
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2019

OR

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

For the transition period from to

Commission file number 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or Other Jurisdiction of
Incorporation or Organization)

20-1296886

(I.R.S. Employer
Identification Number)

**200 Spectrum Center Drive, 21st Floor
Irvine, California**

(Address of Principal Executive Offices)

92618

(Zip Code)

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

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	SHO	New York Stock Exchange
Series E Cumulative Redeemable Preferred Stock, \$0.01 par value	SHO.PRE	New York Stock Exchange
Series F Cumulative Redeemable Preferred Stock, \$0.01 par value	SHO.PRF	New York Stock Exchange

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

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

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

Large accelerated filer

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

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

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

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

As of November 1, 2019, there were 224,855,351 shares of Sunstone Hotel Investors, Inc.'s common stock, \$0.01 par value per share, outstanding.

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

For the Quarterly Period Ended September 30, 2019

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
**SUNSTONE HOTEL INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS**
(In thousands, except share data)

	September 30, 2019 (unaudited)	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 730,039	\$ 809,316
Restricted cash	46,206	53,053
Accounts receivable, net	44,021	33,844
Prepaid expenses and other current assets	14,359	12,261
Assets held for sale, net	18,481	—
Total current assets	853,106	908,474
Investment in hotel properties, net	2,910,852	3,030,998
Finance lease right-of-use asset, net	48,019	—
Operating lease right-of-use assets, net	61,512	—
Deferred financing costs, net	2,924	3,544
Other assets, net	22,424	29,817
Total assets	<u>\$ 3,898,837</u>	<u>\$ 3,972,833</u>
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 33,140	\$ 30,425
Accrued payroll and employee benefits	21,371	25,039
Dividends and distributions payable	14,451	126,461
Other current liabilities	45,843	44,962
Current portion of notes payable, net	6,271	5,838
Liabilities of assets held for sale	12,446	—
Total current liabilities	133,522	232,725
Notes payable, less current portion, net	966,496	971,225
Finance lease obligations, less current portion	15,571	27,009
Operating lease obligations, less current portion	50,905	—
Other liabilities	19,824	30,703
Total liabilities	<u>1,186,318</u>	<u>1,261,662</u>
Commitments and contingencies (Note 12)		
Equity:		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized:		
6.95% Series E Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at September 30, 2019 and December 31, 2018, stated at liquidation preference of \$25.00 per share	115,000	115,000
6.45% Series F Cumulative Redeemable Preferred Stock, 3,000,000 shares issued and outstanding at September 30, 2019 and December 31, 2018, stated at liquidation preference of \$25.00 per share	75,000	75,000
Common stock, \$0.01 par value, 500,000,000 shares authorized, 224,861,978 shares issued and outstanding at September 30, 2019 and 228,246,247 shares issued and outstanding at December 31, 2018	2,249	2,282
Additional paid in capital	2,681,754	2,728,684
Retained earnings	1,274,039	1,182,722
Cumulative dividends and distributions	(1,483,907)	(1,440,202)
Total stockholders' equity	2,664,135	2,663,486
Noncontrolling interest in consolidated joint venture	48,384	47,685
Total equity	<u>2,712,519</u>	<u>2,711,171</u>
Total liabilities and equity	<u>\$ 3,898,837</u>	<u>\$ 3,972,833</u>

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
REVENUES				
Room	\$ 200,242	\$ 207,657	\$ 580,835	\$ 608,237
Food and beverage	61,366	63,911	206,183	217,469
Other operating	20,031	17,740	55,197	52,495
Total revenues	281,639	289,308	842,215	878,201
OPERATING EXPENSES				
Room	52,514	53,928	152,606	159,923
Food and beverage	44,928	46,260	140,149	147,299
Other operating	4,162	4,190	12,494	12,488
Advertising and promotion	13,285	13,593	40,998	41,815
Repairs and maintenance	10,632	10,530	31,107	32,484
Utilities	7,458	8,084	20,656	22,533
Franchise costs	8,606	9,167	24,024	26,981
Property tax, ground lease and insurance	21,880	20,369	62,842	63,658
Other property-level expenses	30,913	31,580	97,768	101,005
Corporate overhead	7,395	7,360	22,989	22,056
Depreciation and amortization	37,573	36,159	110,484	110,181
Impairment loss	—	—	—	1,394
Total operating expenses	239,346	241,220	716,117	741,817
Interest and other income	3,762	2,592	13,497	7,049
Interest expense	(13,259)	(11,549)	(43,401)	(31,609)
Gain on sale of assets	—	53,128	—	68,787
Income before income taxes	32,796	92,259	96,194	180,611
Income tax benefit (provision), net	749	(673)	1,185	692
NET INCOME	33,545	91,586	97,379	181,303
Income from consolidated joint venture attributable to noncontrolling interest	(2,508)	(2,376)	(6,062)	(7,189)
Preferred stock dividends	(3,208)	(3,208)	(9,622)	(9,622)
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ 27,829	\$ 86,002	\$ 81,695	\$ 164,492
Basic and diluted per share amounts:				
Basic and diluted income attributable to common stockholders per common share	\$ 0.12	\$ 0.38	\$ 0.36	\$ 0.73
Basic and diluted weighted average common shares outstanding	224,530	227,068	226,369	225,538

See accompanying notes to consolidated financial statements.

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

	Preferred Stock				Common Stock		Additional Paid in Capital	Retained Earnings	Cumulative Dividends and Distributions	Noncontrolling Interest in Consolidated Joint Venture	Total Equity
	Series E Number of Shares	Series E Amount	Series F Number of Shares	Series F Amount	Number of Shares	Amount					
Balance at December 31, 2018 (audited)	4,600,000	\$115,000	3,000,000	\$75,000	228,246,247	\$ 2,282	\$ 2,728,684	\$1,182,722	\$ (1,440,202)	\$ 47,685	\$ 2,711,171
Amortization of deferred stock compensation	—	—	—	—	—	—	2,221	—	—	—	2,221
Issuance of restricted common stock, net	—	—	—	—	345,132	4	(4,439)	—	—	—	(4,435)
Forfeiture of restricted common stock	—	—	—	—	(3,932)	—	—	—	—	—	—
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,429)	—	(11,429)
Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,209)	—	(1,209)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(1,950)	(1,950)
Net income	—	—	—	—	—	—	—	16,317	—	1,599	17,916
Balance at March 31, 2019	4,600,000	115,000	3,000,000	75,000	228,587,447	2,286	2,726,466	1,199,039	(1,454,838)	47,334	2,710,287
Amortization of deferred stock compensation	—	—	—	—	—	—	3,002	—	—	—	3,002
Issuance of restricted common stock	—	—	—	—	51,840	—	—	—	—	—	—
Repurchase of outstanding common stock	—	—	—	—	(432,464)	(4)	(5,731)	—	—	—	(5,735)
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,411)	—	(11,411)
Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,209)	—	(1,209)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(788)	(788)
Net income	—	—	—	—	—	—	—	43,963	—	1,955	45,918
Balance at June 30, 2019	4,600,000	115,000	3,000,000	75,000	228,206,823	2,282	2,723,737	1,243,002	(1,469,456)	48,501	2,738,066
Amortization of deferred stock compensation	—	—	—	—	—	—	2,249	—	—	—	2,249
Repurchase of outstanding common stock	—	—	—	—	(3,344,845)	(33)	(44,232)	—	—	—	(44,265)
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,243)	—	(11,243)

Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,210)	—	(1,210)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(2,625)	(2,625)
Net income	—	—	—	—	—	—	—	31,037	—	2,508	33,545
Balance at September 30, 2019	<u>4,600,000</u>	<u>\$115,000</u>	<u>3,000,000</u>	<u>\$75,000</u>	<u>224,861,978</u>	<u>\$ 2,249</u>	<u>\$ 2,681,754</u>	<u>\$1,274,039</u>	<u>\$ (1,483,907)</u>	<u>\$ 48,384</u>	<u>\$ 2,712,519</u>

See accompanying notes to consolidated financial statements.

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

	Preferred Stock				Common Stock		Additional Paid in Capital	Retained Earnings	Cumulative Dividends and Distributions	Noncontrolling Interest in Consolidated Joint Venture	Total Equity
	Series E Number of Shares	Amount	Series F Number of Shares	Amount	Number of Shares	Amount					
Balance at December 31, 2017 (audited)	4,600,000	\$115,000	3,000,000	\$75,000	225,321,660	\$ 2,253	\$ 2,679,221	\$ 932,277	\$ (1,270,013)	\$ 48,440	\$ 2,582,178
Amortization of deferred stock compensation	—	—	—	—	—	—	2,113	—	—	—	2,113
Issuance of restricted common stock, net	—	—	—	—	297,013	3	(4,235)	—	—	—	(4,232)
Forfeiture of restricted common stock	—	—	—	—	(3,961)	—	—	—	—	—	—
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,281)	—	(11,281)
Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,209)	—	(1,209)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(1,169)	(1,169)
Net income	—	—	—	—	—	—	—	36,016	—	2,439	38,455
Balance at March 31, 2018	4,600,000	115,000	3,000,000	75,000	225,614,712	2,256	2,677,099	968,293	(1,284,501)	49,710	2,602,857
Amortization of deferred stock compensation	—	—	—	—	—	—	2,966	—	—	—	2,966
Issuance of restricted common stock	—	—	—	—	49,513	1	(1)	—	—	—	—
Forfeiture of restricted common stock	—	—	—	—	(824)	—	—	—	—	—	—
Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,413)	—	(11,413)
Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,209)	—	(1,209)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(1,475)	(1,475)
Net proceeds from sale of common stock	—	—	—	—	2,590,854	26	44,315	—	—	—	44,341
Net income	—	—	—	—	—	—	—	48,888	—	2,374	51,262
Balance at June 30, 2018	4,600,000	115,000	3,000,000	75,000	228,254,255	2,283	2,724,379	1,017,181	(1,299,121)	50,609	2,685,331
Amortization of deferred stock compensation	—	—	—	—	—	—	2,143	—	—	—	2,143
Forfeiture of restricted common stock	—	—	—	—	(7,193)	(1)	1	—	—	—	—

Common stock distributions and distributions payable at \$0.05 per share	—	—	—	—	—	—	—	—	(11,412)	—	(11,412)
Series E preferred stock dividends and dividends payable at \$0.434375 per share	—	—	—	—	—	—	—	—	(1,998)	—	(1,998)
Series F preferred stock dividends and dividends payable at \$0.403125 per share	—	—	—	—	—	—	—	—	(1,210)	—	(1,210)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	—	(4,000)	(4,000)
Net income	—	—	—	—	—	—	—	89,210	—	2,376	91,586
Balance at September 30, 2018	<u>4,600,000</u>	<u>\$115,000</u>	<u>3,000,000</u>	<u>\$75,000</u>	<u>228,247,062</u>	<u>\$ 2,282</u>	<u>\$ 2,726,523</u>	<u>\$1,106,391</u>	<u>\$ (1,313,741)</u>	<u>\$ 48,985</u>	<u>\$ 2,760,440</u>

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 97,379	\$ 181,303
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	405	682
Gain on sale of assets	—	(68,740)
Noncash interest on derivatives and finance lease obligations, net	6,908	(4,995)
Depreciation	110,416	108,744
Amortization of franchise fees and other intangibles	68	1,468
Amortization of right-of-use assets	(523)	—
Amortization of deferred financing costs	2,094	2,240
Amortization of deferred stock compensation	7,168	6,938
Impairment loss	—	1,394
Gain on hurricane-related damage	—	(1,100)
Deferred income taxes, net	(246)	(1,100)
Changes in operating assets and liabilities:		
Accounts receivable	(10,700)	(10,450)
Prepaid expenses and other assets	(1,744)	823
Accounts payable and other liabilities	2,449	6,928
Accrued payroll and employee benefits	(3,045)	(4,599)
Net cash provided by operating activities	<u>210,629</u>	<u>219,536</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of assets	—	231,083
Disposition deposit	—	3,000
Proceeds from property insurance	—	1,100
Acquisitions of hotel property and other assets	(193)	(15,147)
Acquisitions of intangible assets	—	(18,516)
Renovations and additions to hotel properties and other assets	(75,277)	(125,854)
Net cash (used in) provided by investing activities	<u>(75,470)</u>	<u>75,666</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from common stock offerings	—	45,125
Payment of common stock offering costs	—	(784)
Repurchases of outstanding common stock	(50,000)	—
Repurchase of common stock for employee withholding obligations	(4,435)	(4,232)
Payments on notes payable	(5,770)	(5,486)
Payments of deferred financing costs	—	(5)
Dividends and distributions paid	(155,715)	(163,002)
Distributions to noncontrolling interest	(5,363)	(6,644)
Net cash used in financing activities	<u>(221,283)</u>	<u>(135,028)</u>
Net (decrease) increase in cash and cash equivalents and restricted cash	(86,124)	160,174
Cash and cash equivalents and restricted cash, beginning of period	862,369	559,311
Cash and cash equivalents and restricted cash, end of period	<u>\$ 776,245</u>	<u>\$ 719,485</u>

See accompanying notes to consolidated financial statements.

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

Supplemental Disclosure of Cash Flow Information

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the consolidated balance sheets to the amount shown in the consolidated statements of cash flows:

	September 30,	
	2019	2018
Cash and cash equivalents	\$ 730,039	\$ 650,691
Restricted cash	46,206	68,794
Total cash and cash equivalents and restricted cash shown on the consolidated statements of cash flows	\$ 776,245	\$ 719,485

The Company paid the following amounts for interest and income taxes, during the nine months ended September 30, 2019 and 2018:

	Nine Months Ended September 30,	
	2019	2018
Cash paid for interest	\$ 36,703	\$ 36,396
Cash paid for income taxes, net	\$ 354	\$ 571

Supplemental Disclosure of Noncash Investing and Financing Activities

The Company's noncash investing and financing activities during the nine months ended September 30, 2019 and 2018 consisted of the following:

	Nine Months Ended September 30,	
	2019	2018
Accrued renovations and additions to hotel properties and other assets	\$ 8,149	\$ 13,632
Amortization of deferred stock compensation — construction activities	\$ 304	\$ 284
Dividends and distributions payable	\$ 14,451	\$ 14,620

See accompanying notes to consolidated financial statements.

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

1. Organization and Description of Business

Sunstone Hotel Investors, Inc. (the “Company”) was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes, commencing with its taxable year ended on December 31, 2004. The Company, through its 100% controlling interest in Sunstone Hotel Partnership, LLC (the “Operating Partnership”), of which the Company is the sole managing member, and the subsidiaries of the Operating Partnership, including Sunstone Hotel TRS Lessee, Inc. (the “TRS Lessee”) and its subsidiaries, is currently engaged in acquiring, owning, asset managing and renovating or repositioning hotel properties, and may also selectively sell hotels that no longer fit its stated strategy.

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

As of September 30, 2019, the Company had interests in 21 hotels (the “21 Hotels”), one of which was considered held for sale, leaving 20 hotels (the “20 Hotels”) currently held for investment. The Company’s third-party managers included the following:

	Number of Hotels
Subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”)	8
Interstate Hotels & Resorts, Inc.	3 (1)
Highgate Hotels L.P. and an affiliate	3
Crestline Hotels & Resorts	2
Hilton Worldwide	2
Davidson Hotels & Resorts	1
Hyatt Corporation	1
Singh Hospitality, LLC	1
Total hotels owned as of September 30, 2019	<u>21</u>

- (1) The Courtyard by Marriott Los Angeles was considered held for sale as of September 30, 2019, and subsequently sold on October 23, 2019.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of September 30, 2019 and December 31, 2018, and for the three and nine months ended September 30, 2019 and 2018, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their controlled subsidiaries. All significant intercompany balances and transactions have been eliminated. If the Company determines that it has an interest in a variable interest entity, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity.

The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and in conformity with the rules and regulations of the Securities and Exchange Commission. In the Company’s opinion, the interim financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim financial statements. These financial statements should be read in conjunction with the financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2018, filed with the Securities and Exchange Commission on February 14, 2019. Operating results for the three and nine months ended September 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

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

Certain prior year amounts in these financial statements have been reclassified to conform to the presentation for the three and nine months ended September 30, 2019.

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

Use of Estimates

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

Earnings Per Share

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

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating securities and are included in the computation of earnings per share.

Basic earnings (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 (loss) attributable to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period, plus potential common shares considered outstanding during the period, as long as the inclusion of such awards is not anti-dilutive. Potential common shares consist of unvested restricted stock awards and the incremental common shares issuable upon the exercise of stock options (before their expiration in April 2018), using the more dilutive of either the two-class method or the treasury stock method.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Numerator:				
Net income	\$ 33,545	\$ 91,586	\$ 97,379	\$ 181,303
Income from consolidated joint venture attributable to noncontrolling interest	(2,508)	(2,376)	(6,062)	(7,189)
Preferred stock dividends	(3,208)	(3,208)	(9,622)	(9,622)
Distributions paid on unvested restricted stock compensation	(61)	(59)	(183)	(177)
Undistributed income allocated to unvested restricted stock compensation	(89)	(385)	(257)	(689)
Numerator for basic and diluted income attributable to common stockholders	<u>\$ 27,679</u>	<u>\$ 85,558</u>	<u>\$ 81,255</u>	<u>\$ 163,626</u>
Denominator:				
Weighted average basic and diluted common shares outstanding	<u>224,530</u>	<u>227,068</u>	<u>226,369</u>	<u>225,538</u>
Basic and diluted income attributable to common stockholders per common share	<u>\$ 0.12</u>	<u>\$ 0.38</u>	<u>\$ 0.36</u>	<u>\$ 0.73</u>

The Company's unvested restricted shares associated with its long-term incentive plan and shares associated with common stock options, as applicable, have been excluded from the above calculation of earnings per share for the three and nine months ended September 30, 2019 and 2018, as their inclusion would have been anti-dilutive.

Noncontrolling Interest

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

At both September 30, 2019 and December 31, 2018, the noncontrolling interest reported in the Company's consolidated financial statements consisted of a third-party's 25.0% ownership interest in the Hilton San Diego Bayfront.

Investment in Hotel Properties

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

Depreciation expense is based on the estimated life of the Company's assets. The life is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish the Company's hotels, as well as specific market and economic conditions. Hotel properties are depreciated using the straight-line method over estimated useful lives primarily ranging from five to 40 years for buildings and improvements and three to 12 years for FF&E. 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 terms of the franchise agreements ranging from 14 to 27 years. All other franchise fees that are based on the Company's results of operations are expensed as incurred.

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

Impairment losses are recorded on 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, based on the Company's anticipated investment horizon, are less than the assets' carrying amount. No single indicator would necessarily result in the Company preparing an estimate to determine if a hotel's future undiscounted cash flows are less than the book value of the hotel. The Company uses judgment to determine if the severity of any single indicator, or the fact there are a number of indicators of less severity that when combined, would result in an indication that a hotel requires an estimate of the undiscounted cash flows to determine if an impairment has occurred. If a hotel is considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment loss is recognized. The impairment loss recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. The Company performs a fair value assessment using a discounted cash flow analysis to estimate the fair value of the hotel, taking into account the hotel's expected cash flow from operations, the Company's estimate of how long it will continue to own the hotel and the estimated proceeds from the disposition of the hotel. 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's judgment is required in determining the discount rate applied to estimated cash flows, the estimated growth of revenues and expenses, net operating income and margins, the need for capital expenditures, as well as specific market and economic conditions.

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

Restricted Cash

Restricted cash is comprised of reserve accounts for debt service, interest reserves, seasonality reserves, capital replacements, ground leases, property taxes and excess hotel-generated cash that is held in an account for the benefit of a lender. These restricted funds are subject to supervision and disbursement approval by certain of the Company's lenders and/or hotel managers.

Revenue Recognition

Revenues are recognized when control of the promised goods or services is transferred to hotel guests, which is generally defined as the date upon which a guest occupies a room and/or utilizes the hotel's services. Room revenue is recognized over a guest's stay at a previously agreed upon daily rate. Additionally, some of the Company's hotel rooms are booked through independent internet travel intermediaries. If the guest pays the independent internet travel intermediary directly, revenue for the room is recognized by the Company at the price the Company sold the room to the independent internet travel intermediary, less any discount or commission paid. If the guest pays the Company directly, revenue for the room is recognized by the Company on a gross basis, with the related discount or commission recognized in room expense. A majority of the Company's hotels participate in frequent guest programs sponsored by the hotel brand owners whereby the hotel allows guests to earn loyalty points during their hotel stay. The Company expenses charges associated with these programs as incurred, and recognizes revenue at the amount it will receive from the brand when a guest redeems their loyalty points by staying at one of the Company's hotels. In addition, some contracts for rooms or food and beverage services require an advance deposit, which the Company records as deferred revenue (or a contract liability) and recognizes once the performance obligations are satisfied.

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

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

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

	September 30, 2019 (unaudited)	December 31, 2018
Trade receivables, net (1)	\$ 25,090	\$ 18,982
Contract liabilities (2)	\$ 17,581	\$ 16,711

- (1) Trade receivables are included in accounts receivable, net on the accompanying consolidated balance sheets.
- (2) Contract liabilities consist of advance deposits, and are included in both other current liabilities and other liabilities on the accompanying consolidated balance sheets. Of the amount outstanding at December 31, 2018, approximately \$1.0 million and \$16.3 million were recognized in revenue during the three and nine months ended September 30, 2019, respectively.

Segment Reporting

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

New Accounting Standards and Accounting Changes

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-02, "*Leases (Topic 842)*" ("ASU No. 2016-02"), which requires companies to record a right-of-use asset and a lease liability on the balance sheet for all leases with a term greater than 12 months regardless of their classification. All entities will classify leases as either operating or finance to determine how to recognize lease-related revenue and expense. Classification will continue to affect amounts that lessees and lessors record on the balance sheet. The new standard requires the following:

- Lessees: Leases are accounted for using a dual approach, classifying leases as either operating or financing based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. This

classification determines whether the lease expense is recognized on a straight-line basis over the term of the lease (for operating leases) or based on an effective interest method (for finance leases). A lessee is required to record a right-of-use asset and a lease liability on its balance sheet for all leases with a term of greater than 12 months regardless of their classification as operating or finance leases.

- Lessors: Leases are accounted for using an approach that is substantially equivalent to existing guidance for operating, sales-type and financing leases, but aligned with the FASB's revenue standard.

Subsequent to the issuance of ASU No. 2016-02, the FASB issued several clarifications and updates, including Accounting Standards Update No. 2018-01, "*Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*" ("ASU No. 2018-01") in January 2018, Accounting Standards Update No. 2018-10, "*Codification Improvements to Topic 842, Leases*" ("ASU No. 2018-10") and Accounting Standards Update No. 2018-11, "*Leases (Topic 842): Targeted Improvements*" ("ASU No. 2018-11") in July 2018, Accounting Standards Update No. 2018-20, "*Leases (Topic 842): Narrow-Scope Improvements for Lessors*" ("ASU No. 2018-20") in December 2018 and Accounting Standards Update No. 2019-01, "*Leases (Topic 842): Codification Improvements*" ("ASU No. 2019-01") in March 2019.

The Company adopted ASU No. 2016-02 on January 1, 2019, along with its related clarifications and amendments, and made the following elections:

- to not separate lease components from nonlease components by underlying asset. By making this election, the Company is required to account for the nonlease components together with the related lease components as a single lease component (ASU No. 2016-02);
- to not reassess whether a land easement not previously accounted for as a lease would now be a lease (ASU No. 2018-01);
- to not reassess whether an expired or existing contract meets the definition of a lease (ASU No. 2018-11);
- to not reassess the lease classification at the adoption date for existing leases (ASU No. 2018-11);
- to not reassess whether costs previously capitalized as initial direct costs would continue to be amortized (ASU No. 2018-11);
- to apply the optional modified retrospective transition approach, allowing companies to initially apply the standard at the adoption date without revising comparable periods (ASU No. 2018-11); and
- to not evaluate whether sales taxes and other similar taxes imposed by a governmental authority on a specific lease revenue-producing transaction are the primary obligation of the lessor as owner of the underlying leased asset (ASU No. 2018-20).

Lessee Perspective: Adoption of the new standard resulted in the Company recording net balance sheet adjustments for right-of-use ("ROU") assets and related lease obligations totaling \$45.7 million for its operating leases. The Company also reclassified an \$18.4 million ground lease intangible asset, net of accumulated amortization, from investment in hotel properties, net to operating lease ROU assets, net, and reclassified its existing deferred rent liabilities related to its operating leases totaling \$13.0 million from other liabilities to operating lease obligations. The adjustments related to operating leases affected the Company's January 1, 2019 consolidated balance sheet as follows (in thousands):

	Balance Pre-Adoption	Adjustments (unaudited)	Balance Post-Adoption (unaudited)
Operating lease right-of-use assets, net	\$ —	\$ 64,075	\$ 64,075
Investment in hotel properties, net (intangible assets)	\$ 50,889	(18,398)	\$ 32,491
Total asset adjustments		<u>\$ 45,677</u>	
Operating lease obligations, current and noncurrent	\$ —	\$ 58,663	\$ 58,663
Other liabilities (deferred rent)	\$ 12,986	(12,986)	\$ —
Total liability adjustments		<u>\$ 45,677</u>	

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Upon adoption of the new standard, the Company reclassified amounts related to its finance leases as follows (in thousands):

	Balance Pre-Adoption	Adjustments (unaudited)	Balance Post-Adoption (unaudited)
Finance lease right-of-use assets, net	\$ —	\$ 55,727	\$ 55,727
Investment in hotel properties, net (land)	\$ 611,993	(6,605)	\$ 605,388
Investment in hotel properties, net (buildings and improvements, net of accumulated depreciation)	\$ 2,167,680	(49,122)	\$ 2,118,558
Total asset adjustments		\$ —	
Finance lease obligations, current and noncurrent	\$ —	\$ 27,010	\$ 27,010
Capital lease obligations, current and noncurrent	\$ 27,010	(27,010)	\$ —
Total liability adjustments		\$ —	

The Company determines if a contract is a lease at inception. Leases with an initial term of 12 months or less are not recorded on the balance sheet. Expense for these short-term leases is recognized on a straight-line basis over the lease term. For leases with an initial term greater than 12 months, the Company records a ROU asset and a corresponding lease obligation. ROU assets represent the Company's right to use an underlying asset for the lease term, and lease obligations represent the Company's obligation to make fixed lease payments as stipulated by the lease. Operating lease obligations are recognized at the lease commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate ("IBR") based on information available at the commencement date in determining the present value of lease payments over the lease term. The IBR is the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment. In order to estimate the Company's IBR, the Company first looks to its own unsecured debt offerings, and adjusts the rate for both length of term and secured borrowing using available market data as well as consultations with leading national financial institutions that are active in the issuance of both secured and unsecured notes.

Operating lease ROU assets are recognized at the lease commencement date, and include the amount of the initial operating lease obligation, any lease payments made at or before the commencement date, excluding any lease incentives received, and any initial direct costs incurred. For leases that have extension options that the Company can exercise at its discretion, management uses judgment to determine if it is reasonably certain that the Company will in fact exercise such option. If the extension option is reasonably certain to occur, the Company includes the extended term's lease payments in the calculation of the respective lease liability. None of the Company's leases contain any material residual value guarantees or material restrictive covenants. The Company reviews its right-of-use assets for indicators of impairment. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment loss is recognized. The impairment loss recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Lessor Perspective: For lease agreements in which the Company is the lessor, the Company analyzed the impact of the standard and determined that there was no material impact to the recognition, measurement, or presentation of these revenues. Upon adoption, the Company analyzed the lease and nonlease components, including real estate taxes and common area maintenance expenses, of its lease agreements and determined that the timing and pattern of transfer for both components are the same. In addition, the Company determined that the predominate component was the lease component and, as such, the leases will continue to qualify as operating leases and the Company will account for and present the lease component and the nonlease component as a single component. The Company will continue to collect nonlease amounts directly from its tenants, including real estate taxes and other expenses, and remit these amounts directly to third-parties. None of the Company's tenants pay third-parties directly. The Company believes that all of its tenant receivables are probable of collection as of September 30, 2019.

See Note 9 for additional lease disclosures.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ("ASU No. 2016-13"), which will replace today's "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward looking "expected loss" model that generally will result in the earlier recognition of allowances for losses. In addition, entities will have to disclose significantly more information, including information they use to track credit quality by year of origination for most financing receivables. In November 2018, the FASB issued Accounting Standards Update No. 2018-19, *Codification Improvements to Topic 326, Financial Instruments-Credit Losses* ("ASU No. 2018-19"), which clarifies that operating lease receivables accounted for under ASC 842 are not in the scope of ASU No. 2016-13. Both ASU No. 2016-13 and ASU No. 2018-19 are effective during the first quarter of 2020. Both standards will require a modified retrospective approach, with early adoption permitted during the first quarter of 2019. The Company is currently evaluating the impact that ASU No. 2016-13 and ASU No. 2018-19 will have on its consolidated financial statements.

3. Investment in Hotel Properties

Investment in hotel properties, net for the 20 Hotels consisted of the following (in thousands):

	September 30, 2019 (unaudited)	December 31, 2018
Land	\$ 605,581	\$ 611,993
Buildings and improvements	2,968,241	2,983,308
Furniture, fixtures and equipment	512,333	486,441
Intangible assets	33,050	56,021
Franchise fees	743	778
Construction in progress	34,884	60,744
Investment in hotel properties, gross	4,154,832	4,199,285
Accumulated depreciation and amortization	(1,243,980)	(1,168,287)
Investment in hotel properties, net	<u>\$ 2,910,852</u>	<u>\$ 3,030,998</u>

4. Disposals

The Company classified the Courtyard by Marriott Los Angeles as held for sale at September 30, 2019, and subsequently sold the hotel in October 2019 (see Note 13). The sale did not represent a strategic shift that had a major impact on the Company's business plan or its primary markets; therefore, the hotel did not qualify as a discontinued operation.

The Company classified the assets and liabilities of the Courtyard by Marriott Los Angeles as held for sale at September 30, 2019 as follows (unaudited and in thousands):

	September 30, 2019
Accounts receivable	\$ 118
Prepaid expenses and other current assets	126
Investment in hotel properties, net	10,551
Finance lease right-of-use asset	6,605
Other assets	1,081
Assets held for sale, net	<u>\$ 18,481</u>
Accounts payable and accrued expenses	\$ 202
Accrued payroll and employee benefits	229
Other current liabilities	409
Finance lease obligation, less current portion (1)	11,606
Liabilities of assets held for sale	<u>\$ 12,446</u>

(1) The finance lease at the Courtyard by Marriott Los Angeles had a discount rate of 10.25%.

5. Fair Value Measurements and Interest Rate Derivatives

Fair Value Measurements

As of September 30, 2019 and December 31, 2018, 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.

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

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

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

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

As of both September 30, 2019 and December 31, 2018, the Company measured its interest rate derivatives at fair value on a recurring basis. Prior to the Company's release of collateral assignment in August 2019, the Company also measured a life insurance policy and a related retirement benefit agreement at fair value on a recurring basis. The Company estimates the fair value of its interest rate derivatives using Level 2 measurements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. Both the life insurance policy and the related retirement benefit agreement, which were for a former Company associate, were valued using Level 2 measurements.

No assets were measured at fair value at September 30, 2019. The following table presents the Company's assets measured at fair value on a recurring and nonrecurring basis at December 31, 2018 (in thousands):

	Total	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
December 31, 2018:				
Interest rate swap derivatives	\$ 4,789	\$ —	\$ 4,789	\$ —
Life insurance policy (1)	386	—	386	—
Total assets measured at fair value at December 31, 2018	<u>\$ 5,175</u>	<u>\$ —</u>	<u>\$ 5,175</u>	<u>\$ —</u>

- (1) Prior to the Company's release of collateral assignment in August 2019, the split life insurance policy was for a former Company associate. As of December 31, 2018, the amount was included in other assets, net on the accompanying consolidated balance sheet.

The following table presents the Company's liabilities measured at fair value on a recurring and nonrecurring basis at September 30, 2019 and December 31, 2018 (in thousands):

	Total	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
September 30, 2019 (unaudited):				
Interest rate swap derivatives	\$ 1,951	\$ —	\$ 1,951	\$ —
Total liabilities measured at fair value at September 30, 2019	<u>\$ 1,951</u>	<u>\$ —</u>	<u>\$ 1,951</u>	<u>\$ —</u>
December 31, 2018:				
Retirement benefit agreement (1)	\$ 386	\$ —	\$ 386	\$ —
Total liabilities measured at fair value at December 31, 2018	<u>\$ 386</u>	<u>\$ —</u>	<u>\$ 386</u>	<u>\$ —</u>

- (1) Prior to the Company's release of collateral assignment in August 2019, the retirement benefit agreement was for a former Company associate. As of December 31, 2018, the amount was included in accrued payroll and employee benefits on the accompanying consolidated balance sheet.

Interest Rate Derivatives

The Company's interest rate derivatives, which are not designated as effective cash flow hedges, consisted of the following at September 30, 2019 (unaudited) and December 31, 2018 (in thousands):

Hedged Debt	Type	Strike / Capped Rate	Index	Effective Date	Maturity Date	Notional Amount	Estimated Fair Value of Assets (Liabilities) (1)	
							September 30, 2019	December 31, 2018
Hilton San Diego Bayfront	Cap	4.250 %	1-Month LIBOR	May 1, 2017	May 1, 2019	N/A	\$ N/A	\$ —
Hilton San Diego Bayfront	Cap	6.000 %	1-Month LIBOR	November 10, 2017	December 9, 2020	\$ 220,000	—	—
\$85.0 million term loan	Swap	1.591 %	1-Month LIBOR	October 29, 2015	September 2, 2022	\$ 85,000	(453)	2,521
\$100.0 million term loan	Swap	1.853 %	1-Month LIBOR	January 29, 2016	January 31, 2023	\$ 100,000	(1,498)	2,268
							<u>\$ (1,951)</u>	<u>\$ 4,789</u>

- (1) The fair values of both swap agreements are included in other liabilities and in other assets, net on the accompanying consolidated balance sheets as of September 30, 2019 and December 31, 2018, respectively.

Noncash changes in the fair values of the Company's interest rate derivatives resulted in increases (decreases) to interest expense for the three and nine months ended September 30, 2019 and 2018 as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Noncash interest on derivatives	<u>\$ 1,098</u>	<u>\$ (870)</u>	<u>\$ 6,740</u>	<u>\$ (5,147)</u>

Fair Value of Debt

As of September 30, 2019 and December 31, 2018, 77.5% and 77.6%, respectively, of the Company's outstanding debt had fixed interest rates, including the effects of interest rate swap agreements. The Company uses Level 3 measurements to estimate the fair value of its debt by discounting the future cash flows of each instrument at estimated market rates.

The Company's principal balances and fair market values of its consolidated debt as of September 30, 2019 (unaudited) and December 31, 2018 were as follows (in thousands):

	September 30, 2019		December 31, 2018	
	Carrying Amount (1)	Fair Value	Carrying Amount (1)	Fair Value
Debt	<u>\$ 977,058</u>	<u>\$ 979,569</u>	<u>\$ 982,828</u>	<u>\$ 971,082</u>

- (1) The principal balance of debt is presented before any unamortized deferred financing costs.

6. Other Assets

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

	September 30, 2019 (unaudited)	December 31, 2018
Property and equipment, net	\$ 7,833	\$ 8,426
Goodwill	—	990
Deferred rent on straight-lined third-party tenant leases	3,435	3,177
Deferred income tax asset, net	8,349	8,407
Interest rate derivatives	—	4,789
Other receivables	2,478	3,209
Other	329	819
Total other assets, net	<u>\$ 22,424</u>	<u>\$ 29,817</u>

7. Notes Payable

Notes payable consisted of the following (in thousands):

	September 30, 2019 (unaudited)	December 31, 2018
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.12% to 5.95%; maturing at dates ranging from November 2020 through January 2025. The notes are collateralized by first deeds of trust on four hotel properties at both September 30, 2019 and December 31, 2018.	\$ 332,058	\$ 337,828
Note payable requiring payments of interest only, bearing a blended rate of one-month LIBOR plus 105 basis points; initial maturity in December 2020 with three one-year extensions. The note is collateralized by a first deed of trust on one hotel property.	220,000	220,000
Unsecured term loan requiring payments of interest only, with a blended interest rate based on a pricing grid with a range of 135 to 220 basis points over one-month LIBOR, depending on the Company's leverage ratios. LIBOR has been swapped to a fixed rate of 1.591%, resulting in an effective interest rate of 2.941%. Matures in September 2022.	85,000	85,000
Unsecured term loan requiring payments of interest only, with a blended interest rate based on a pricing grid with a range of 135 to 220 basis points over one-month LIBOR, depending on the Company's leverage ratios. LIBOR has been swapped to a fixed rate of 1.853%, resulting in an effective interest rate of 3.203%. Matures in January 2023.	100,000	100,000
Unsecured Senior Notes requiring semi-annual payments of interest only, bearing interest at 4.69%; maturing in January 2026.	120,000	120,000
Unsecured Senior Notes requiring semi-annual payments of interest only, bearing interest at 4.79%; maturing in January 2028.	120,000	120,000
Total notes payable	\$ 977,058	\$ 982,828
Current portion of notes payable	\$ 8,237	\$ 7,804
Less: current portion of deferred financing costs	(1,966)	(1,966)
Carrying value of current portion of notes payable	\$ 6,271	\$ 5,838
Notes payable, less current portion	\$ 968,821	\$ 975,024
Less: long-term portion of deferred financing costs	(2,325)	(3,799)
Carrying value of notes payable, less current portion	\$ 966,496	\$ 971,225

As of September 30, 2019, the Company had no outstanding amounts due under its credit facility.

Interest Expense

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

	Three Months Ended September 30, 2019	2018	Nine Months Ended September 30, 2019	2018
Interest expense on debt and finance lease obligations	\$ 11,406	\$ 11,619	\$ 34,399	\$ 34,364
Noncash interest on derivatives and finance lease obligations, net	1,155	(818)	6,908	(4,995)
Amortization of deferred financing costs	698	748	2,094	2,240
Total interest expense	\$ 13,259	\$ 11,549	\$ 43,401	\$ 31,609

8. Other Current Liabilities and Other Liabilities

Other Current Liabilities

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

	September 30, 2019 (unaudited)	December 31, 2018
Property, sales and use taxes payable	\$ 18,934	\$ 15,684
Income tax payable	25	125
Accrued interest	4,521	7,306
Advance deposits	17,085	16,711
Management fees payable	786	1,142
Other	4,492	3,994
Total other current liabilities	<u>\$ 45,843</u>	<u>\$ 44,962</u>

Other Liabilities

Other liabilities consisted of the following (in thousands):

	September 30, 2019 (unaudited)	December 31, 2018
Deferred revenue	\$ 5,296	\$ 5,017
Deferred rent	—	12,986
Deferred property taxes payable (1)	9,342	9,284
Interest rate derivatives	1,951	—
Deferred income tax liability	—	304
Other	3,235	3,112
Total other liabilities	<u>\$ 19,824</u>	<u>\$ 30,703</u>

- (1) Under the terms of a sublease agreement at the Hilton Times Square, sublease rent amounts are currently considered to be property taxes under a payment-in-lieu of taxes (“PILOT”) program, and will be paid beginning in 2020 through 2029. When the PILOT program ends in 2020, the sublease agreement will be modified, rent amounts will be reassessed and the Company will determine if the sublease agreement qualifies as a lease.

9. Leases

Lessee Accounting

The Company has both operating and finance leases for ground, building, office and air leases, maturing in dates ranging from 2028 through 2097, including expected renewal options. Including all renewal options available to the Company, the lease maturity date extends to 2147.

Leases were included on the Company's consolidated balance sheet as follows (unaudited and in thousands):

	September 30, 2019
Finance Lease:	
Right-of-use asset, net (buildings and improvements)	\$ 58,799
Accumulated depreciation	(10,780)
Right-of-use asset, net	<u>\$ 48,019</u>
Accounts payable and accrued expenses	\$ 1
Lease obligations, less current portion	15,571
Total lease obligation	<u>\$ 15,572</u>
Remaining lease term	78.3 years
Discount rate	9.0 %
Operating Leases:	
Right-of-use assets, net	<u>\$ 61,512</u>
Accounts payable and accrued expenses	\$ 4,671
Lease obligations, less current portion	50,905
Total lease obligations	<u>\$ 55,576</u>
Weighted average remaining lease term	24.7 years
Weighted average discount rate	5.4 %

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

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Finance lease cost:		
Amortization of right-of-use assets	\$ 367	\$ 1,103
Interest on lease obligations (1)	647	1,936
Total finance lease cost	<u>\$ 1,014</u>	<u>\$ 3,039</u>
Operating lease cost (2)	<u>\$ 3,687</u>	<u>10,065</u>

- (1) Interest on lease obligations includes interest expense on the Courtyard by Marriott Los Angeles's finance lease obligation, which, along with certain of the hotel's other assets and liabilities, was classified as held for sale as of September 30, 2019 (see Note 4). For the three and nine months ended September 30, 2019, interest expense on the hotel's finance lease obligation totaled \$0.3 million and \$0.9 million, respectively.
- (2) Several of the Company's hotels pay percentage rent, which is calculated on operating revenues above certain thresholds. During the three and nine months ended September 30, 2019, the Company recorded \$2.0 million and \$4.9 million, respectively, in percentage rent related to its operating leases.

Supplemental cash flow information related to leases was as follows (unaudited and in thousands):

	Nine Months Ended September 30, 2019
Operating cash flows used for operating leases	\$ 5,365
Operating right-of-use assets obtained in exchange for operating lease obligations	\$ 45,677

Future maturities of the Company's finance and operating lease obligations at September 30, 2019 were as follows (unaudited and in thousands):

	Finance Lease (1)	Operating Lease
Year 1	\$ 1,403	\$ 7,506
Year 2	1,403	7,557
Year 3	1,403	7,608
Year 4	1,403	7,662
Year 5	1,403	7,717
Thereafter	102,751	75,925
Total lease payments	109,766	113,975
Less: interest (2)	(94,194)	(58,399)
Present value of lease obligations	\$ 15,572	\$ 55,576

- (1) Does not include the finance lease obligation at the Courtyard by Marriott Los Angeles, which was classified as held for sale at September 30, 2019 (see Note 4).
- (2) Calculated using the appropriate discount rate for each lease.

Lessor Accounting

During the three and nine months ended September 30, 2019, the Company recognized \$2.9 million and \$8.3 million, respectively, in lease-related revenue, which is included in other operating revenue on the Company's unaudited consolidated statement of operations.

10. Stockholders' Equity

Series E Cumulative Redeemable Preferred Stock

In March 2016, the Company issued 4,600,000 shares of its 6.95% Series E Cumulative Redeemable Preferred Stock ("Series E preferred stock") with a liquidation preference of \$25.00 per share for gross proceeds of \$115.0 million. In conjunction with the offering, the Company incurred \$4.0 million in preferred offering costs. On or after March 11, 2021, the Series E preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control, as defined by the Articles Supplementary for Series E preferred stock, holders of the Series E preferred stock may, under certain circumstances, convert their preferred shares into shares of the Company's common stock.

Series F Cumulative Redeemable Preferred Stock

In May 2016, the Company issued 3,000,000 shares of its 6.45% Series F Cumulative Redeemable Preferred Stock ("Series F preferred stock") with a liquidation preference of \$25.00 per share for gross proceeds of \$75.0 million. In conjunction with the offering, the Company incurred \$2.6 million in preferred offering costs. On or after May 17, 2021, the Series F preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control, as defined by the Articles Supplementary for Series F preferred stock, holders of the Series F preferred stock may, under certain circumstances, convert their preferred shares into shares of the Company's common stock.

Common Stock

In February 2017, the Company entered into separate “At the Market” Agreements (the “ATM Agreements”) with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC and Wells Fargo Securities, LLC. In accordance with the terms of the ATM Agreements, the Company may from time to time offer and sell shares of its common stock having an aggregate offering price of up to \$00.0 million. The Company did not issue any shares of its common stock in connection with the ATM agreements during the three and nine months ended September 30, 2019. During 2017 and 2018, the Company issued a total of 7,467,709 shares of its common stock in connection with the ATM Agreements for gross proceeds of \$124.5 million, leaving \$175.5 million available for sale under the ATM Agreements. The Company paid a total of \$2.3 million in costs during 2017 and 2018 in connection with common stock issued under the ATM Agreements.

In February 2017, the Company’s board of directors authorized a stock repurchase program to acquire up to an aggregate of \$00.0 million of the Company’s common and preferred stock. During the three and nine months ended September 30, 2019, the Company repurchased 3,344,845 and 3,777,309 shares of its common stock, respectively, for \$44.3 million and \$50.0 million, including fees and commissions, respectively, leaving approximately \$250.1 million of remaining authorized capacity under the program. As of September 30, 2019, no shares of the Company’s preferred stock have been repurchased. Future repurchases will depend on various factors, including the Company’s capital needs, as well as the Company’s common and preferred stock price.

11. Long-Term Incentive Plan**Stock Grants**

Restricted shares granted pursuant to the Company’s Long-Term Incentive Plan (“LTIP”) generally vest over a period of three years from the date of grant. Should a stock grant be forfeited prior to its vesting, the shares covered by the stock grant are added back to the LTIP and remain available for future issuance. Shares of common stock tendered or withheld to satisfy the grant or exercise price or tax withholding obligations upon the vesting of a stock grant are not added back to the LTIP.

Compensation expense related to awards of restricted 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 has elected to account for forfeitures as they occur.

The Company’s amortization expense and forfeitures related to restricted shares for the three and nine months ended September 30, 2019 and 2018 were as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Amortization expense, including forfeitures	\$ 2,146	\$ 2,073	\$ 7,168	\$ 6,938

In addition, the Company capitalizes compensation costs related to restricted shares granted to certain employees whose work is directly related to the Company’s capital investment in its hotels. These capitalized costs totaled \$0.1 million during both the three months ended September 30, 2019 and 2018, and \$0.3 million during both the nine months ended September 30, 2019 and 2018.

12. Commitments and Contingencies

Management Agreements

Management agreements with the Company's third-party hotel managers require the Company to pay between 1.75% and 3.0% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers.

Total basic and incentive management fees incurred by the Company during the three and nine months ended September 30, 2019 and 2018 were included in other property-level expenses on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Basic management fees	\$ 7,767	\$ 7,879	\$ 23,404	\$ 24,225
Incentive management fees	511	1,339	6,041	6,187
Total basic and incentive management fees	<u>\$ 8,278</u>	<u>\$ 9,218</u>	<u>\$ 29,445</u>	<u>\$ 30,412</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.

Total license and franchise fees incurred by the Company during the three and nine months ended September 30, 2019 and 2018 were included in franchise costs on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Franchise assessments (1)	\$ 6,391	\$ 6,501	\$ 18,005	\$ 19,633
Franchise royalties	2,215	2,666	6,019	7,348
Total franchise costs	<u>\$ 8,606</u>	<u>\$ 9,167</u>	<u>\$ 24,024</u>	<u>\$ 26,981</u>

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

Renovation and Construction Commitments

At September 30, 2019, the Company had various contracts outstanding with third parties in connection with the ongoing renovations of certain of its hotel properties. The remaining commitments under these contracts at September 30, 2019 totaled \$53.3 million.

Concentration of Risk

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

As of September 30, 2019, 15 of the 20 Hotels were geographically concentrated as follows (unaudited):

	Number of Hotels	Percentage of Total Rooms	Trailing 12-Month Total Consolidated Revenue
California	5	30 %	33 %
Florida	2	9 %	10 %
Greater Washington DC area	2	13 %	11 %
Hawaii	1	5 %	11 %
Illinois	3	11 %	7 %
Massachusetts	2	14 %	15 %

Other

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

At September 30, 2019, the Company had \$0.4 million of outstanding irrevocable letters of credit to guarantee the Company's financial obligations related to workers' compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon 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 September 30, 2019.

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

13. Subsequent Event

On October 23, 2019, the Company sold the leasehold interest in the Courtyard by Marriott Los Angeles for a gross sale price of \$0.0 million.

Cautionary Statement

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. The Company intends such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe the Company's future plans, strategies, opinions and expectations, are generally identifiable by use of the words "anticipate," "believe," "estimate," "expect," "intend," "project," or similar expressions. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond the Company's control, and which could materially affect actual results, performances or achievements. Accordingly, there is no assurance that the Company's expectations will be realized. In evaluating these statements, you should specifically consider the risks outlined in detail in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 14, 2019, under the caption "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q, including but not limited to the following factors:

- general economic and business conditions, including a U.S. recession, changes in the European Union or global economic slowdown, which may diminish the desire for leisure travel or the need for business travel, as well as any type of flu, disease-related pandemic or the adverse effects of climate change, affecting the lodging and travel industry, internationally, nationally and locally;
- our need to operate as a REIT and comply with other applicable laws and regulations, including new laws, interpretations or court decisions that may change the federal or state tax laws or the federal or state income tax consequences of our qualification as a REIT;
- rising hotel operating expenses, including the impact of the Patient Protection and Affordable Care Act or its potential replacement, increases in minimum wages, changes in work rules or additional costs incurred from new or renegotiated labor contracts;
- relationships with, and the requirements and reputation of, our franchisors and hotel brands;
- relationships with, and the requirements, performance and reputation of, the managers of our hotels;
- the ground, building or air leases for five of the 21 hotels we have interests in as of September 30, 2019;
- competition for the acquisition of hotels, and our ability to complete acquisitions and dispositions;
- performance of hotels after they are acquired;
- new hotel supply, or alternative lodging options such as timeshare, vacation rentals or sharing services such as Airbnb, in our markets, which could harm our occupancy levels and revenue at our hotels;
- competition from hotels not owned by us;
- the need for renovations, repositionings and other capital expenditures for our hotels;
- the impact, including any delays, of renovations and repositionings on hotel operations;
- changes in our business strategy or acquisition or disposition plans;
- our level of debt, including secured, unsecured, fixed and variable rate debt;
- financial and other covenants in our debt and preferred stock;
- our hotels and related goodwill may become impaired, or our hotels which have previously become impaired may become further impaired, in the future, which may adversely affect our financial condition and results of operations;
- volatility in the capital markets and the effect on lodging demand or our ability to obtain capital on favorable terms or at all;
- potential adverse tax consequences in the event that our operating leases with our taxable REIT subsidiaries are not held to have been made on an arm's-length basis;
- system security risks, data protection breaches, cyber-attacks, including those impacting our hotel managers or other third parties, and systems integration issues; and
- other events beyond our control, including natural disasters, terrorist attacks or civil unrest.

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

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

Overview

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

Our business is to acquire, own, asset manage and renovate or reposition hotels that we consider to be Long-Term Relevant Real Estate® (or LTRR®) in the United States, specifically hotels in urban and resort locations that benefit from significant barriers to entry by competitors and diverse economic drivers. As part of our ongoing portfolio management strategy, on an opportunistic basis, we may also selectively sell hotel properties that we believe do not meet our criteria of LTRR®. As of September 30, 2019, we had interests in 21 hotels (the "21 Hotels"), including the Courtyard by Marriott Los Angeles which we classified as held for sale and subsequently sold in October 2019, leaving 20 hotels currently held for investment (the "20 Hotels"), which average 530 rooms in size. Of the 20 Hotels, we classify 18 as upper upscale, and one each as upscale and luxury as defined by STR, Inc. All but two (the Boston Park Plaza and the Oceans Edge Resort & Marina) of the 20 Hotels are operated under nationally recognized brands such as Marriott, Hilton and Hyatt, which are among the most respected and widely recognized brands in the lodging industry. Our two unbranded hotels are located in top urban and resort markets that have enabled them to establish awareness with both group and transient customers.

As demand for lodging generally fluctuates with the overall economy, we seek to own a portfolio of hotels that will maintain a high appeal with travelers over long periods of time and will generate economic earnings materially in excess of recurring capital requirements. Our strategy is to maximize stockholder value through focused asset management and disciplined capital recycling, which is likely to include selective acquisitions and dispositions, while maintaining balance sheet flexibility and strength. Our goal is to maintain appropriate leverage and financial flexibility to position the Company to create value throughout all phases of the operating and financial cycles.

2019 Year-To-Date Highlights

As of September 30, 2019, we have repurchased 3,777,309 shares of our common stock for \$50.0 million, including fees and commissions, and no shares of our preferred stock. We repurchased an additional 6,627 shares of our common stock in October 2019 for \$0.1 million, including fees and commissions, leaving approximately \$250.0 million of remaining authorized capacity under our \$300.0 million stock repurchase program. Future repurchases will depend on various factors, including our capital needs, as well as the price of our common and preferred stock.

In October 2019, we sold the leasehold interest in the 187-room Courtyard by Marriott Los Angeles for a gross sale price of \$50.0 million.

Operating Activities

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

- *Room revenue*, which is the product of the number of rooms sold and the average daily room rate, or "ADR," as defined below;
- *Food and beverage revenue*, which is comprised of revenue realized in the hotel food and beverage outlets as well as banquet and catering events; and
- *Other operating revenue*, which includes ancillary hotel revenue and other items primarily driven by occupancy such as telephone/internet, parking, spa, facility fees, entertainment and other guest services. Additionally, this category includes, among other things, attrition and cancellation revenue, tenant revenue derived from hotel space and marina slips leased by third parties and any business interruption proceeds or performance guarantee payments received.

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, however property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality, along with amortization on our operating lease right-of-use assets, general excise tax assessed by Hawaii and city taxes imposed by San Francisco;
- *Other property-level expenses*, which includes our property-level general and administrative expenses, such as payroll, benefits and other employee-related expenses, contract and professional fees, credit and collection expenses, employee recruitment, relocation and training expenses, consulting fees, management fees and other expenses;
- *Corporate overhead expense*, which includes our corporate-level expenses, such as payroll, benefits and other employee-related expenses, amortization of deferred stock compensation, business acquisition and due diligence expenses, legal expenses, association, contract and professional fees, board of director expenses, entity-level state franchise and minimum taxes, travel expenses, office rent and other customary expenses;
- *Depreciation and amortization expense*, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment (“FF&E”), along with amortization on our finance lease right-of-use assets, franchise fees and certain intangibles. Additionally, this category includes depreciation and amortization related to FF&E for our corporate office; and
- *Impairment loss*, which includes the charges we have recognized to reduce the carrying values of certain hotels on our balance sheet to their fair values in association with our impairment evaluations.

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

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

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

- *Occupancy*, which is the quotient of total rooms sold divided by total rooms available;
- *Average daily room rate*, or ADR, which is the quotient of room revenue divided by total rooms sold;

- *Revenue per available room*, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;
- *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, those hotels that are undergoing a material renovation or repositioning and those hotels whose room counts have materially changed during either the current or prior year. For hotels that were not owned for the entirety of the comparison periods, comparable RevPAR is calculated using RevPAR generated during periods of prior ownership. We refer to this subset of our hotels used to calculate comparable RevPAR as our “Comparable Portfolio.” Currently, our Comparable Portfolio is comprised of the 20 Hotels;
- *RevPAR index*, which is the quotient of a hotel’s RevPAR divided by the average RevPAR of its competitors, multiplied by 100. A RevPAR index in excess of 100 indicates a hotel is achieving higher RevPAR than the average of its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;
- *EBITDAre*, which is net income (loss) excluding: interest expense; benefit or provision for income taxes, including any changes to deferred tax assets, liabilities or valuation allowances and income taxes applicable to the sale of assets; depreciation and amortization; gains or losses on disposition of depreciated property (including gains or losses on change in control); and any impairment write-downs of depreciated property;
- *Adjusted EBITDAre, excluding noncontrolling interest*, which is EBITDAre adjusted to exclude: the net income (loss) allocated to a third-party’s 25.0% ownership interest in the joint venture that owns the Hilton San Diego Bayfront, along with the noncontrolling partner’s pro rata share of any EBITDAre components; amortization of deferred stock compensation; amortization of favorable and unfavorable contracts; amortization of right-of-use assets; the cash component of ground lease expense for our finance lease obligations that has been included in interest expense; the impact of any gain or loss from undepreciated asset sales or property damage from natural disasters; any lawsuit settlement costs; prior year property tax assessments or credits; the write-off of development costs associated with abandoned projects; and any other nonrecurring identified adjustments;
- *Funds from operations (“FFO”) attributable to common stockholders*, which is net income (loss), excluding: preferred stock dividends; gains and losses from sales of property; real estate-related depreciation and amortization (excluding amortization of deferred financing costs and right-of-use assets); any real estate-related impairment losses; and the noncontrolling partner’s pro rata share of net income (loss) and any FFO components; and
- *Adjusted FFO attributable to common stockholders*, which is FFO attributable to common stockholders adjusted to exclude: amortization of favorable and unfavorable contracts; real estate-related amortization of right-of-use assets; noncash interest on our derivative and finance lease obligations; income tax benefits or provisions associated with any changes to deferred tax assets, liabilities or valuation allowances, the application of net operating loss carryforwards and uncertain tax positions; gains or losses due to property damage from natural disasters; any lawsuit settlement costs; prior year property tax assessments or credits; the write-off of development costs associated with abandoned projects; non-real estate-related impairment losses; the noncontrolling interest’s pro rata share of any Adjusted FFO components; and any other nonrecurring identified adjustments.

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

- *Demand.* The demand for lodging generally fluctuates with the overall economy. In 2018, Comparable Portfolio RevPAR, which was impacted by renovations at the Hyatt Regency San Francisco, the JW Marriott New Orleans, the Marriott Boston Long Wharf and the Renaissance Los Angeles Airport (the “Four 2018 Renovation Hotels”), increased 2.9% as compared to 2017, with a 30 basis point decrease in occupancy. Our third quarter and year-to-date 2019 Comparable Portfolio RevPAR, which were impacted by renovations at the Hilton San Diego Bayfront, the Hyatt Regency San Francisco, the Oceans Edge Resort & Marina and the Renaissance Harborplace (the “Four 2019 Renovation Hotels”), increased 0.9% and 2.3%, respectively, as compared to the same periods in 2018. Occupancy decreased 20 basis points during the third quarter of 2019 as compared to the same period in 2018, and remained constant at 84.1% for both the nine months ended September 30, 2019 and 2018.
- *Supply.* The addition of new competitive hotels affects the ability of existing hotels to absorb demand for lodging and, therefore, impacts the ability to drive RevPAR and profits. The development of new hotels is largely driven by construction costs and expected performance of existing hotels. In aggregate, we expect the U.S. hotel supply to increase

over the near term. On a market-by-market basis, some markets may experience new hotel room openings at or greater than historic levels, including in Boston, New York City, Orlando and Portland where there are currently higher-than-average new hotel room openings. Additionally, an increase in the supply of vacation rental or sharing services such as Airbnb also affects the ability of existing hotels to drive RevPAR and profits.

- *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 continually 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, guest supplies, labor and utilities expense. Our Comparable Portfolio RevPAR index increased 310 basis points during the first nine months of 2019 as compared to the same period in 2018. The increase in our Comparable Portfolio RevPAR index was primarily due to increases in the RevPAR index at the Wailea Beach Resort post-repositioning, the Marriott Portland, which added new contract crew business this year, allowing the hotel to charge higher transient rates than its competitor hotels, the Hilton Times Square, which benefited from the temporary closure of a nearby Hilton hotel, and at the Four 2018 Renovation Hotels. These increases were partially offset by decreases in the RevPAR index at two of the Four 2019 Renovation Hotels and at the Hilton Garden Inn Chicago Downtown/Magnificent Mile due to a weak market and to the hotel's high exposure to Chicago's volatile transient market.

We continue to work with our operators to identify operational efficiencies designed to reduce expenses and our impact on the environment while minimally affecting guest experience and hotel employee satisfaction. Key asset management initiatives include working with our operators to optimize hotel staffing levels (albeit ultimate staffing levels are determined by our operators), increasing the efficiency of the hotels, such as installing energy efficient management and inventory control systems, and selectively combining certain food and beverage outlets. Our operators may have difficulty implementing certain operational efficiency initiatives and success levels may vary, 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. Our operators have experienced, either currently or in the past, increases in hourly wages, employee benefits, utility costs and property insurance, which have negatively affected our operating margins. Moreover, our operators are limited in their ability to reduce expenses without affecting brand standards or the competitiveness of our hotels.

Operating Results. The following table presents our unaudited operating results for our total portfolio for the three months ended September 30, 2019 and 2018, including the amount and percentage change in the results between the two periods.

	Three Months Ended September 30,			
	2019	2018	Change \$	Change %
	(in thousands, except statistical data)			
REVENUES				
Room	\$ 200,242	\$ 207,657	\$ (7,415)	(3.6)%
Food and beverage	61,366	63,911	(2,545)	(4.0)%
Other operating	20,031	17,740	2,291	12.9 %
Total revenues	281,639	289,308	(7,669)	(2.7)%
OPERATING EXPENSES				
Hotel operating	163,465	166,121	(2,656)	(1.6)%
Other property-level expenses	30,913	31,580	(667)	(2.1)%
Corporate overhead	7,395	7,360	35	0.5 %
Depreciation and amortization	37,573	36,159	1,414	3.9 %
Total operating expenses	239,346	241,220	(1,874)	(0.8)%
Interest and other income	3,762	2,592	1,170	45.1 %
Interest expense	(13,259)	(11,549)	(1,710)	(14.8)%
Gain on sale of assets	—	53,128	(53,128)	(100.0)%
Income before income taxes	32,796	92,259	(59,463)	(64.5)%
Income tax benefit (provision), net	749	(673)	1,422	211.3 %
NET INCOME	33,545	91,586	(58,041)	(63.4)%
Income from consolidated joint venture attributable to noncontrolling interest	(2,508)	(2,376)	(132)	(5.6)%
Preferred stock dividends	(3,208)	(3,208)	—	— %
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ 27,829	\$ 86,002	\$ (58,173)	(67.6)%

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The following table presents our unaudited operating results for our total portfolio for the nine months ended September 30, 2019 and 2018, including the amount and percentage change in the results between the two periods.

	Nine Months Ended September 30,			
	2019	2018	Change \$	Change %
(in thousands, except statistical data)				
REVENUES				
Room	\$ 580,835	\$ 608,237	\$ (27,402)	(4.5)%
Food and beverage	206,183	217,469	(11,286)	(5.2)%
Other operating	55,197	52,495	2,702	5.1 %
Total revenues	842,215	878,201	(35,986)	(4.1)%
OPERATING EXPENSES				
Hotel operating	484,876	507,181	(22,305)	(4.4)%
Other property-level expenses	97,768	101,005	(3,237)	(3.2)%
Corporate overhead	22,989	22,056	933	4.2 %
Depreciation and amortization	110,484	110,181	303	0.3 %
Impairment loss	—	1,394	(1,394)	(100.0)%
Total operating expenses	716,117	741,817	(25,700)	(3.5)%
Interest and other income	13,497	7,049	6,448	91.5 %
Interest expense	(43,401)	(31,609)	(11,792)	(37.3)%
Gain on sale of assets	—	68,787	(68,787)	(100.0)%
Income before income taxes	96,194	180,611	(84,417)	(46.7)%
Income tax benefit, net	1,185	692	493	71.2 %
NET INCOME	97,379	181,303	(83,924)	(46.3)%
Income from consolidated joint venture attributable to noncontrolling interest	(6,062)	(7,189)	1,127	15.7 %
Preferred stock dividends	(9,622)	(9,622)	—	— %
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ 81,695	\$ 164,492	\$ (82,797)	(50.3)%

Operating Statistics. The following table includes comparisons of the key operating metrics for both our 21 hotel actual portfolio and our 20 hotel Comparable Portfolio.

	Three Months Ended September 30,								
	2019			2018			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Actual Portfolio	86.4 %	\$ 233.72	\$ 201.93	86.6 %	\$ 231.19	\$ 200.21	(20) bps	1.1 %	0.9 %
Comparable Portfolio	86.2 %	\$ 235.00	\$ 202.57	86.4 %	\$ 232.33	\$ 200.73	(20) bps	1.1 %	0.9 %

	Nine Months Ended September 30,								
	2019			2018			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Actual Portfolio	84.3 %	\$ 234.00	\$ 197.26	84.3 %	\$ 228.84	\$ 192.91	— bps	2.3 %	2.3 %
Comparable Portfolio	84.1 %	\$ 235.40	\$ 197.97	84.1 %	\$ 230.08	\$ 193.50	— bps	2.3 %	2.3 %

Summary of Operating Results. The year-over-year comparability of our operations is affected by changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. We sold six hotels in 2018 (the “Six Sold Hotels”): two hotels in the first quarter of 2018; one hotel in the third quarter of 2018; and three hotels in the fourth quarter of 2018. In addition, renovations at the Four 2019 Renovation Hotels negatively impacted our operating results during both the three and nine months ended September 30, 2019, and the Four 2018 Renovation Hotels negatively impacted our operating results during the same periods in 2018.

Room revenue. Room revenue decreased \$7.4 million, or 3.6%, for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

The sale of four hotels during the third and fourth quarters of 2018 (the “Four Sold Hotels”) caused room revenue to decrease by \$9.1 million in the third quarter of 2019 as compared to the same period in 2018.

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Room revenue generated by the 21 Hotels increased \$1.7 million during the third quarter of 2019 as compared to the same period in 2018, due to a \$2.2 million increase in ADR partially offset by a \$0.5 million decrease due to occupancy. The overall increase in ADR was primarily driven by changes in the average daily rate at the following hotels:

ADR	
Increases	Decreases
Boston hotels	Chicago hotels
New Orleans hotels	Hyatt Regency San Francisco
Wailea Beach Resort	Oceans Edge Resort & Marina

The decrease in the 21 Hotels' occupancy during the third quarter of 2019 as compared to the same period in 2018 was caused by 11,643 fewer group room nights, partially offset by 9,515 additional transient room nights. The overall changes in room nights occurred primarily at the following hotels:

Group Room Nights	
Increases	Decreases
Hilton San Diego Bayfront	Boston Park Plaza
JW Marriott New Orleans	Embassy Suites Chicago
Renaissance Washington DC	Hilton Garden Inn Chicago Downtown/Magnificent Mile
	Hyatt Regency San Francisco
	Renaissance Harborplace
	Renaissance Los Angeles Airport
	Renaissance Westchester
	Wailea Beach Resort

Transient Room Nights	
Increases	Decreases
Boston Park Plaza	Hilton San Diego Bayfront
Hyatt Regency San Francisco	Oceans Edge Resort & Marina
JW Marriott New Orleans	Renaissance Orlando at SeaWorld®
Renaissance Washington DC	
Wailea Beach Resort	

For the nine months ended September 30, 2019, room revenue decreased \$27.4 million, or 4.5%, as compared to the nine months ended September 30, 2018.

The Six Sold Hotels caused room revenue to decrease by \$40.6 million in the first nine months of 2019 as compared to the same period in 2018.

Room revenue generated by the 21 Hotels increased \$13.2 million during the first nine months of 2019 as compared to the same period in 2018, due to a \$12.8 million increase in ADR combined with a \$0.4 million increase due to occupancy. The overall increase in ADR was primarily driven by changes in the average daily rate at the following hotels:

ADR	
Increases	Decreases
Hyatt Regency San Francisco	Chicago hotels
Renaissance Long Beach	
Wailea Beach Resort	

The increase in the 21 Hotels' occupancy during the first nine months of 2019 as compared to the same period in 2018 was caused by 14,931 additional transient room nights, mostly offset by 13,446 fewer group room nights. The overall changes in room nights occurred primarily at the following hotels:

Group Room Nights	
Increases	Decreases
Boston hotels	Chicago hotels
JW Marriott New Orleans	Hilton San Diego Bayfront
	Renaissance Harborplace
	Renaissance Los Angeles Airport
	Renaissance Westchester

Transient Room Nights	
Increases	Decreases
Boston hotels	Hilton San Diego Bayfront
JW Marriott New Orleans	Oceans Edge Resort & Marina
Renaissance Los Angeles Airport	Renaissance Harborplace
	Renaissance Orlando at SeaWorld®

Room revenue generated by the 21 Hotels was negatively impacted during the first nine months of 2019 as compared to the same period in 2018 by the Four 2019 Renovation Hotels, where a combined total of 19,678 room nights were out of service, displacing approximately \$4.7 million in room revenue based on the hotels achieving a combined potential 79.1% occupancy rate and RevPAR of \$195.63 without the renovations.

Food and beverage revenue. Food and beverage revenue decreased \$2.5 million, or 4.0%, for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

The Four Sold Hotels caused food and beverage revenue to decrease by \$2.9 million in the third quarter of 2019 as compared to the same period in 2018.

Food and beverage revenue generated by the 21 Hotels increased \$0.4 million during the third quarter of 2019 as compared to the same period in 2018 primarily due to changes in both banquet and event technology revenue and outlet revenue at the following hotels:

Banquet and Event Technology Revenue	
Increases	Decreases
Boston Park Plaza	Hilton Garden Inn Chicago Downtown/Magnificent Mile
Renaissance Long Beach	Hyatt Regency San Francisco
Renaissance Washington DC	Renaissance Harborplace
	Renaissance Los Angeles Airport
	Renaissance Westchester
	Wailea Beach Resort

Outlet Revenue	
Increases	Decreases
Boston Park Plaza	Hyatt Regency San Francisco
Hilton San Diego Bayfront	Renaissance Harborplace
Wailea Beach Resort	Renaissance Orlando at SeaWorld®
	Renaissance Washington DC

For the nine months ended September 30, 2019, food and beverage revenue decreased \$11.3 million, or 5.2%, as compared to the nine months ended September 30, 2018.

The Six Sold Hotels caused food and beverage revenue to decrease by \$17.1 million in the first nine months of 2019 as compared to the same period in 2018.

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Food and beverage revenue generated by the 21 Hotels increased \$5.8 million during the first nine months of 2019 as compared to the same period in 2018 primarily due to changes in both banquet and event technology revenue and outlet revenue at the following hotels:

Banquet and Event Technology Revenue	
Increases	Decreases
Boston hotels	Chicago hotels
JW Marriott New Orleans	Hilton San Diego Bayfront
Renaissance Harborplace	Hyatt Regency San Francisco
Renaissance Long Beach	Renaissance Los Angeles Airport
Renaissance Orlando at SeaWorld®	Renaissance Westchester
Renaissance Washington DC	
Wailea Beach Resort	

Outlet Revenue	
Increases	Decreases
Boston hotels	Hyatt Regency San Francisco
Hilton San Diego Bayfront	Renaissance Harborplace
Oceans Edge Resort & Marina	Renaissance Orlando at SeaWorld®
Renaissance Los Angeles Airport	
Wailea Beach Resort	

Other operating revenue. Other operating revenue increased \$2.3 million, or 12.9%, for the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

Other operating revenue generated by the 21 Hotels increased \$2.7 million during the three months ended September 30, 2019 as compared to the same period in 2018, primarily due to increased facility fees, marina and watersports revenue, cancellation and attrition revenue, retail revenue, parking revenue, tenant lease revenue, commission revenue, and other miscellaneous revenues.

The Four Sold Hotels caused other operating revenue to decrease by \$0.4 million in the third quarter of 2019 as compared to the same period in 2018.

For the nine months ended September 30, 2019, other operating revenue increased \$2.7 million, or 5.1%, as compared to the nine months ended September 30, 2018.

Other operating revenue generated by the 21 Hotels increased \$5.7 million during the nine months ended September 30, 2019 as compared to the same period in 2018, primarily due to increased facility fees, tenant lease revenue, marina and watersports revenue, commission revenue, cancellation and attrition revenue, retail revenue and parking revenue. These increases were partially offset as we recognized \$0.8 million in business interruption proceeds related to Hurricane Irma at the Oceans Edge Resort & Marina during the first quarter of 2018, with no corresponding revenue recognized during the first nine months of 2019.

The Six Sold Hotels caused other operating revenue to decrease by \$3.0 million in the first nine months of 2019 as compared to the same period in 2018.

Hotel operating expenses. Hotel operating expenses, which are comprised of room, food and beverage, advertising and promotion, repairs and maintenance, utilities, franchise costs, property tax, ground lease and insurance, and other hotel operating expenses decreased \$2.7 million, or 1.6%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

The Four Sold Hotels caused hotel operating expenses to decrease by \$9.0 million in the third quarter of 2019 as compared to the same period in 2018.

Hotel operating expenses generated by the 21 Hotels increased \$6.3 million during the three months ended September 30, 2019 as compared to the same period in 2018. This increase is primarily related to the corresponding increases in room revenue, food and beverage revenue and other operating revenue. In addition, hotel operating expenses increased in the third quarter of 2019 as compared to the same period in 2018 due to the following increased expenses: advertising and promotion due to increased payroll and related expenses in this department, as well as increased general advertising expenses; repairs and maintenance due to increased payroll and related expenses in this department, as well as increased building repairs; franchise costs due to the increase in revenue; property and liability insurance due to increased rates; property taxes due to increased rates and assessments received at several of our

hotels; taxes at the Hyatt Regency San Francisco due to new taxes imposed by the city; and Hawaii general excise tax due to higher revenue at the Wailea Beach Resort. These increases in other operating expenses were partially offset by decreased utilities expense.

For the nine months ended September 30, 2019, hotel operating expenses decreased \$22.3 million, or 4.4%, as compared to the nine months ended September 30, 2018.

The Six Sold Hotels caused hotel operating expenses to decrease by \$38.9 million in the first nine months of 2019 as compared to the same period in 2018.

Hotel operating expenses generated by the 21 Hotels increased \$16.6 million during the nine months ended September 30, 2019 as compared to the same period in 2018, primarily due to the same reasons noted above in the discussion regarding the third quarter. Slightly offsetting these increases, the following expenses decreased: franchise costs primarily due to decreased revenue at our Chicago hotels; rent expense at the Renaissance Washington DC due to our May 2018 purchase of the exclusive perpetual rights to a small portion of the hotel's meeting space, restaurant and fitness center that were previously leased; and ground lease expense at the Hilton San Diego Bayfront due to decreased percentage rent and at the JW Marriott New Orleans due to our purchase of the land underlying the hotel in July 2018.

Other property-level expenses. Other property-level expenses decreased \$0.7 million, or 2.1%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

The Four Sold Hotels caused other property-level expenses to decrease by \$1.9 million in the third quarter of 2019 as compared to the same period in 2018.

Other property-level expenses generated by the 21 Hotels increased \$1.3 million in the third quarter of 2019 as compared to the same period in 2018, primarily due to increased computer hardware and software expenses, credit and collection expenses, basic management fees and contract and professional fees. These increases were partially offset by decreased incentive management fees, employee relocation expenses and supply expenses.

For the nine months ended September 30, 2019, other property-level expenses decreased \$3.2 million, or 3.2%, as compared to the nine months ended September 30, 2018.

The Six Sold Hotels caused other property-level expenses to decrease by \$9.1 million in the first nine months of 2019 as compared to the same period in 2018.

Other property-level expenses generated by the 21 Hotels increased \$5.9 million in the first nine months of 2019 as compared to the same period in 2018, primarily due to increased computer hardware and software expenses, basic and incentive management fees, payroll and related expenses, credit and collection expenses, legal fees and contract and professional fees. These increases were partially offset by decreased supply expenses.

Corporate overhead expense. Corporate overhead expense increased \$35,000, or 0.5%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018, as increased payroll and related expenses and deferred stock compensation were mostly offset by decreased office rent expenses and contract and professional fees.

Corporate overhead expense increased \$0.9 million, or 4.2%, during the nine months ended September 30, 2019 as compared to the nine months ended September 30, 2018, primarily due to increased payroll and related expenses, deferred stock compensation, investor relations and legal fees. These increases to corporate overhead expense were partially offset by decreased contract and professional fees.

Depreciation and amortization expense. Depreciation and amortization expense increased \$1.4 million, or 3.9%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018.

Depreciation and amortization expense generated by the 21 Hotels increased \$2.5 million in the third quarter of 2019 as compared to the same period in 2018, due to increased depreciation and amortization at our newly renovated hotels and corporate office space. These increases were partially offset by decreases in the amortization of intangible assets, consisting of advanced deposits related to our purchase of the Wailea Beach Resort, which were fully amortized in July 2018, as well as by assets at our hotels being fully depreciated.

The Four Sold Hotels caused depreciation and amortization to decrease by \$1.1 million in the third quarter of 2019 as compared to the same period in 2018.

For the nine months ended September 30, 2019, depreciation and amortization expense increased \$0.3 million, or 0.3%, as compared to the nine months ended September 30, 2018.

Depreciation and amortization expense generated by the 21 Hotels increased \$5.6 million in the first nine months of 2019 as compared to the same period in 2018, primarily due to the same reasons noted above in the discussion regarding the third quarter. These increases to depreciation and amortization expense were further offset by decreases in the amortization of intangible assets, consisting of advanced deposits related to our purchase of the Boston Park Plaza, which were fully amortized in June 2018.

The Six Sold Hotels caused depreciation and amortization to decrease by \$5.3 million in the first nine months of 2019 as compared to the same period in 2018.

Impairment loss. Impairment loss was zero for both the three and nine months ended September 30, 2019, and zero and \$1.4 million for the three and nine months ended September 30, 2018, respectively. During the second quarter of 2018, we recorded an impairment loss of \$1.4 million on two hotels that we subsequently sold in October 2018.

Interest and other income. Interest and other income increased \$1.2 million, or 45.1%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018, primarily due to higher interest rates. During the third quarter of 2019, we recognized \$3.6 million in interest income and \$0.1 million in energy rebates due to energy efficient renovations at our hotels. During the third quarter of 2018, we recognized \$2.6 million in interest and miscellaneous income.

For the nine months ended September 30, 2019, interest and other income increased \$6.4 million, or 91.5%, as compared to the nine months ended September 30, 2018, primarily due to higher interest rates. During the first nine months of 2019, we recognized \$11.1 million in interest income, \$1.0 million related to an area of protection agreement with Hyatt Corporation for the Hyatt Regency San Francisco, \$0.9 million related to a contingency funding payment received from the prior owner of one of our hotels, \$0.2 million in energy rebates and \$0.3 million in vendor rebates and other miscellaneous income. During the first nine months of 2018, we recognized \$5.8 million in interest and miscellaneous income, along with \$1.1 million in insurance proceeds for hurricane-related property damage at two hotels we subsequently sold in October 2018 and \$0.1 million in energy rebates.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Interest expense on debt and finance lease obligations	\$ 11,406	\$ 11,619	\$ 34,399	\$ 34,364
Noncash interest on derivatives and finance lease obligations, net	1,155	(818)	6,908	(4,995)
Amortization of deferred financing costs	698	748	2,094	2,240
Total interest expense	<u>\$ 13,259</u>	<u>\$ 11,549</u>	<u>\$ 43,401</u>	<u>\$ 31,609</u>

Interest expense increased \$1.7 million, or 14.8%, during the three months ended September 30, 2019 as compared to the three months ended September 30, 2018, and increased \$11.8 million, or 37.3%, during the nine months ended September 30, 2019 as compared to the nine months ended September 30, 2018.

The increase in interest expense for both the three and nine months ended September 30, 2019 as compared to the same periods in 2018 is primarily due to the noncash changes in the fair market values of our derivatives, which caused interest expense to increase \$2.0 million and \$11.9 million, respectively.

Excluding the noncash impact from changes in the fair market values of our derivatives, interest expense would have decreased \$0.3 million and \$0.1 million in the third quarter and first nine months of 2019, respectively, as compared to the same periods in 2018, due to lower debt balances and lower deferred financing costs resulting from monthly amortization, and lower interest expense on our term loans, which we amended and repriced in October 2018. These decreases were partially offset by higher interest on our variable rate debt during both the third quarter and first nine months of 2019 as compared to the same periods in 2018.

Our weighted average interest rate per annum, including our variable rate debt obligation, was approximately 4.2% at both September 30, 2019 and 2018. Approximately 77.5% and 77.7% of our outstanding notes payable had fixed interest rates at September 30, 2019 and 2018, respectively.

Gain on sale of assets. Gain on sale of assets totaled zero for both the three and nine months ended September 30, 2019, and \$53.1 million and \$68.8 million for the three and nine months ended September 30, 2018, respectively. During the first nine months of

2018, we recognized a \$53.1 million net gain on the July 2018 sale of the Hyatt Regency Newport Beach, and a \$15.7 million net gain on the January 2018 sale of the Marriott Philadelphia and the Marriott Quincy.

Income tax benefit (provision), net. Income tax benefit (provision), net was incurred as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Current	\$ 1,139	\$ 46	\$ 939	\$ (408)
Deferred	(390)	(719)	246	1,100
Total income tax benefit (provision), net	\$ 749	\$ (673)	\$ 1,185	\$ 692

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

During the third quarter and first nine months of 2019, we recognized a current net income tax benefit of \$1.1 million and \$0.9 million, respectively, which includes combined current federal and state income tax expense based on 2019 projected taxable income, net of tax credits available under the Tax Cuts & Jobs Act of 2017 and operating loss carryforwards for our taxable entities. During the third quarter and first nine months of 2019, we also recognized a deferred income tax provision of \$0.4 million and a deferred income tax benefit of \$0.2 million, respectively, related to adjustments to our deferred tax assets, net. Our earnings are seasonal, resulting in quarterly fluctuations in our taxable income. We anticipate our deferred tax assets will continue to fluctuate during 2019 as our earnings increase based on the historical seasonal earnings pattern of our hotels.

During the third quarter of 2018, we slightly reduced our combined federal and state current income tax expense based on 2018 projected taxable income net of operating loss carryforwards for our taxable entities, resulting in \$0.4 million of expense recognized during the nine months ended September 30, 2018. In addition, during the three and nine months ended September 30, 2018, we recognized a deferred income tax provision of \$0.7 million and a deferred income tax benefit of \$1.1 million, respectively, related to adjustments to our deferred tax assets, net.

Income from consolidated joint venture attributable to noncontrolling interest Income from consolidated joint venture attributable to noncontrolling interest, which represents the outside 25.0% interest in the entity that owns the Hilton San Diego Bayfront, totaled \$2.5 million and \$2.4 million for the three months ended September 30, 2019 and 2018, respectively, and \$6.1 million and \$7.2 million for the nine months ended September 30, 2019 and 2018, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Series E preferred stock	\$ 1,998	\$ 1,998	5,994	5,994
Series F preferred stock	1,210	1,210	3,628	3,628
Total preferred stock dividends	\$ 3,208	\$ 3,208	\$ 9,622	\$ 9,622

Non-GAAP Financial Measures. We use the following “non-GAAP financial measures” that we believe are useful to investors as key supplemental measures of our operating performance: EBITDA_{re}; Adjusted EBITDA_{re}, excluding noncontrolling interest; FFO attributable to common stockholders; Adjusted FFO attributable to common stockholders; and Comparable Portfolio revenues. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP. In addition, our calculation of these measures may not be comparable to other companies that do not define such terms exactly the same as the Company. These non-GAAP measures are used in addition to and in conjunction with results presented in accordance with GAAP. They should not be considered as alternatives to net income, cash flow from operations, or any other operating performance measure prescribed by GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with our GAAP results and the reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. For example, we believe that Comparable Portfolio revenues are useful to both us and investors in evaluating our operating performance by removing the impact of non-hotel results such as the amortization of favorable and unfavorable tenant lease contracts. We also believe that our use of Comparable Portfolio revenues is useful to both us and our investors as it facilitates the comparison of our operating results from period to period by removing fluctuations caused by any acquisitions or dispositions, as well as by those hotels that we classify as held for sale, those hotels that are undergoing a material renovation or repositioning and those hotels whose room counts have materially changed during either the current or prior year. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

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

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

- *Amortization of deferred stock compensation:* we exclude the noncash expense incurred with the amortization of deferred stock compensation as this expense is based on historical stock prices at the date of grant to our corporate employees and does not reflect the underlying performance of our hotels.
- *Amortization of favorable and unfavorable contracts:* we exclude the noncash amortization of the favorable management contract asset recorded in conjunction with our acquisition of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, along with the favorable and unfavorable tenant lease contracts, as applicable, recorded in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hyatt Regency San Francisco and the Wailea Beach Resort. We exclude the noncash amortization of favorable and unfavorable contracts because it is based on historical cost accounting and is of lesser significance in evaluating our actual performance for the current period.
- *Amortization of right-of-use assets:* we exclude the amortization of our right-of-use assets, which includes the amortization of our operating lease intangible, as well as the noncash expense incurred from straight-lining our lease obligations, as these expenses are based on historical cost accounting and do not reflect the actual rent amounts due to the respective lessors or the underlying performance of our hotels.
- *Finance lease obligation interest – cash ground rent:* we include an adjustment for the cash finance lease expenses recorded on the ground lease at the Courtyard by Marriott Los Angeles and the building lease at the Hyatt Centric Chicago Magnificent Mile. We determined that both of these leases are finance leases, and, therefore, we include a portion of the lease payments each month in interest expense. We adjust EBITDAre for these two finance leases in order to more accurately reflect the actual rent due to both hotels’ lessors in the current period, as well as the operating performance of both hotels.
- *Undepreciated asset transactions:* we exclude the effect of gains and losses on the disposition of undepreciated assets because we believe that including them in Adjusted EBITDAre, excluding noncontrolling interest is not consistent with reflecting the ongoing performance of our assets.
- *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired because, like interest expense, their removal helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure.
- *Acquisition costs:* under GAAP, costs associated with completed acquisitions that meet the definition of a business are expensed in the year incurred. We exclude the effect of these costs because we believe they are not reflective of the ongoing performance of the Company or our hotels.
- *Noncontrolling interest:* we exclude the noncontrolling partner’s pro rata share of the net income (loss) allocated to the Hilton San Diego Bayfront partnership, as well as the noncontrolling partner’s pro rata share of any EBITDAre and Adjusted EBITDAre components.
- *Cumulative effect of a change in accounting principle:* from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting

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principle. We exclude these one-time adjustments, which include the accounting impact from prior periods, because they do not reflect our actual performance for that period.

- *Other adjustments:* we exclude other adjustments that we believe are outside the ordinary course of business because we do not believe these costs reflect our actual performance for that period and/or the ongoing operations of our hotels. Such items may include: lawsuit settlement costs; prior year property tax assessments or credits; the write-off of development costs associated with abandoned projects; property-level restructuring, severance and management transition costs; lease terminations; and property insurance proceeds or uninsured losses.

The following table reconciles our unaudited net income to EBITDA_{re} and Adjusted EBITDA_{re}, excluding noncontrolling interest for our total portfolio for the three and nine months ended September 30, 2019 and 2018 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	\$ 33,545	\$ 91,586	\$ 97,379	\$ 181,303
Operations held for investment:				
Depreciation and amortization	37,573	36,159	110,484	110,181
Interest expense	13,259	11,549	43,401	31,609
Income tax (benefit) provision, net	(749)	673	(1,185)	(692)
Gain on sale of assets	—	(53,077)	—	(68,740)
Impairment loss	—	—	—	1,394
EBITDA _{re}	83,628	86,890	250,079	255,055
Operations held for investment:				
Amortization of deferred stock compensation	2,146	2,073	7,168	6,938
Amortization of favorable and unfavorable contracts, net	—	(2)	—	3
Amortization of right-of-use assets (1)	(253)	(385)	(523)	(832)
Finance lease obligation interest — cash ground rent	(589)	(590)	(1,768)	(1,768)
Hurricane-related uninsured losses (insurance proceeds), net	—	25	—	(990)
Prior year property tax adjustments, net	(9)	—	289	117
Prior owner contingency funding	—	—	(900)	—
Noncontrolling interest:				
Income from consolidated joint venture attributable to noncontrolling interest	(2,508)	(2,376)	(6,062)	(7,189)
Depreciation and amortization	(793)	(637)	(2,072)	(1,915)
Interest expense	(532)	(513)	(1,650)	(1,437)
Amortization of right-of-use asset (1)	72	72	217	217
	(2,466)	(2,333)	(5,301)	(6,856)
Adjusted EBITDA _{re} , excluding noncontrolling interest	\$ 81,162	\$ 84,557	\$ 244,778	\$ 248,199

- (1) Amounts originally reported for the three and nine months ended September 30, 2018 for amortization of lease intangibles and noncash ground rent have been reclassified to amortization of right-of-use assets to conform to the current year's reporting.

Adjusted EBITDA_{re}, excluding noncontrolling interest was \$81.2 million and \$84.6 million for the three months ended September 30, 2019 and 2018, respectively, and \$244.8 million and \$248.2 million for the nine months ended September 30, 2019 and 2018, respectively. The sale of the Four Sold Hotels and the Six Sold Hotels caused Adjusted EBITDA_{re}, excluding noncontrolling interest to decrease by \$1.5 million and \$12.5 million during the third quarter and first nine months of 2019, respectively, as compared to the same periods in 2018.

Excluding the impact of these hotel sales, Adjusted EBITDA_{re}, excluding noncontrolling interest would have decreased \$1.9 million and increased \$9.0 million for the third quarter and first nine months of 2019, respectively, as compared to the same periods in 2018. Adjusted EBITDA_{re}, excluding noncontrolling interest decreased during the third quarter of 2019 as compared to the same period in 2018 due to decreased EBITDA_{re} generated by the Hyatt Regency San Francisco, the Chicago hotels, the Renaissance Orlando at SeaWorld®, the Hilton Times Square, the Oceans Edge Resort & Marina and the Renaissance Harborplace, partially offset by increased EBITDA_{re} generated by the Wailea Beach Resort, the Hilton San Diego Bayfront, the JW Marriott New Orleans and the Boston hotels, combined with an increase in interest and other income.

Adjusted EBITDA_{re}, excluding noncontrolling interest increased during the first nine months of 2019 as compared to the same period in 2018 primarily due to additional EBITDA_{re} generated by the Wailea Beach Resort, the JW Marriott New Orleans, the

Boston hotels and the Renaissance Long Beach, combined with an increase in interest and other income. These increases were partially offset by decreased EBITDA generated by the Hilton San Diego Bayfront, the Hilton Times Square, the Chicago hotels, the Oceans Edge Resort & Marina and the Renaissance Harborplace.

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

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

- *Amortization of favorable and unfavorable contracts:* we exclude the noncash amortization of the favorable management contract asset recorded in conjunction with our acquisition of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, along with the favorable and unfavorable tenant lease contracts, as applicable, recorded in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hyatt Regency San Francisco and the Wailea Beach Resort. We exclude the noncash amortization of favorable and unfavorable contracts because it is based on historical cost accounting and is of lesser significance in evaluating our actual performance for the current period.
- *Real estate amortization of right-of-use assets:* we exclude the amortization of our real estate right-of-use assets, which includes the amortization of both our finance and operating lease intangibles, as well as the noncash expense incurred from straight-lining our lease obligations (with the exception of our corporate operating lease), as these expenses are based on historical cost accounting and do not reflect the actual rent amounts due to the respective lessors or the underlying performance of our hotels.
- *Gains or losses from debt transactions:* we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired, as well as the noncash interest on our derivatives and finance lease obligations. We believe that these items are not reflective of our ongoing finance costs.
- *Acquisition costs:* under GAAP, costs associated with completed acquisitions that meet the definition of a business are expensed in the year incurred. We exclude the effect of these costs because we believe they are not reflective of the ongoing performance of the Company or our hotels.
- *Noncontrolling interest:* we deduct the noncontrolling partner’s pro rata share of any FFO adjustments related to our consolidated Hilton San Diego Bayfront partnership.
- *Cumulative effect of a change in accounting principle:* from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting principle. We exclude these one-time adjustments, which include the accounting impact from prior periods, because they do not reflect our actual performance for that period.
- *Other adjustments:* we exclude other adjustments that we believe are outside the ordinary course of business because we do not believe these costs reflect our actual performance for that period and/or the ongoing operations of our hotels. Such items may include: lawsuit settlement costs; prior year property tax assessments or credits; the write-off of development costs associated with abandoned projects; changes to deferred tax assets, liabilities or valuation allowances; property-level restructuring, severance and management transition costs; lease terminations; property insurance proceeds or uninsured losses; and income tax benefits or provisions associated with the application of net operating loss carryforwards, uncertain tax positions or with the sale of assets other than real estate investments.

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The following table reconciles our unaudited net income to FFO attributable to common stockholders and Adjusted FFO attributable to common stockholders for our total portfolio for the three and nine months ended September 30, 2019 and 2018 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	\$ 33,545	\$ 91,586	\$ 97,379	\$ 181,303
Preferred stock dividends	(3,208)	(3,208)	(9,622)	(9,622)
Operations held for investment:				
Real estate depreciation and amortization (1)	36,951	35,603	108,621	108,707
Gain on sale of assets	—	(53,077)	—	(68,740)
Impairment loss	—	—	—	1,394
Noncontrolling interest:				
Income from consolidated joint venture attributable to noncontrolling interest	(2,508)	(2,376)	(6,062)	(7,189)
Real estate depreciation and amortization	(793)	(637)	(2,072)	(1,915)
FFO attributable to common stockholders	63,987	67,891	188,244	203,938
Operations held for investment:				
Amortization of favorable and unfavorable contracts, net	—	(2)	—	3
Real estate amortization of right-of-use assets (1)	146	(18)	443	268
Noncash interest on derivatives and finance lease obligations, net	1,155	(818)	6,908	(4,995)
Hurricane-related uninsured losses (insurance proceeds), net	—	25	—	(990)
Prior year property tax adjustments, net	(9)	—	289	117
Prior owner contingency funding	—	—	(900)	—
Noncash income tax provision (benefit), net	390	719	(246)	(1,100)
Noncontrolling interest:				
Real estate amortization of right-of-use asset (1)	72	72	217	217
Noncash interest on derivative, net	—	—	—	(1)
	1,754	(22)	6,711	(6,481)
Adjusted FFO attributable to common stockholders	\$ 65,741	\$ 67,869	\$ 194,955	\$ 197,457

- (1) Amounts originally reported for the three and nine months ended September 30, 2018 for real estate depreciation and amortization related to finance leases, amortization of lease intangibles and noncash ground rent have been reclassified to real estate amortization of right-of-use assets to conform to the current year's reporting.

Adjusted FFO attributable to common stockholders was \$65.7 million and \$67.9 million for the three months ended September 30, 2019 and 2018, respectively, and \$195.0 million and \$197.5 million for the nine months ended September 30, 2019 and 2018, respectively. The sale of the Four Sold Hotels and the Six Sold Hotels caused Adjusted FFO attributable to common stockholders to decrease by \$1.5 million and \$12.5 million during the third quarter and first nine months of 2019, respectively, as compared to the same periods in 2018.

Excluding the impact of these hotel sales, Adjusted FFO attributable to common stockholders would have decreased \$0.7 million and increased \$10.0 million for the third quarter and first nine months of 2019, respectively, as compared to the same periods in 2018, primarily due to the same reasons noted in the discussion above regarding Adjusted EBITDA_{re}, excluding noncontrolling interest. In addition, Adjusted FFO attributable to common stockholders increased during the third quarter and first nine months of 2019 as compared to the same periods in 2018 due to a decrease in current income tax expense.

Liquidity and Capital Resources

During the periods presented, our sources of cash included our operating activities and working capital, as well as proceeds from sales of hotels and other assets, property insurance and our common stock issuances pursuant to separate "At the Market" Agreements (the "ATM Agreements") with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC and Wells Fargo Securities, LLC. Our primary uses of cash were for capital expenditures for hotels and other assets, acquisitions of assets, operating expenses, repurchases of our common stock, repayment of notes payable, dividends and distributions on our common and preferred stock and distributions to our joint venture partner. We cannot be certain that traditional sources of funds will be available in the future.

Operating activities. Our net cash provided by or used in operating activities fluctuates primarily as a result of changes in hotel revenue and the operating cash flow of our hotels. Our net cash provided by or used in operating activities may also be affected by

changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. Net cash provided by operating activities was \$210.6 million and \$219.5 million for the nine months ended September 30, 2019 and 2018, respectively. The net decrease to cash provided by operating activities during the first nine months of 2019 as compared to the same period in 2018 was primarily due to the sale of the Six Sold Hotels and renovation-related disruption at the Four 2019 Renovation Hotels, partially offset by increased operating cash generated by the 21 Hotels, including the Four 2018 Renovation Hotels, combined with increased interest and other income.

Investing activities. Our net cash provided by or used in investing activities fluctuates primarily as a result of acquisitions, dispositions and renovations of hotels and other assets. Net cash used in or provided by investing activities during the first nine months of 2019 as compared to the first nine months of 2018 was as follows (in thousands):

	Nine Months Ended September 30,	
	2019	2018
Proceeds from sales of assets	\$ —	\$ 231,083
Disposition deposit	—	3,000
Proceeds from property insurance	—	1,100
Acquisitions of hotel property and other assets	(193)	(15,147)
Acquisitions of intangible assets	—	(18,516)
Renovations and additions to hotel properties and other assets	(75,277)	(125,854)
Net cash (used in) provided by investing activities	<u>\$ (75,470)</u>	<u>\$ 75,666</u>

During the first nine months of 2019, we paid \$0.2 million to purchase an additional wet boat slip at the Oceans Edge Resort & Marina and invested \$75.3 million for renovations and additions to our portfolio and other assets.

During the first nine months of 2018, we received proceeds of \$231.1 million from our sales of the Marriott Philadelphia, the Marriott Quincy, and the Hyatt Regency Newport Beach, as well as from sales of surplus FF&E at our hotels. In addition, the buyer of the Houston hotels, which were sold in October 2018, provided a cash deposit of \$3.0 million, which was held in escrow as earnest money as of September 30, 2018. During the first nine months of 2018, we also received \$1.1 million in insurance proceeds for hurricane-related property damage at our Houston hotels. These cash inflows were partially offset as we paid \$15.1 million to acquire the land underlying the JW Marriott New Orleans and a total of \$18.5 million for acquisitions of intangible assets, including \$18.4 million to purchase the exclusive perpetual rights to certain space at the Renaissance Washington DC and \$0.1 million to purchase three additional dry boat slips at the Oceans Edge Resort & Marina, and invested \$125.9 million for renovations and additions to our portfolio and other assets.

Financing activities. Our net cash provided by or used in financing activities fluctuates primarily as a result of our distributions paid, issuance and repurchase of common stock, issuance and repayment of notes payable, and our issuance and redemption of other forms of capital, including preferred equity. Net cash used in financing activities during the first nine months of 2019 as compared to the first nine months of 2018 was as follows (in thousands):

	Nine Months Ended September 30,	
	2019	2018
Proceeds from common stock offerings	\$ —	\$ 45,125
Payment of common stock offering costs	—	(784)
Repurchases of outstanding common stock	(50,000)	—
Repurchase of common stock for employee withholding obligations	(4,435)	(4,232)
Payments on notes payable	(5,770)	(5,486)
Payments of deferred financing costs	—	(5)
Dividends and distributions paid	(155,715)	(163,002)
Distributions to noncontrolling interest	(5,363)	(6,644)
Net cash used in financing activities	<u>\$ (221,283)</u>	<u>\$ (135,028)</u>

During the first nine months of 2019, we paid the following: \$50.0 million to repurchase 3,777,309 shares of our outstanding common stock; \$4.4 million to repurchase common shares to satisfy the tax obligations in connection with the vesting of restricted common shares issued to employees; \$5.8 million in principal payments on our notes payable; \$155.7 million in dividends and distributions to our common and preferred stockholders; and \$5.4 million in distributions to the noncontrolling interest in the Hilton San Diego Bayfront.

During the first nine months of 2018, we received total net proceeds of \$44.3 million from the issuance of our common stock. This cash inflow was offset as we paid the following: \$4.2 million to repurchase common shares to satisfy the tax obligations in

connection with the vesting of restricted common shares issued to employees; \$5.5 million in principal payments on our notes payable; \$5,000 in deferred financing costs related to refinancing the loan secured by the Hilton San Diego Bayfront; \$163.0 million in dividends and distributions to our common and preferred stockholders; and \$6.6 million in distributions to the noncontrolling interest in the Hilton San Diego Bayfront.

Future. We expect our primary uses of cash to be for operating expenses, capital investments in our hotels, repayment of principal on our notes payable and possibly our credit facility, interest expense, dividends and distributions on our common and preferred stock, potential purchases of debt or other securities in other hotels, and acquisitions of hotels or interests in hotels, including possibly hotel portfolios. We may also repurchase shares of our common and/or preferred stock pursuant to the February 2017 stock repurchase program authorized by our board of directors. Under the terms of the program, we are authorized to repurchase up to an aggregate of \$300.0 million of our common and preferred stock. Through September 30, 2019, we have repurchased 3,777,309 shares of our common stock for a total purchase price of \$50.0 million, including fees and commissions. We repurchased an additional 6,627 shares of our common stock in October 2019 for \$0.1 million, including fees and commissions, leaving approximately \$250.0 million of remaining authorized capacity under the program. Future repurchases will depend on various factors, including our capital needs, as well as the price of our common and preferred stock.

We expect our primary sources of cash will continue to be our operating activities, working capital, notes payable and our credit facility, dispositions of hotel properties, and proceeds from public and private offerings of debt securities and common and preferred stock. Our financial objectives include the maintenance of our credit ratios, appropriate levels of liquidity and continued balance sheet strength. Consistent with maintaining our low leverage and balance sheet strength, in the near-term, we expect to fund future acquisitions, if any, largely through cash on hand, appropriate amounts of newly-issued debt, the issuance of common or preferred equity, provided that our stock price is at an attractive level, or by proceeds received from sales of existing assets in order to selectively grow the quality and scale of our portfolio. Our ability to raise funds through the issuance of equity securities depends on, among other things, general market conditions for hotel companies and REITs and market perceptions about us. We will continue to analyze alternate sources of capital in an effort to minimize our capital costs and maximize our financial flexibility, including under the ATM Agreements we entered into in February 2017. Under the terms of the ATM Agreements, we may issue and sell from time to time through or to the managers, as sales agents and/or principals, shares of our common stock having an aggregate offering amount of up to \$300.0 million. Through September 30, 2019, we have received \$122.3 million in net proceeds from the issuance of 7,467,709 shares of our common stock in connection with the ATM Agreements, leaving \$175.5 million available for sale under the ATM Agreements. However, when needed, the capital markets may not be available to us on favorable terms or at all.

Cash Balance. As of September 30, 2019, our unrestricted cash balance was \$730.0 million. By minimizing our need to access external capital by maintaining higher than typical cash balances, our financial security and flexibility are meaningfully enhanced because we are able to fund our business needs (including payment of cash distributions on our common stock, if declared) and near-term debt maturities with our cash on hand. Certain of our loan agreements contain cash trap provisions that may be triggered if the performance of the hotels securing the loans decline. During the second quarter of 2019, these provisions were triggered for the loan secured by the Hilton Times Square, and, as of September 30, 2019, \$0.7 million in excess cash generated by the hotel was held in a lockbox account for the benefit of the lender and included in restricted cash on our consolidated balance sheet.

Debt. As of September 30, 2019, we had \$977.1 million of consolidated debt, \$776.2 million of cash and cash equivalents, including restricted cash, and total assets of \$3.9 billion. We believe that by controlling debt levels, staggering maturity dates and maintaining a highly flexible capital structure, we will have lower capital costs than more highly leveraged companies, or companies with limited flexibility due to restrictive corporate-level financial covenants.

As of September 30, 2019, all of our outstanding debt had fixed interest rates or had been swapped to fixed interest rates, except the \$220.0 million non-recourse mortgage on the Hilton San Diego Bayfront, which is subject to an interest rate cap agreement that caps the interest rate at 6.0% until December 2020. Our remaining mortgage debt is in the form of single asset non-recourse loans rather than cross-collateralized multi-property pools. In addition to our mortgage debt, as of September 30, 2019, we have two unsecured corporate-level term loans as well as two unsecured corporate-level senior notes. We currently believe this structure is appropriate for the operating characteristics of our business as it isolates risk and provides flexibility for various portfolio management initiatives, including the sale of individual hotels subject to existing debt.

As of September 30, 2019, we have no outstanding amounts due under our credit facility.

We may in the future seek to obtain mortgages on one or more of our 16 unencumbered hotels (subject to certain stipulations under our unsecured term loans and senior notes), 14 of which are currently held by subsidiaries whose interests are pledged to our credit facility. Our 16 unencumbered hotels include: Boston Park Plaza; Courtyard by Marriott Los Angeles; Embassy Suites Chicago; Hilton Garden Inn Chicago Downtown/Magnificent Mile; Hilton New Orleans St. Charles; Hyatt Centric Chicago Magnificent Mile; Hyatt Regency San Francisco; Marriott Boston Long Wharf; Marriott Portland; Oceans Edge Resort & Marina; Renaissance Harborplace; Renaissance Long Beach; Renaissance Los Angeles Airport; Renaissance Orlando at SeaWorld®; Renaissance Westchester; and Wailea Beach Resort. Should we obtain secured financing on any or all of our unencumbered hotels, the amount of

capital available through our credit facility may be reduced. Upon completion of the sale of the Courtyard by Marriott Los Angeles, we will have 15 unencumbered hotels, 13 of which will be pledged to our credit facility.

Contractual Obligations. The following table summarizes our payment obligations and commitments as of September 30, 2019 (in thousands):

	Payment due by period				
	Total	Less Than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Notes payable	\$ 977,058	\$ 8,237	\$ 496,748	\$ 107,249	\$ 364,824
Interest obligations on notes payable (1)	162,094	41,574	54,883	35,591	30,046
Finance lease obligation, including imputed interest (2) (3)	109,766	1,403	2,806	2,806	102,751
Operating lease obligations, including imputed interest (2) (4)	113,975	7,506	15,165	15,379	75,925
Payments-in-lieu of taxes obligation	63,852	894	1,789	1,789	59,380
Construction commitments	53,331	53,331	—	—	—
Employment obligations	1,325	1,325	—	—	—
Total	<u>\$ 1,481,401</u>	<u>\$ 114,270</u>	<u>\$ 571,391</u>	<u>\$ 162,814</u>	<u>\$ 632,926</u>

- (1) Interest on our variable-rate debt obligation is calculated based on the variable rate at September 30, 2019, and includes the effect of our interest rate derivative agreements.
- (2) See Note 9 – Leases in the Notes to the Unaudited Consolidated Financial Statements (Item 1 of this Form 10-Q).
- (3) Finance lease obligation does not include the ground lease on the Courtyard by Marriott Los Angeles, which was classified as held for sale as of September 30, 2019.
- (4) Operating lease obligations on one of our ground leases expiring in 2071 requires a reassessment of rent payments due after 2025, agreed upon by both us and the lessor; therefore, no amounts are included in the above table for this ground lease after 2025.

Capital Expenditures and Reserve Funds

We believe we maintain each of our hotels in good repair and condition and in general conformity with applicable franchise and management agreements, ground, 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 cyclical renovations, hotel repositionings and development. We invested \$75.3 million in our portfolio and other assets during the first nine months of 2019. As of September 30, 2019, we have contractual construction commitments totaling \$53.3 million for ongoing renovations. If we renovate or develop additional hotels or other assets in the future, our capital expenditures will likely increase.

With respect to our hotels that are operated under management or franchise agreements with major national hotel brands and 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 applicable annual revenue. As of September 30, 2019, our balance sheet includes restricted cash of \$42.6 million, which was held in FF&E reserve accounts for future capital expenditures at the majority of the 21 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 Hawaii, Key West and Orlando, the second quarter is strong for the Mid-Atlantic business hotels, and the fourth quarter is strong for Hawaii, Key West and New York City). Quarterly revenue also may be adversely affected by renovations and repositionings, our managers' effectiveness in generating business and by events beyond our control, such as extreme weather conditions, natural disasters, terrorist attacks or alerts, civil unrest, public health concerns, government shutdowns, airline strikes or reduced airline capacity, economic factors and other considerations affecting travel. Revenues for our Comparable Portfolio by quarter for 2018 and 2019 were as follows (dollars in thousands):

Revenues	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2018:					
Total revenues	\$ 271,446	\$ 317,447	\$ 289,308	\$ 280,852	\$ 1,159,053
Held for sale hotel revenues (1)	(3,125)	(3,167)	(3,354)	(2,916)	(12,562)
Sold hotel revenues (2)	(23,610)	(24,514)	(12,440)	(6,501)	(67,065)
Non-hotel revenues (3)	(832)	(21)	(25)	(4,987)	(5,865)
Total Comparable Portfolio revenues (4)	<u>\$ 243,879</u>	<u>\$ 289,745</u>	<u>\$ 273,489</u>	<u>\$ 266,448</u>	<u>\$ 1,073,561</u>
Quarterly Comparable Portfolio revenues as a percentage of total annual revenues	22.7 %	27.0 %	25.5 %	24.8 %	100.0 %
2019:					
Total revenues	\$ 257,680	\$ 302,896	\$ 281,639		
Held for sale hotel revenues (1)	(3,070)	(3,252)	(3,337)		
Non-hotel revenues (3)	(23)	(25)	(22)		
Total Comparable Portfolio revenues (4)	<u>\$ 254,587</u>	<u>\$ 299,619</u>	<u>\$ 278,280</u>		

- (1) Held for sale hotel revenues include those generated by the Courtyard by Marriott Los Angeles, which was classified as held for sale as of September 30, 2019.
- (2) Sold hotel revenues include those generated by the Six Sold Hotels, which we sold in January 2018, July 2018, October 2018 and December 2018.
- (3) Non-hotel revenues include the amortization of favorable and unfavorable tenant lease contracts received in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hyatt Regency San Francisco and the Wailea Beach Resort. Non-hotel revenues for the first quarter and fourth quarter of 2018 also include business interruption insurance proceeds of \$0.8 million and \$5.0 million, respectively, for the Oceans Edge Resort & Marina.
- (4) Total Comparable Portfolio revenues include those generated by our 20 hotel Comparable Portfolio.

Inflation

Inflation may affect our expenses, including, without limitation, by increasing such costs as labor, employee-related benefits, food, commodities, 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.** We will impair a long-lived asset when indicators of an impairment are present, and the future undiscounted net cash flows expected to be generated by the asset are less than the carrying amount of the asset. No single indicator would necessarily result in our preparing an estimate to determine if the future undiscounted cash flows are less than the book value of the asset. We use judgment to determine if the severity of any single indicator, or the fact there are a number of indicators of less severity that when combined, would result in an indication that an asset requires an

estimate of the undiscounted cash flows to determine if an impairment of the asset has occurred. If such asset is considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset. We perform a fair value assessment, using a discounted cash flow analysis to estimate the fair value of the asset, taking into account the asset's expected cash flow from operations, our estimate of how long we plan to own the asset and estimated proceeds from the disposition of the asset. 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, the estimated growth of revenues and expenses, net operating income and margins, the need for capital expenditures, as well as specific market and economic conditions.

- **Acquisition related assets and liabilities.** Accounting for the acquisition of a hotel property or other entity requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective relative fair values for an asset acquisition or at their estimated fair values for a business combination. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment, intangible assets and finance lease obligations that are assumed as part of the acquisition of a leasehold interest. When we acquire a hotel property or other entity, we use all available information to make these fair value determinations, and engage independent valuation specialists to assist in the fair value determinations of the long-lived assets acquired and the liabilities assumed. 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.

In addition, the acquisition of a hotel property or other entity requires an analysis to determine if it qualifies as the purchase of a business or an asset. If the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the transaction is an asset acquisition. Transaction costs associated with asset acquisitions are capitalized and subsequently depreciated over the life of the related asset, while the same costs associated with a business combination are expensed as incurred and included in corporate overhead on our consolidated statements of operations. Also, asset acquisitions are not subject to a measurement period, as are business combinations.

- **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, including related assets under finance leases, are depreciated using the straight-line method over estimated useful lives primarily ranging from five to 40 years for buildings and improvements and three to 12 years for FF&E. 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.
- **Income Taxes.** To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we currently distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and excluding net capital gains) to our stockholders. As a REIT, we generally will not be subject to federal corporate income tax on that portion of our taxable income that is currently distributed to stockholders. We are subject to certain state and local taxes on our income and property, and to federal income and excise taxes on our undistributed taxable income. In addition, our wholly owned TRS, which leases our hotels from the Operating Partnership, is subject to federal and state income taxes. We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and for net operating loss, capital loss and tax credit carryforwards. The deferred tax assets and liabilities are measured using the enacted income tax rates in effect for the year in which those temporary differences are expected to be realized or settled. The effect on the deferred tax assets and liabilities from a change in tax rates is recognized in earnings in the period when the new rate is enacted. However, deferred tax assets are recognized only to the extent that it is more likely than not that they will be realized based on consideration of all available evidence, including the future reversals of existing taxable temporary differences, future projected taxable income and tax planning strategies. Valuation allowances are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

As of September 30, 2019, 77.5% of our debt obligations are fixed in nature, which largely mitigates the effect of changes in interest rates on our cash interest payments. If the market rate of interest on our variable-rate debt increases or decreases by 100 basis points, interest expense would increase or decrease, respectively, our future consolidated earnings and cash flows by approximately \$2.2 million based on the variable rate at September 30, 2019. After adjusting for the noncontrolling interest in the Hilton San Diego Bayfront, this increase or decrease in interest expense would increase or decrease, respectively, our future consolidated earnings and cash flows by \$1.7 million, based on the variable rate at September 30, 2019.

Item 4. Controls and Procedures

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

Evaluation of Disclosure Controls and Procedures. Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the Securities and Exchange Commission and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. During our fiscal quarter to which this Quarterly Report on Form 10-Q relates, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION**Item 1. Legal Proceedings**

None.

Item 1A. Risk Factors

None.

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

(c) Issuer Purchases of Equity Securities:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 1, 2019 — July 31, 2019	3,108,261	\$ 13.21		
August 1, 2019 — August 31, 2019	236,584	\$ 13.25		
September 1, 2019 — September 30, 2019	—	—		
Total	<u>3,344,845</u>	\$ 13.21	<u>3,777,309</u>	<u>\$ 250,075,548</u> (1)

- (1) On February 17, 2017, the Company's board of directors authorized a stock repurchase program to acquire up to an aggregate of \$300.0 million of the Company's common and preferred stock. As of September 30, 2019, the Company has repurchased 3,777,309 shares of its common stock for a total purchase price of \$50.0 million, including fees and commissions, leaving approximately \$250.1 million of remaining authorized capacity under the stock repurchase program. Future repurchases will depend on various factors, including the Company's capital needs, as well as the Company's common and preferred stock price.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

Exhibit Number	Description
3.1	Articles of Amendment and Restatement of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 3.1 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
3.2	Second Amended and Restated Bylaws of Sunstone Hotel Investors, Inc. effective as of November 15, 2018 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed by the Company on November 15, 2018).
3.3	Articles Supplementary Prohibiting the Company From Electing to be Subject to Section 3-803 of the Maryland General Corporation Law Absent Shareholder Approval (incorporated by reference to Exhibit 3.1 to Form 8-K, filed by the Company on April 29, 2013).
3.4	Articles Supplementary for Series E preferred stock (incorporated by reference to Exhibit 3.5 to the registration statement on Form 8-A, filed by the Company on March 10, 2016).
3.5	Articles Supplementary for Series F preferred stock (incorporated by reference to Exhibit 3.5 to the registration statement on Form 8-A, filed by the Company on May 16, 2016).
10.1	Form of Amended and Restated Employment Agreement by and between Sunstone Hotel Investors, Inc. and Executive Officers of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 10.1 to Form 8-K, filed by the Company on November 4, 2019).
10.2	2004 Long-Term Incentive Plan of Sunstone Hotel Investors, Inc., as amended and restated effective November 1, 2019 (incorporated by reference to Exhibit 10.2 to Form 8-K, filed by the Company on November 4, 2019).
31.1	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document - The instance document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL document.*
101.SCH	Inline XBRL Taxonomy Extension Schema Document. *
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document. *
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document. *
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document. *
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document. *
104	Cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 formatted in Inline XBRL (included in Exhibit 101).

* Filed herewith.

SIGNATURES

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

Sunstone Hotel Investors, Inc.

Date: November 5, 2019

By: /s/ Bryan A. Giglia
Bryan A. Giglia
(Chief Financial Officer and Duly Authorized Officer)

Exhibit 31.1

**Certification of Principal Executive Officer Pursuant to
Securities Exchange Act Rules 13a-14 and 15d-14
as Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, John V. Arabia, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sunstone Hotel Investors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2019

/s/ John V. Arabia
John V. Arabia
President and Chief Executive Officer

Exhibit 31.2

**Certification of Principal Financial Officer Pursuant to
Securities Exchange Act Rules 13a-14 and 15d-14**

**as Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Bryan A. Giglia, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sunstone Hotel Investors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2019

/s/ Bryan A. Giglia
Bryan A. Giglia
Chief Financial Officer

Exhibit 32.1

**Certification of Principal Executive Officer and Principal Financial Officer Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned, the Chief Executive Officer and the Chief Financial Officer of Sunstone Hotel Investors, Inc. (the "Company"), pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each hereby certifies that to his knowledge on the date hereof:

(a) The Quarterly Report on Form 10-Q of the Company for the quarter ended September 30, 2019, filed on the date hereof with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(b) Information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 5, 2019

/s/ John V. Arabia
John V. Arabia
President and Chief Executive Officer

Date: November 5, 2019

/s/ Bryan A. Giglia
Bryan A. Giglia
Chief Financial Officer