 in deferred financing fees and \$0.1 million of the Senior Notes discount, and recognized a loss of \$0.2 million on this early extinguishment of debt.

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

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

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

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

In February 2011, the Company purchased the JW Marriott New Orleans, and assumed a \$42.2 million floating-rate, non-recourse senior mortgage secured by the hotel. The mortgage, which matures in September 2015, was swapped to a fixed rate of 5.45%, and is subject to a 25-year amortization schedule.

In April 2011, the Company acquired a 75.0% majority interest in the joint venture that owns the Hilton San Diego Bayfront. Concurrent with the acquisition, the joint venture replaced the hotel’s \$233.8 million construction loan (which was scheduled to mature in April 2011) with a new \$240.0 million mortgage secured by the hotel. The new mortgage bears a floating interest rate of 3-month LIBOR plus 325 basis points, matures in April 2016, and is subject to a 30-year amortization schedule.

In October 2011, the Company refinanced the \$270.0 million non-recourse senior mortgage and mezzanine debt which the Company assumed in connection with its acquisition of the outside 62.0% equity interests in its Doubletree Guest Suites Times Square joint venture in January 2011. The \$270.0 million non-recourse senior mortgage and mezzanine debt was scheduled to mature in January 2012, and bore a blended rate of 3-month LIBOR plus 115 basis points. The Company refinanced this debt in October 2011 with a new \$180.0 million non-recourse mortgage which matures in October 2018, and bears a floating interest rate of 3-month LIBOR plus 325 basis points. The new mortgage requires payments of interest only for the first 24 months of the term, and is subject to a 30-year amortization schedule. The Company funded the remainder of the repayment of the prior loan with approximately \$90.0 million of its unrestricted cash.

As of December 31, 2012 and 2011, the Company had \$58.0 million and \$62.5 million, respectively, in outstanding Senior Notes, which have a maturity date of July 2027 and a stated interest rate of 4.60%. The Company follows the requirements of the Debt Topic of the FASB ASC which states that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer’s non-convertible debt borrowing rate at the time of issuance. As a result, the liability component is recorded at a discount reflecting its below market interest rate. The liability component is subsequently accreted to its par value over its expected life based on a rate of interest that reflects the issuer’s non-convertible debt borrowing rate at the time of issuance, and is reflected in the results of operations as interest expense. Under the guidelines of the Debt Topic of the FASB ASC, the implicit interest rate for the Senior Notes is 6.5% based on the Company’s non-convertible debt borrowing rate at the time of issuance. Interest expense included accretion of the Senior Notes of \$1.1 million for the both of the years ended December 31, 2012 and 2011, and \$1.0 million for the year ended December 31, 2010. The Company did not have the right to redeem the Senior Notes until after January 20, 2013. In January 2013, pursuant to a tender offer, the Company validly tendered, accepted and repurchased \$42.0 million of the Senior Notes. In addition, the Company redeemed the remaining \$16.0 million of the Senior Notes. The Company paid for all of the \$58.0 million in Senior Notes with available cash. The Company will write off \$35,000 in deferred financing fees during the first quarter of 2013.

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

	2012	2011	2010
Interest expense	\$71,664	\$67,319	\$54,839
Loss on derivatives	406	2,655	—
Accretion of Senior Notes	1,058	1,062	996
Amortization of deferred financing fees	3,690	3,138	1,457
Write-off of deferred financing fees	3	21	1,462
Loan penalties and fees	—	—	177
	<u>\$76,821</u>	<u>\$74,195</u>	<u>\$58,931</u>

Aggregate future principal maturities and amortization of notes payable at December 31, 2012, are as follows (in thousands):

2013	\$ 76,726
2014	22,321
2015	158,217
2016	423,586
2017	250,223
Thereafter	432,319
Total	<u>\$1,363,392</u>

10. INCOME TAXES

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

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

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Current:			
Federal	\$ 850	\$ —	\$ —
State	298	—	—
Total current income tax provision	\$ 1,148	\$ —	\$ —
Deferred:			
Federal	\$ 1,031	\$ 345	\$ 4,187
State	278	96	1,069
	1,309	441	5,256
Valuation allowance	(1,309)	(441)	(5,256)
Total deferred income tax provision	\$ —	\$ —	\$ —

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

	December 31,	
	2012	2011
NOL carryover	\$ 40,330	\$ 39,097
Other reserves	2,919	3,035
State taxes and other	(1,534)	(1,725)
Deferred tax asset before valuation allowance	41,715	40,407
Depreciation	(49)	(50)
Deferred tax liability before valuation allowance	(49)	(50)
Deferred tax assets (liabilities), net	41,666	40,357
Valuation allowance	(41,666)	(40,357)
	\$ —	\$ —

The Company has provided a valuation allowance against its net deferred tax asset at December 31, 2012 and 2011. The valuation allowance is due to the uncertainty of realizing the Company’s historical operating losses. Accordingly, no provision or benefit for income taxes related to the Company is reflected in the accompanying consolidated statements of operations and comprehensive income.

At December 31, 2012 and 2011, the net operating loss carryforwards for federal income tax purposes totaled approximately \$102.6 million and \$99.5 million, respectively. These losses, which begin to expire in 2024, are available to offset future income through 2032.

In January 2013, the Internal Revenue Service issued a notice of proposed adjustment to the Company that challenged certain aspects of the Company’s leases with its TRS Lessee and its subsidiaries under Code sections 482 and 857 and related regulations. The Company disagrees with the IRS’s position, and management believes that its positions are more-likely-than-not to prevail upon appeal. No amounts have been accrued under the Income Taxes Topic of the FASB ASC as of December 31, 2012, as the Company has no uncertain tax positions that warrant accrual.

CHARACTERIZATION OF DISTRIBUTIONS

For income tax purposes, distributions paid consist of ordinary income, capital gains, return of capital or a combination thereof. For the years ended December 31, 2012, 2011 and 2010, distributions paid per share were characterized as follows (unaudited):

	2012		2011		2010	
	Amount	%	Amount	%	Amount	%
Common Stock:						
Ordinary income	\$ —	—%	\$ —	—%	\$ —	—%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$ —	—%	\$ —	—%	\$ —	—%
Preferred Stock—Series A						
Ordinary income	\$2.000	100.000%	\$2.500	100.000%	\$1.010	67.321%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	0.490	32.679
Total	\$2.000	100.000%	\$2.500	100.000%	\$1.500	100.000%
Preferred Stock—Series C						
Ordinary income	\$1.572	100.000%	\$1.965	100.000%	\$0.794	67.321%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	0.385	32.679
Total	\$1.572	100.000%	\$1.965	100.000%	\$1.179	100.000%
Preferred Stock—Series D						
Ordinary income	\$2.000	100.000%	\$1.472	100.000%	\$ —	—%
Capital gain	—	—	—	—	—	—
Return of capital	—	—	—	—	—	—
Total	\$2.000	100.000%	\$1.472	100.000%	\$ —	—%

11. SERIES C CUMULATIVE CONVERTIBLE REDEEMABLE PREFERRED STOCK

The Company’s 4,102,564 shares of Series C preferred stock have a liquidation preference of \$24.375 per share. As a result of the Company’s stock dividend paid in January 2009, the Series C conversion price was adjusted to \$22.23 per share. Each share of the Series C preferred stock is convertible into 1.096 shares of the Company’s common stock at the option of the holder, subject to customary antidilution provisions, including stock splits, stock dividends, non-cash distributions and above-market issuer self-tender or exchange offers. As of July 8, 2010, the Series C preferred stock is 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 \$24.375 per share, plus accrued and unpaid dividends up to and including the redemption date. The holders of the Series C preferred stock have the right to require the Company to redeem the Series C preferred stock in the event of any of the following: (1) a change in control of the Company, if certain conditions are not met; (2) a REIT termination event; or, (3) a termination of the Company’s listing on either the New York Stock Exchange or NASDAQ. In general, holders of Series C preferred stock vote on an as-converted basis as a single class with holders of the Company’s common stock. The quarterly dividend on the Series C preferred stock is currently \$0.393 per share. The holders are eligible to receive a participating dividend to the extent the Company’s dividend on its common stock exceeds \$0.339 per share per quarter. If the Company fails to meet certain financial ratios for four consecutive quarters, a financial ratio violation will occur with respect to the Company’s Series C preferred stock. During the continuation of a financial ratio violation, among other things, the Company would be restricted from paying dividends on its common stock, and may incur a 50 basis point per quarter dividend increase on the Series C preferred stock. Additionally, the Series C preferred stockholders would gain the right to appoint one board member. The Company currently does not expect to incur a financial ratio violation as it expects to meet its covenants. The Series C preferred stock has no maturity date and, except as set forth above, the Company is not required to redeem the Series C preferred stock at any time. As the Series C preferred stockholders may redeem their shares in certain circumstances outside of the control of the Company, the Series C preferred stock has not been classified as permanent equity.

The initial carrying value of the Series C preferred stock was recorded at its sales price less costs to issue on the date of issuance. This carrying value was periodically adjusted so that the carrying value equals the redemption value on the redemption date, which is the earliest date available for the Company to redeem the Series C preferred stock. The carrying value may also be periodically adjusted for any accrued and unpaid dividends. The initial carrying value of the Series C preferred stock was fully accreted to its redemption value during the third quarter of 2010, resulting in a carrying value of \$100.0 million at both December 31, 2012 and 2011.

12. STOCKHOLDERS' EQUITY

SERIES A CUMULATIVE REDEEMABLE PREFERRED STOCK

The Company's 7,050,000 shares of 8.0% Series A Cumulative Redeemable Preferred Stock ("Series A preferred stock") have a liquidation preference of \$25.00 per share, and are 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 and including the redemption date. Holders of Series A preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series A preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series A preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company's board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series A preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. As of December 31, 2012, the Company is in compliance with the dividend requirements for the Series A preferred stock. The Series A preferred stock has no maturity date, and the Company is not required to redeem the Series A preferred stock at any time.

SERIES D CUMULATIVE REDEEMABLE PREFERRED STOCK

In April 2011, the Company sold an aggregate of 4,600,000 shares, including the full exercise of the underwriters' overallotment option, of 8.0% Series D Cumulative Redeemable Preferred Stock ("Series D preferred stock") with a liquidation preference of \$25.00 per share for gross proceeds of \$115.0 million. Underwriting and other costs of the offering totaled \$4.1 million. Net proceeds of \$110.9 million were contributed to the Operating Partnership in exchange for preferred membership units with economic terms substantially identical to the Series D preferred stock. The proceeds were used to partially fund the Company's acquisition of the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront. On or after April 6, 2016, the Series D preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control of the Company, (i) the Company may, at its option, redeem the Series D preferred stock in whole or in part and within 120 days after the first date on which such change of control occurred, by paying \$25.00 per share, plus any accrued and unpaid dividends to, but not including, the redemption date, and (ii) holders of Series D preferred stock will have the right (unless, prior to the change of control conversion date, the Company has provided or provides notice of its election to redeem the Series D preferred stock) to convert some or all of their shares of Series D preferred stock into shares of the Company's common stock. Holders of Series D preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series D preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series D preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company's board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series D preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. The Series D preferred stock has no maturity date and the Company is not required to redeem the Series D preferred stock at any time, unless the Company decides, at its option, to exercise its redemption right or, under circumstances where the holders of Series D preferred stock decide to convert the Series D preferred stock. If the Company does not exercise its right to redeem the Series D preferred stock upon a change of control, holders of the Series D preferred stock have the right to convert some or all of their shares into a number of the Company's common shares based on a defined formula subject to a cap of 22,571,280 common shares.

COMMON STOCK

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

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

In November 2010, the Company issued 19,500,000 shares of its common stock for net proceeds of approximately \$190.6 million. The Company used a portion of these proceeds to fund the purchase of the outside 62.0% interests in its Doubletree Guest Suites Times Square joint venture in January 2011, the purchase of the outside 50.0% equity interest in its BuyEfficient joint venture in January 2011, the purchase of the JW Marriott New Orleans in February 2011, the purchase of a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront in April 2011, and for growth capital expenditures and other general corporate purposes, including working capital.

DIVIDENDS

The Company declared dividends per share on its Series A preferred stock, Series D preferred stock and common stock during 2012, 2011 and 2010 as follows:

	2012	2011	2010
Series A preferred stock	\$2.000	\$2.000	\$2.000
Series D preferred stock	2.000	1.472	—
Common stock—cash	—	—	—
Common stock—stock	—	—	—
	<u>\$4.000</u>	<u>\$3.472</u>	<u>\$2.000</u>

OPERATING PARTNERSHIP UNITS

As of December 31, 2012, the Operating Partnership had 135,237,438 units outstanding, all of which are held by the Company.

13. LONG-TERM INCENTIVE PLAN
STOCK GRANTS

The Company’s Long-Term Incentive Plan (“LTIP”) provides for the granting to directors, officers and eligible employees incentive or nonqualified share options, restricted shares, deferred shares, share purchase rights and share appreciation rights in tandem with options, or any combination thereof. The Company has reserved 6,050,000 common shares for issuance under the LTIP, and 2,178,185 shares remain available for future issuance as of December 31, 2012.

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

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

The Company’s compensation expense and forfeitures related to these restricted shares and performance awards for the years ended December 31, 2012, 2011 and 2010 were as follows (in thousands):

	2012	2011	2010
Compensation expense, including forfeitures	<u>\$5,139</u>	<u>\$4,135</u>	<u>\$5,811</u>
Forfeiture expense (credit) adjustments	<u>\$ 10</u>	<u>\$ 134</u>	<u>\$ (48)</u>

In December 2010, the Company recorded \$1.7 million in stock compensation and amortization expense related to the departure of its former Chief Executive Officer, Arthur L. Buser.

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

	2012		2011		2010	
	Shares	Weighted Average Price	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at beginning of year	1,407,152	\$8.55	668,934	\$7.70	1,301,451	\$7.68
Granted	647,171	9.51	1,260,845	9.10	438,665	9.06
Vested	(513,095)	8.08	(428,935)	8.85	(767,052)	8.84
Forfeited	(1,236)	9.38	(93,692)	8.43	(304,130)	6.71
Outstanding at end of year	<u>1,539,992</u>	<u>9.11</u>	<u>1,407,152</u>	<u>8.55</u>	<u>668,934</u>	<u>7.70</u>

At December 31, 2012, there were no deferred shares, share purchase rights, or share appreciation rights issued or outstanding under the LTIP.

STOCK OPTIONS

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

The initial fair value of the Options was \$0.7 million, and was estimated using a binomial option pricing model with the following assumptions:

Expected dividend yield	7.90%
Risk-free interest rate	3.29%
Expected volatility	26.90%
Expected life (in years)	5.5

The expected life was calculated using the simplified method as outlined in the Securities and Exchange Commission’s Staff Accounting Bulletin No. 107.

14. COMMITMENTS AND CONTINGENCIES
MANAGEMENT AGREEMENTS

Management agreements with the Company’s third-party hotel managers require the Company to pay between 2% and 3.5% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. Total basic management fees incurred by the Company during the years ended December 31, 2012, 2011 and 2010 were included in the Company’s consolidated statements of operations and comprehensive income as follows (in thousands):

	2012	2011	2010
Continuing operations—property general and administrative expense, and corporate overhead expense	\$22,807	\$19,549	\$13,123
Discontinued operations	2,061	2,643	4,595
	<u>\$24,868</u>	<u>\$22,192</u>	<u>\$17,718</u>

In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers. Total incentive management fees incurred by the Company during the years ended December 31, 2012, 2011 and 2010 were included in the Company’s consolidated statements of operations and comprehensive income as follows (in thousands):

	2012	2011	2010
Continuing operations—property general and administrative expense	\$ 2,738	\$ 2,916	\$ 2,509
Discontinued operations	587	675	487
	<u>\$ 3,325</u>	<u>\$ 3,591</u>	<u>\$ 2,996</u>

LICENSE AND FRANCHISE AGREEMENTS

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

Total license and franchise fees incurred by the Company during the years ended December 31, 2012, 2011 and 2010 were included in the Company’s consolidated statements of operations and comprehensive income as follows (in thousands):

	2012	2011	2010
Continuing operations—franchise costs	\$30,067	\$25,595	\$18,032
Discontinued operations	2,996	3,520	8,107
	<u>\$33,063</u>	<u>\$29,115</u>	<u>\$26,139</u>

Total license and franchise costs included royalties of \$10.6 million, \$8.8 million and \$9.2 million incurred by the Company during the years ended December 31, 2012, 2011 and 2010, respectively. The remaining costs included advertising, reservation and priority club assessments.

RENOVATION AND CONSTRUCTION COMMITMENTS

At December 31, 2012, the Company had various contracts outstanding with third parties in connection with the renovation of certain of its hotel properties aimed at maintaining the appearance and quality of its hotels. The remaining commitments under these contracts at December 31, 2012 totaled \$43.6 million.

CAPITAL LEASES

The Hyatt Chicago Magnificent Mile is subject to a building lease which expires in December 2097 (see Note 3). The Company evaluated the terms of the lease agreement and determined the lease to be a capital lease pursuant to the Leases Topic of the FASB ASC. Upon acquisition of the hotel in June 2012, the Company recorded a capital asset related to its leasehold interest of \$58.8 million to buildings and improvements, based upon the estimated fair value of the right to use the leased property for the then remaining term of 85.6 years, and a capital lease obligation of \$15.6 million, based upon the fair value of the remaining rent payments. In addition to minimum rent, the capital lease is subject to percentage rent equal to 4.0% of the hotel’s gross room revenues over a certain threshold.

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

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

	December 31,	
	2012	2011
Buildings and improvements	\$58,799	\$—
Furniture, fixtures and equipment	104	—
	58,903	—
Accumulated depreciation	(871)	—
	\$58,032	\$—

Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2012 are as follows (in thousands):

2013	\$ 1,437
2014	1,437
2015	1,412
2016	1,403
2017	1,403
Thereafter	112,219
Total minimum lease payments ⁽¹⁾	119,311
Less: Amount representing interest ⁽²⁾	(103,655)
Present value of net minimum lease payments ⁽³⁾	\$ 15,656

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

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

(3) The present value of net minimum lease payments are reflected in the Company's consolidated balance sheet as of December 31, 2012 as a current obligation of \$35,000, which is included in accounts payable and accrued expenses, and as a long-term obligation of \$15.6 million, which is included in capital lease obligations, less current portion.

GROUND, BUILDING AND AIR LEASES

During 2012, 2011 and 2010, certain of the Company's 26 hotels were obligated to unaffiliated third parties under the terms of ground, building and air leases as follows:

	2012	2011	2010
Number of hotels with ground, building and/or air leases	10	9	6
Number of ground leases	9	9	6
Number of building leases	1	—	—
Number of air leases	3	3	1
Total number of ground, building and air leases	13	12	7

At December 31, 2012, the ground, building and air leases mature in dates ranging from 2037 through 2097, excluding renewal options. One of the air leases requires a payment of \$1.00 annually, which the Company has paid in full for the life of the lease. Total rent expense incurred pursuant to ground, building and air lease agreements for the years ended December 31, 2012, 2011 and 2010 was included in the Company's consolidated statements of operations and comprehensive income as follows (in thousands):

	2012	2011	2010
Continuing operations—property tax, ground lease and insurance ⁽¹⁾	\$16,950	\$14,787	\$5,182
Discontinued operations	14	52	555
	\$16,964	\$14,839	\$5,737

(1) Ground lease expense recorded in both 2012 and 2011 includes amortization of lease intangibles on two ground leases and an air lease at three of the Company's 26 hotels. Ground lease expense recorded in 2010 includes amortization of lease intangibles on a ground lease at one of the Company's 26 hotels.

At December 31, 2012, the Company was obligated to an unaffiliated party under the terms of a sublease on the corporate facility, which matures in 2018. Rent expense incurred pursuant to leases on the corporate facility totaled \$0.4 million for the year ended December 31, 2012, and \$0.3 million for both of the years ended December 31, 2011 and 2010, and was included in corporate overhead expense.

Future minimum payments under the terms of the 13 ground, building and air leases, as well as the sublease on the corporate facility, in effect at December 31, 2012 are as follows (in thousands):

2013	\$ 10,105
2014	10,162
2015	10,221
2016	10,387
2017	13,200
Thereafter	493,265
Total	\$547,340

EMPLOYMENT AGREEMENTS

As of December 31, 2012, the Company has employment agreements with certain executive employees, which expire through April 2014. The terms of the agreements stipulate payments of base salaries and bonuses.

Approximate minimum future obligations under employment agreements are as follows as of December 31, 2012 (in thousands):

2013	\$ 914
2014	94
	\$ 1,008

COLLECTIVE BARGAINING AGREEMENTS

The Company is subject to exposure to collective bargaining agreements at certain hotels operated by its management companies. At December 31, 2012, approximately 19.2% of workers employed by the Company's third-party managers were covered by such collective bargaining agreements.

401(K) SAVINGS AND RETIREMENT PLAN

The Company’s employees may participate, subject to eligibility, in the Company’s 401(k) Savings and Retirement Plan (the “401(k) Plan”). Employees are eligible to participate in the 401(k) Plan after attaining 21 years of age and after the first of the month following the performance of six months of service. Three percent of eligible employee annual base earnings is contributed by the Company as a Safe Harbor elective contribution. Safe Harbor contributions made by the Company totaled \$0.2 million for each of the years ended December 31, 2012, 2011 and 2010, and were included in corporate overhead expense.

The Company is also responsible for funding various retirement plans at certain hotels operated by its management companies. Property general and administrative expense on the Company’s consolidated statement of operations and comprehensive income includes matching contributions into these various retirement plans of \$0.9 million, \$0.3 million and \$0.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. Matching contributions into these retirement plans of \$0.1 million for both the years ended December 31, 2012 and 2011, and \$0.2 million for the year ended December 31, 2010 are included in discontinued operations in the Company’s consolidated statements of operations and comprehensive income.

CONCENTRATION OF RISK

The concentration of the Company’s hotels in California, New York and Illinois exposes the Company’s business to economic conditions, competition and real and personal property tax rates unique to California, New York and Illinois. As of December 31, 2012, the Company’s 26 hotels were concentrated in California, New York and Illinois as follows:

	2012
California:	
Number of hotels	8
Percentage of total rooms	31%
Percentage of total 2012 revenue	31%
New York:	
Number of hotels	3
Percentage of total rooms	11%
Percentage of total 2012 revenue	17%
Illinois:	
Number of hotels	3
Percentage of total rooms	10%
Percentage of total 2012 revenue	8%

LITIGATION

During the third quarter of 2011, the Company accrued \$1.6 million in settlement costs related to litigation involving three separate claims by certain employees at four of its hotels: Marriott Del Mar; Marriott Quincy; Renaissance Los Angeles Airport; and Renaissance Long Beach. The Company agreed to fund these costs in exchange for certain concessions by Marriott, including the termination of their management contract for the Renaissance Westchester, which is now managed by Highgate Hotels. The Company had previously estimated that the ultimate liability for these lawsuits would range from between zero and \$0.1 million, and, accordingly, the Company recorded a liability of \$0.1 million in November 2010 in accordance with the Contingencies Topic of the FASB Accounting Standards Codification, which requires a liability be recorded based on the Company’s estimate of the probable cost of the resolution of a contingency. The Company and certain other defendants reached court-approved settlements regarding two of the lawsuits comprising \$1.0 million of the total \$1.7 million accrual, resulting in a \$0.1 million reversal of a portion of the liability for one of the claims during the first quarter of 2012. The Company and certain other defendants reached a court-approved settlement regarding the remaining \$0.7 million settlement during the fourth quarter of 2012. As of December 31, 2012, the Company has paid all amounts due under all three settlement agreements.

During the second quarter of 2012, the Company accrued \$0.3 million in legal settlement costs based on a settlement reached in July 2012 involving a claim by certain employees at the Fairmont Newport Beach. As of December 31, 2012, the Company has paid all amounts due under this settlement agreement.

OTHER

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

At December 31, 2012, the Company had \$3.8 million of outstanding irrevocable letters of credit to guaranty the Company’s financial obligations related to the building lease for the Hyatt Chicago Magnificent Mile and to workers’ compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon these letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through December 31, 2012.

15. QUARTERLY OPERATING RESULTS (UNAUDITED)

The consolidated quarterly results for the years ended December 31, 2012 and 2011, of the Company are as follows (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<i>REVENUES—CONTINUING OPERATIONS</i>				
2012	\$178,234	\$212,842	\$205,041	\$232,967
2011	\$134,307	\$190,256	\$181,585	\$215,646
<i>OPERATING INCOME (LOSS)—CONTINUING OPERATIONS</i>				
2012	\$ 5,151	\$ 28,614	\$ 16,248	\$ 28,997
2011	\$ (3,759)	\$ 23,739	\$ (1,874)	\$ 24,569
<i>NET INCOME (LOSS)</i>				
2012	\$ (12,968)	\$ 11,855	\$ 39,556	\$ 11,114
2011	\$ 51,335	\$ 38,929	\$ (16,553)	\$ 7,588
<i>INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS PER SHARE— BASIC AND DILUTED</i>				
2012	\$ (0.18)	\$ 0.03	\$ 0.23	\$ 0.03
2011	\$ 0.39	\$ 0.27	\$ (0.20)	\$ 0.00

Income available (loss attributable) to common stockholders per share is computed independently for each of the quarters presented and therefore may not sum to the annual amount for the year. Previously reported revenues and operating income have been adjusted to account for current discontinued operations in accordance with the Property, Plant and Equipment Topic of the FASB ASC.

16. SUBSEQUENT EVENTS

On January 17, 2013, the Company validly tendered, accepted and repurchased \$42.0 million of the Senior Notes pursuant to a tender offer statement on Schedule TO originally filed with the Securities and Exchange Commission on December 17, 2012. On January 22, 2013, the remaining \$16.0 million of the Senior Notes were redeemed. The Company funded the total \$58.0 million in Senior Note redemptions with available cash, leaving no future amounts outstanding related to the Senior Notes.

On January 25, 2013, the Company completed the sale of a four-hotel 1,222-room portfolio and a commercial laundry facility (collectively, the “Portfolio”), in Rochester, Minnesota, to an unaffiliated third party, for a gross sales price of \$230.0 million. The four hotels include the 660-room Kahler Grand, the 271-room Kahler Inn & Suites, the 202-room Marriott Rochester and the 89-room Residence Inn by Marriott Rochester. The Company has retained a \$25.0 million preferred equity investment in the four-hotel Portfolio that yields an 11% dividend. In addition, the Company has retained a \$14.0 million liability related to the Portfolio’s pension plan, which could be triggered in certain circumstances, including termination of the pension plan. The Company has also provided a \$3.7 million working cash advance to the buyer that will be repaid to the Company from the Portfolio’s available cash flow. Concurrent with the Portfolio sale, the Company has defeased the outstanding \$26.7 million mortgage secured by the Kahler Grand for a total cost of approximately \$30.0 million, prepaid the \$0.4 million loan secured by the commercial laundry facility, and has written off \$51,000 in related deferred financing fees.

On January 28, 2013, the Company announced its intention to redeem all 7,050,000 shares of its Series A preferred stock for \$176.3 million, plus accrued dividends to and including the date of redemption totaling \$2.3 million. The Company will redeem the Series A preferred shares on March 1, 2013, using cash received from its February 2013 common stock offering. After the redemption date, the Company will have no outstanding shares of Series A preferred stock, and all rights of the holders of such shares will be terminated. Because the redemption of the Series A preferred stock is a redemption in full, trading of the Series A preferred stock on the New York Stock Exchange will cease after the redemption date.

On February 1, 2013, the Company issued 22,000,000 shares of its common stock for net proceeds of approximately \$256.7 million. On February 21, 2013, the underwriters exercised their over-allotment option, and the Company issued an additional 3,300,000 shares on February 25, 2013 for net proceeds of \$38.5 million. The Company will use a portion of these proceeds to redeem all of its Series A preferred stock for an aggregate redemption price of \$178.6 million, including \$2.3 million in accrued dividends, and will use the remaining proceeds for potential future acquisitions, capital investment in the Company’s portfolio and other general corporate purposes, including working capital.

STOCK
Information

Our common stock is traded on the NYSE under the symbol “SHO.” On February 11, 2013, the last reported price per share of common stock on the NYSE was \$11.81. The table below sets forth the high and low closing price per share of our common stock as reported on the NYSE and the cash dividends per share of common stock we declared with respect to each period.

	High	Low	Dividends Declared
2011			
First Quarter	\$10.90	\$9.28	\$—
Second Quarter	\$10.50	\$8.65	\$—
Third Quarter	\$10.03	\$5.10	\$—
Fourth Quarter	\$ 8.15	\$5.07	\$—
2012			
First Quarter	\$10.00	\$8.06	\$—
Second Quarter	\$10.99	\$9.27	\$—
Third Quarter	\$11.70	\$9.68	\$—
Fourth Quarter	\$10.97	\$9.34	\$—

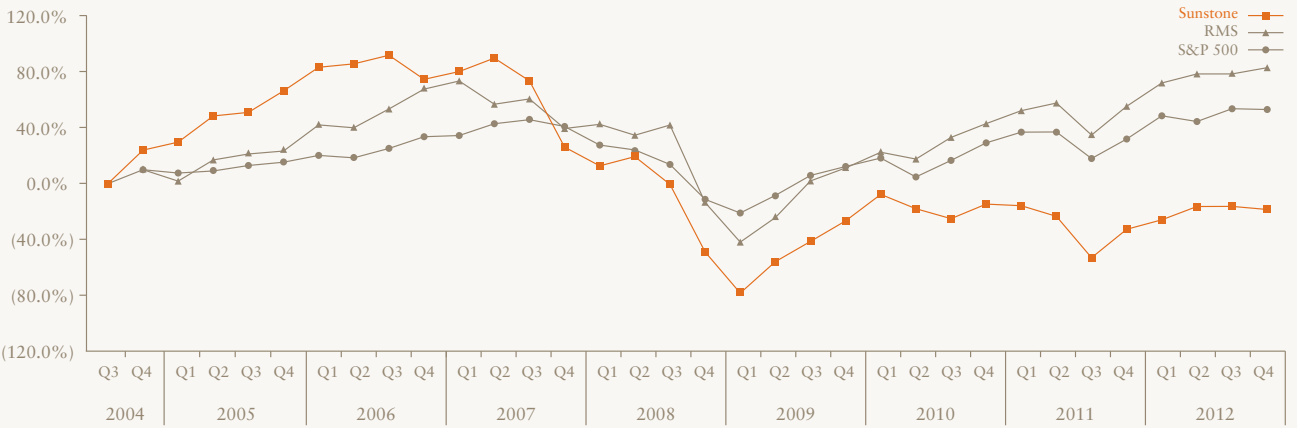
We may pay quarterly cash dividends to common stockholders at the discretion of our board of directors, however it is our current policy to minimize cash dividends in order to maximize cash available to reduce our indebtedness. In addition, we expect to apply net operating loss carryforwards to reduce our taxable income in 2013, which will affect the level of common stock dividends declared for 2013. The level of any future dividends will be determined by our board of directors after considering taxable income projections, expected capital requirements, risks affecting the Company’s business and in context of our leverage-reduction initiatives. We have elected in the past, and may elect in the future, to pay dividends on our common stock in cash, or a combination of cash and shares of common stock. The Company intends to maintain its annual common dividend payouts at a level approximating 100% of taxable income.

As of February 11, 2013, we had approximately 28 holders of record of our common stock. In order to comply with certain requirements related to our qualification as a REIT, our charter limits the number of common shares that may be owned by any single person or affiliated group to 9.8% of the outstanding common shares, subject to the ability of our board to waive this limitation under certain conditions.

HISTORICAL PERFORMANCE COMPARISON⁽¹⁾

October 21, 2004–December 31, 2012

Sunstone Hotel Investors, Inc., Morgan Stanley REIT Index, Standard & Poor’s 500 Composite Stock Index
Source: FactSet Research Systems as of 12/31/12



(1) This graph provides a comparison of cumulative total stockholder returns for the period from October 21, 2004, the date of our initial public offering, through December 31, 2012, among Sunstone Hotel Investors, Inc. (“Sunstone”), the Standard & Poor’s 500 Composite Stock Index (“S&P 500”) and the Morgan Stanley REIT Index (“RMS”). The total return values were calculated assuming a \$100 investment on October 21, 2004 with reinvestment of all dividends in (i) our common stock, (ii) the S&P 500 and (iii) the RMS, respectively. The total return values do not include any dividends declared, but not paid, during the period.

CORPORATE
Information

BOARD OF DIRECTORS

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

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

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

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

Keith P. Russell
*President
Russell Financial, Inc.*

Thomas A. Lewis, Jr.
*Vice Chairman of the Board of Directors
and Chief Executive Officer
Realty Income Corporation*

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

Douglas M. Pasquale
Director

EXECUTIVE OFFICERS

Kenneth E. Cruse
Chief Executive Officer

John V. Arabia
President

Marc A. Hoffman
*Executive Vice President &
Chief Operating Officer*

Bryan Giglia
*Senior Vice President &
Chief Financial Officer*

Robert Springer
*Senior Vice President &
Chief Investment Officer*

Lindsay Monge
*Senior Vice President &
Chief Administrative Officer*

ANNUAL MEETING OF
STOCKHOLDERS

The Annual Meeting will be held at
11:30 A.M. on May 1, 2013 at:
Renaissance Washington, D.C.
999 9th Street NW
Washington, D.C. 20001

TRANSFER AGENT

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

STOCK LISTING

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

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

INDEPENDENT
REGISTERED PUBLIC
ACCOUNTANTS

Ernst & Young LLP

FORM 10-K AND OTHER
MATERIALS

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

INVESTOR RELATIONS

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

CEO AND CFO
CERTIFICATIONS

In 2012, the Company’ Chief Executive
Officer (CEO) provided to the New York
Stock Exchange the annual CEO certifi-
cation regarding the Company’s compli-
ance with the New York Stock Exchange’s
corporate governance listing standards.
In addition, all required certifications
by the Company’s CEO and Chief Finan-
cial Officer regarding the quality of the
Company’s public disclosures in its fiscal
2012 reports were filed with the U.S.
Securities and Exchange Commission.

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

 MIX Paper from responsible sources FSC® C019076	 13 TREES preserved for the future	 9,217,364 BTUs energy not consumed	 1,204 LBS net greenhouse gases prevented	 5,528 GAL wastewater flow saved	 612 LBS solid waste not generated
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