

Chesapeake Lodging Trust  
Form 10-Q  
August 04, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended June 30, 2014

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 001-34572

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CHESAPEAKE LODGING TRUST  
(Exact name of registrant as specified in its charter)

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MARYLAND (State or other jurisdiction of incorporation or organization) 1997 Annapolis Exchange Parkway, Suite 410 Annapolis, Maryland (Address of principal executive offices) (410) 972-4140 (Registrant's telephone number, including area code)	27-0372343 (I.R.S. Employer Identification No.) 21401 (Zip Code)
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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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

As of July 31, 2014, there were 50,048,154 shares of the registrant's common shares issued and outstanding.

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## PART I

## Item 1. Financial Statements

CHESAPEAKE LODGING TRUST  
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2014 (unaudited)	December 31, 2013
<b>ASSETS</b>		
Property and equipment, net	\$1,440,848	\$1,422,439
Intangible assets, net	38,480	38,781
Cash and cash equivalents	40,047	28,713
Restricted cash	36,313	34,235
Accounts receivable, net of allowance for doubtful accounts of \$116 and \$91, respectively	21,123	13,011
Prepaid expenses and other assets	15,362	10,478
Deferred financing costs, net of accumulated amortization of \$4,943 and \$3,497, respectively	5,178	6,501
Total assets	\$1,597,351	\$1,554,158
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Long-term debt	\$576,776	\$531,771
Accounts payable and accrued expenses	51,440	45,982
Other liabilities	31,564	29,848
Total liabilities	659,780	607,601
Commitments and contingencies (Note 10)		
Preferred shares, \$.01 par value; 100,000,000 shares authorized; Series A Cumulative Redeemable Preferred Shares; 5,000,000 shares issued and outstanding, respectively (\$127,422 liquidation preference)	50	50
Common shares, \$.01 par value; 400,000,000 shares authorized; 50,048,154 shares and 49,574,005 shares issued and outstanding, respectively	501	496
Additional paid-in capital	993,801	991,417
Cumulative dividends in excess of net income	(56,781	) (45,339
Accumulated other comprehensive loss	—	(67
Total shareholders' equity	937,571	946,557
Total liabilities and shareholders' equity	\$1,597,351	\$1,554,158

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

Table of ContentsCHESAPEAKE LODGING TRUST  
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2014	2013	2014	2013
<b>REVENUE</b>				
Rooms	\$98,118	\$86,946	\$168,957	\$138,490
Food and beverage	26,063	24,313	46,331	40,225
Other	4,684	4,311	8,351	7,456
Total revenue	128,865	115,570	223,639	186,171
<b>EXPENSES</b>				
Hotel operating expenses:				
Rooms	21,326	19,167	39,945	33,186
Food and beverage	18,730	17,142	34,940	29,734
Other direct	1,998	1,936	3,779	3,707
Indirect	39,633	35,125	75,782	61,705
Total hotel operating expenses	81,687	73,370	154,446	128,332
Depreciation and amortization	12,524	10,838	25,022	19,677
Air rights contract amortization	130	130	260	260
Corporate general and administrative	3,891	3,643	7,811	6,985
Hotel acquisition costs	—	1,237	—	4,136
Total operating expenses	98,232	89,218	187,539	159,390
Operating income	30,633	26,352	36,100	26,781
Interest income	—	25	—	243
Interest expense	(6,828 )	(6,346 )	(13,514 )	(11,787 )
Income before income taxes	23,805	20,031	22,586	15,237
Income tax benefit (expense)	(2,556 )	(2,974 )	841	(690 )
Net income	21,249	17,057	23,427	14,547
Preferred share dividends	(2,422 )	(2,422 )	(4,844 )	(4,844 )
Net income available to common shareholders	\$18,827	\$14,635	\$18,583	\$9,703
Net income available per common share—basic and diluted	\$0.38	\$0.30	\$0.37	\$0.21

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$21,249	\$17,057	\$23,427	\$14,547
Other comprehensive income:				
Unrealized losses on cash flow hedge instruments	—	(13	) (9	) (55
Reclassification of unrealized losses on cash flow hedge instruments to interest expense	39	278	76	537
Comprehensive income	\$21,288	\$17,322	\$23,494	\$15,029

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

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CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands, except share data)

(unaudited)

	Preferred Shares		Common Shares		Additional Paid-In Capital	Cumulative Dividends in Excess of Net Income	Accumulated Other Comprehensive Loss	Total
	Shares	Amount	Shares	Amount				
Balances at December 31, 2013	5,000,000	\$ 50	49,574,005	\$ 496	\$ 991,417	\$ (45,339 )	\$ (67 )	\$ 946,557
Repurchase of common shares	—	—	(18,104 )	—	(430 )	—	—	(430 )
Issuance of restricted common shares	—	—	491,564	5	(5 )	—	—	—
Issuance of unrestricted common shares	—	—	1,439	—	40	—	—	40
Forfeiture of restricted common shares	—	—	(750 )	—	—	—	—	—
Amortization of deferred compensation	—	—	—	—	2,779	—	—	2,779
Declaration of dividends on common shares	—	—	—	—	—	(30,025 )	—	(30,025 )
Declaration of dividends on preferred shares	—	—	—	—	—	(4,844 )	—	(4,844 )
Net income	—	—	—	—	—	23,427	—	23,427
Other comprehensive income	—	—	—	—	—	—	67	67
Balances at June 30, 2014	5,000,000	\$ 50	50,048,154	\$ 501	\$ 993,801	\$ (56,781 )	\$ —	\$ 937,571

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$23,427	\$14,547
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,022	19,677
Air rights contract amortization	260	260
Deferred financing costs amortization	1,446	1,372
Share-based compensation	2,819	2,277
Other	(282	) (275
Changes in assets and liabilities:		
Accounts receivable, net	(8,112	) (12,458
Prepaid expenses and other assets	(2,769	) (1,658
Accounts payable and accrued expenses	5,078	11,323
Other liabilities	(14	) 788
Net cash provided by operating activities	46,875	35,853
Cash flows from investing activities:		
Acquisition of hotels, net of cash acquired	—	(331,058
Receipt of deposit on hotel acquisition	—	700
Improvements and additions to hotels	(43,431	) (9,979
Repayment of hotel construction loan	—	7,810
Change in restricted cash	(2,078	) (3,872
Net cash used in investing activities	(45,509	) (336,399
Cash flows from financing activities:		
Proceeds from sale of common shares, net of underwriting fees	—	166,083
Payment of offering costs related to sale of common shares	—	(215
Borrowings under revolving credit facility	50,000	105,000
Repayments under revolving credit facility	—	(55,000
Proceeds from issuance of mortgage debt	—	127,000
Scheduled principal payments on mortgage debt	(4,889	) (1,701
Payment of deferred financing costs	(123	) (1,769
Deposits on loan applications	(2,115	) (3,032
Payment of dividends to common shareholders	(27,631	) (20,322
Payment of dividends to preferred shareholders	(4,844	) (4,844
Repurchase of common shares	(430	) (1,088
Net cash provided by financing activities	9,968	310,112
Net increase in cash	11,334	9,566
Cash and cash equivalents, beginning of period	28,713	33,194
Cash and cash equivalents, end of period	\$40,047	\$42,760
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$12,164	\$10,154
Cash paid for income taxes	\$260	\$826

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





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CHESAPEAKE LODGING TRUST  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

1. Organization and Description of Business

Chesapeake Lodging Trust (the “Trust”) is a self-advised real estate investment trust (“REIT”) that was organized in the state of Maryland in June 2009. The Trust is focused on investments primarily in upper-upscale hotels in major business and convention markets and, on a selective basis, premium select-service hotels in urban settings or unique locations in the United States of America (“U.S.”). The Trust completed its initial public offering (“IPO”) in January 2010. As of June 30, 2014, the Trust owned 20 hotels with an aggregate of 5,932 rooms in eight states and the District of Columbia.

Substantially all of the Trust’s assets are held by, and all of its operations are conducted through, Chesapeake Lodging, L.P., a Delaware limited partnership, which is wholly owned by the Trust (the “Operating Partnership”). For the Trust to qualify as a REIT, it cannot operate hotels. Therefore, the Operating Partnership leases its hotels to CHSP TRS LLC (“CHSP TRS”), which is a wholly owned subsidiary of the Operating Partnership. CHSP TRS then engages hotel management companies to operate the hotels pursuant to management agreements. CHSP TRS is treated as a taxable REIT subsidiary for federal income tax purposes.

2. Summary of Significant Accounting Policies

**Basis of Presentation**—The interim consolidated financial statements presented herein include all of the accounts of Chesapeake Lodging Trust and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

The interim consolidated statement of operations for the three months ended June 30, 2014 includes the operating activity of 20 hotels for the full period, whereas the interim consolidated statement of operations for the three months ended June 30, 2013 includes the operating activity of 17 hotels for the full period and three hotels for part of the period. The interim consolidated statement of operations for the six months ended June 30, 2014 includes the operating activity of 20 hotels for the full period, whereas the interim consolidated statement of operations for the six months ended June 30, 2013 includes the operating activity of 15 hotels for the full period and five hotels for part of the period.

The information in these interim consolidated financial statements is unaudited but, in the opinion of management, reflects all adjustments necessary for a fair presentation of the results for the periods covered. All such adjustments are of a normal, recurring nature unless disclosed otherwise. These interim consolidated financial statements, including notes, have been prepared in accordance with the applicable rules of the Securities and Exchange Commission (“SEC”) and do not include all of the information and disclosures required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Trust’s Form 10-K for the year ended December 31, 2013.

**Cash and Cash Equivalents**—The Trust considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

**Restricted Cash**—Restricted cash includes reserves held in escrow for normal replacements of furniture, fixtures and equipment (“FF&E”), property improvement plans (each, a “PIP”), real estate taxes, and insurance pursuant to certain requirements in the Trust’s hotel management, franchise, and loan agreements.

**Investments in Hotels**—The Trust allocates the purchase prices of hotels acquired based on the fair value of the property, FF&E, and identifiable intangible assets acquired and the fair value of the liabilities assumed. In making estimates of fair value for purposes of allocating the purchase price, the Trust utilizes a number of sources of information that are obtained in connection with the acquisition of a hotel, including valuations performed by independent third parties and cost segregation studies. The Trust also considers information obtained about each hotel as a result of its pre-acquisition due diligence in estimating the fair value of the tangible and intangible assets acquired and liabilities

assumed. Hotel acquisition costs, such as transfer taxes, title insurance, environmental and property condition reviews, and legal and accounting fees, are expensed in the period incurred.

Property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, generally 15 to 40 years for buildings and building improvements and three to ten years for FF&E. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets. Replacements and improvements at the hotels are capitalized, while repairs and maintenance are expensed as incurred. Upon the sale or retirement of property and equipment, the cost and related accumulated depreciation are removed from the Trust's accounts and any resulting gain or loss is recognized in the consolidated statements of operations.

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Intangible assets and liabilities are recorded on non-market contracts, including air rights, lease, management, and franchise agreements, assumed as part of the acquisition of certain hotels. Above-market and below-market contract values are based on the present value of the difference between contractual amounts to be paid pursuant to the contracts assumed and the Trust's estimate of the fair market contract rates for corresponding contracts measured over a period equal to the remaining non-cancelable term of the contracts assumed. No value is allocated to market contracts. Intangible assets and liabilities are amortized using the straight-line method over the remaining non-cancelable term of the related contracts.

The Trust reviews its hotels for impairment whenever events or changes in circumstances indicate that the carrying values of the hotels may not be recoverable. Events or circumstances that may cause a review include, but are not limited to, adverse changes in the demand for lodging at the hotels due to declining national or local economic conditions and/or new hotel construction in markets where the hotels are located. When such conditions exist, management performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel exceed its carrying value. If the estimated undiscounted future cash flows are less than the carrying amount of the asset, an adjustment to reduce the carrying amount to the related hotel's estimated fair market value is recorded and an impairment loss is recognized. No impairment losses have been recognized for the three and six months ended June 30, 2014 and 2013.

The Trust classifies a hotel as held for sale in the period in which it has made the decision to dispose of the hotel, a binding agreement to purchase the hotel has been signed under which the buyer has committed a significant amount of nonrefundable cash, and no significant financing contingencies exist which could cause the transaction not to be completed in a timely manner. If these criteria are met, depreciation and amortization of the hotel will cease and an impairment loss will be recognized if the fair value of the hotel, less the costs to sell, is lower than the carrying amount of the hotel. The Trust will classify the loss, together with the related operating results, as discontinued operations in the consolidated statements of operations and classify the related assets and liabilities as held for sale in the consolidated balance sheets. As of June 30, 2014, the Trust had no assets held for sale or liabilities related to assets held for sale.

**Revenue Recognition**—Revenues from operations of the hotels are recognized when the services are provided. Revenues consist of room sales, food and beverage sales, and other hotel department revenues, such as parking, marina, telephone, and gift shop sales.

**Prepaid Expenses and Other Assets**—Prepaid expenses and other assets consist of prepaid real estate taxes, prepaid insurance, deposits on hotel acquisitions and loan applications, deferred franchise costs, inventories, and other assets.

**Deferred Financing Costs**—Deferred financing costs are recorded at cost and consist of loan fees and other costs incurred in issuing debt. Amortization of deferred financing costs is computed using a method that approximates the effective interest method over the term of the related debt and is included in interest expense in the consolidated statements of operations.

**Derivative Instruments**—The Trust is a party to interest rate swaps, which are considered derivative instruments, in order to manage its interest rate exposure. The Trust's interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows. The Trust records these derivative instruments at fair value as either assets or liabilities and has designated them as cash flow hedging instruments at inception. The Trust evaluates the hedge effectiveness of the designated cash flow hedging instruments on a quarterly basis and records the effective portion of the change in the fair value of the cash flow hedging instruments as other comprehensive income (loss). Amounts reported in accumulated other comprehensive income (loss) related to cash flow hedging instruments are reclassified to interest expense as interest payments are made on the variable-rate debt being hedged. The Trust does not enter into derivative instruments for trading or speculative purposes and monitors the financial stability and credit standing of its counterparties.

**Fair Value Measurements**—The Trust accounts for certain assets and liabilities at fair value. In evaluating the fair value of both financial and non-financial assets and liabilities, GAAP outlines a valuation framework and creates a fair value hierarchy that distinguishes between market assumptions based on market data (observable inputs) and the reporting entity's own assumptions about market data (unobservable inputs). The three levels of the fair value hierarchy are as follows:

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Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date. An active market is defined as a market in which transactions occur with sufficient frequency and volume to provide pricing on an ongoing basis.

Level 2 – Inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active (markets with few transactions), inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates, yield curves), and inputs that are derived principally from or corroborated by observable market data correlation or other means.

Level 3 – Unobservable inputs reflect the reporting entity's own assumptions about the pricing of an asset or liability when observable inputs are not available or when there is minimal, if any, market activity for an identical or similar asset or liability at the measurement date.

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**Income Taxes**—The Trust has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code. As a REIT, the Trust generally will not be subject to federal income tax on that portion of its net income that does not relate to CHSP TRS, the Trust’s wholly owned taxable REIT subsidiary, and that is currently distributed to its shareholders. CHSP TRS, which leases the Trust’s hotels from the Operating Partnership, is subject to federal and state income taxes.

The Trust accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Valuation allowances are provided if based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

**Share-Based Compensation**—From time to time, the Trust grants restricted share awards to employees and trustees. To date, the Trust has granted two types of restricted share awards: (1) awards that vest solely on continued employment or service (time-based awards) and (2) awards that vest based on the Trust achieving specified levels of relative total shareholder return and continued employment (performance-based awards). The Trust measures share-based compensation expense for the restricted share awards based on the fair value of the awards on the date of grant. The fair value of time-based awards is determined based on the closing price of the Trust’s common shares on the measurement date, which is generally the date of grant. The fair value of performance-based awards is determined using a Monte Carlo simulation performed by an independent third party. For time-based awards, share-based compensation expense is recognized on a straight-line basis over the life of the entire award. For performance-based awards, share-based compensation expense is recognized over the requisite service period for each award. No share-based compensation expense is recognized for awards for which employees or trustees do not render the requisite service.

**Earnings Per Share**—Basic earnings per share is computed by dividing net income available to common shareholders, adjusted for dividends declared on and undistributed earnings allocated to unvested time-based awards, by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common shareholders, adjusted for dividends declared on and undistributed earnings allocated to unvested time-based awards, by the weighted-average number of common shares outstanding, plus potentially dilutive securities, such as unvested performance-based awards, during the period. The Trust’s unvested time-based awards are entitled to receive non-forfeitable dividends, if declared. Therefore, unvested time-based awards qualify as participating securities, requiring the allocation of dividends and undistributed earnings under the two-class method to calculate basic earnings per share. The percentage of undistributed earnings allocated to the unvested time-based awards is based on the proportion of the weighted-average unvested time-based awards outstanding during the period to the total of the weighted-average common shares and unvested time-based awards outstanding during the period. No adjustment is made for shares that are anti-dilutive during the period.

**Segment Information**—The Trust has determined that its business is conducted in one reportable segment, hotel ownership.

**Use of Estimates**—The preparation of the interim 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 interim consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Recent Accounting Pronouncements**—In April 2014, the Financial Accounting Standards Board (the “FASB”) issued updated accounting guidance for reporting discontinued operations and disposals of components of an entity. Under the new accounting guidance only disposals representing a strategic shift that has (or will have) a major effect on an entity’s financial results or a business activity classified as held for sale should be reported as discontinued operations. The update also expands the disclosure requirements for discontinued operations and adds new disclosures for individually significant dispositions that do not meet the definition of discontinued operations. The new accounting guidance is to be applied prospectively and is effective for interim and annual periods beginning on or after December 15, 2014 (early adoption is permitted only for disposals that have not been previously reported). Upon adoption, this

guidance will impact the Trust's classification of discontinued operations and disclosures regarding any future dispositions.

In May 2014, the FASB issued updated accounting guidance for recognition of revenue from contracts with customers. The comprehensive new accounting guidance will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new accounting guidance is to be applied prospectively and is effective for interim and annual periods beginning on or after December 15, 2016. The Trust will adopt the new accounting guidance on January 1, 2017. The Trust is currently evaluating the impact, if any, that the adoption of this new accounting guidance will have on its consolidated financial statements.

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## 3. Property and Equipment

Property and equipment as of June 30, 2014 and December 31, 2013 consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Land and land improvements	\$262,325	\$262,322
Buildings and leasehold improvements	1,165,353	1,136,808
Furniture, fixtures and equipment	118,309	103,291
Construction-in-progress	16,458	16,593
	1,562,445	1,519,014
Less: accumulated depreciation and amortization	(121,597)	(96,575)
Property and equipment, net	\$1,440,848	\$1,422,439

## 4. Intangible Assets and Liability

Intangible assets and liability as of June 30, 2014 and December 31, 2013 consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Intangible assets:		
Air rights contract <sup>(1)</sup>	\$36,105	\$36,105
Favorable ground leases <sup>(2)</sup>	4,828	4,828
	40,933	40,933
Less: accumulated amortization	(2,453)	(2,152)
Intangible assets, net	\$38,480	\$38,781
Intangible liability:		
Unfavorable contract liability <sup>(2)</sup>	\$14,236	\$14,236
Less: accumulated amortization	(1,079)	(883)
Intangible liability, net (included within other liabilities)	\$13,157	\$13,353

(1) In conjunction with the acquisition of the Hyatt Regency Boston on March 18, 2010, the Trust acquired an air rights contract which expires in September 2079 and that requires no payments through maturity. The Trust recorded the fair value of the air rights contract of \$36.1 million as an intangible asset and is amortizing the value over the term of the contract.

(2) In conjunction with the acquisition of the Denver Marriott City Center on October 3, 2011, the Trust assumed three lease agreements for land parcels underlying a portion of the hotel with initial terms ending July 2068, February 2072 and April 2072. The Trust concluded that the terms of two of the three ground leases were below market terms and recorded an aggregate of \$4.8 million of favorable ground lease assets, which the Trust is amortizing over the life of the respective leases and including within indirect hotel operating expenses in the interim consolidated statements of operations. The Trust also assumed a management contract with a non-cancelable term ending December 2047. The Trust concluded that the management agreement terms were above market terms and recorded a \$14.2 million unfavorable contract liability, which the Trust is amortizing over the remaining non-cancelable term and including within indirect hotel operating expenses in the interim consolidated statements of operations.

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## 5. Long-Term Debt

Long-term debt as of June 30, 2014 and December 31, 2013 consisted of the following (in thousands):

	Origination	Original Principal Amount	Maturity	Interest Rate	Principal Amortization Period	June 30, 2014	December 31, 2013
Revolving credit facility <sup>(1)</sup>	July 2010	n/a	April 2016	Floating	n/a	\$50,000	\$—
Term loan:							
Hyatt Herald Square/Hyatt Place New York Midtown South <sup>(2)</sup>	July 2012	\$60,000	July 2014	Floating	n/a	60,000	60,000
Other mortgage loans:							
Hyatt Regency Boston Courtyard Washington Capitol Hill/Navy Yard <sup>(3)</sup>	June 2011	\$95,000	July 2016	5.01%	30	90,939	91,689
	June 2011	\$37,497	November 2016	5.90%	30	35,603	35,956
Boston Marriott Newton Le Meridien San Francisco	May 2013	\$60,000	June 2020	3.63%	25	58,529	59,274
	July 2013	\$92,500	August 2020	3.50%	25	90,578	91,742
Denver Marriott City Center <sup>(4)</sup>	July 2012	\$70,000	August 2022	4.90%	30	68,032	68,586
Hilton Checkers Los Angeles	February 2013	\$32,000	March 2023	4.11%	30	31,331	31,606
W Chicago – City Center	July 2013	\$93,000	August 2023	4.25%	25	91,272	92,320
						576,284	531,173
Unamortized premium <sup>(3)</sup>						492	598
Long-term debt						\$576,776	\$531,771

The Trust may exercise an option to extend the maturity by one year, subject to certain customary conditions. As of

(1) June 30, 2014, the interest rate in effect was 1.90%. See below for additional information related to the revolving credit facility.

At origination, \$25.0 million was advanced by the lender and was secured by the Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street). On March 14, 2013, \$35.0 million was advanced by the lender in connection with the acquisition of the Hyatt Place New York Midtown South. Following the subsequent advance, the entire \$60.0 million principal amount of the loan was secured by both hotels. The loan bore interest equal to LIBOR plus 3.25%. Contemporaneous with the origination of the term loan, the Trust entered into an interest rate swap to effectively fix the interest rate on the initial \$25.0 million advance for the original two-year term at 3.75% per annum. Under the terms of this interest rate swap, the Trust paid fixed interest of 0.50% per (2) annum on a notional amount of \$25.0 million and received floating rate interest equal to the one-month LIBOR.

The effective date of this interest rate swap was July 3, 2012 and it matured on July 3, 2014. Contemporaneous with the subsequent advance, the Trust entered into an interest rate swap to effectively fix the interest rate on the \$35.0 million subsequent advance for the remaining initial term of the loan at 3.65% per annum. Under the terms of this interest rate swap, the Trust paid fixed interest of 0.40% per annum on a notional amount of \$35.0 million and received floating rate interest equal to the one-month LIBOR. The effective date of this interest rate swap was March 14, 2013 and it matured on July 3, 2014. The Trust repaid the term loan at maturity on July 3, 2014. See Note 11, "Subsequent Event," to our interim consolidated financial statements for additional information.

(3) On June 30, 2011, in connection with the acquisition of the Courtyard Washington Capitol Hill/Navy Yard, the Trust assumed an existing loan agreement with an outstanding principal balance of \$37.5 million. Based on interest rates on similar types of debt instruments at the time of assumption, the Trust recorded the loan at its estimated fair value of \$38.6 million, which included a premium on mortgage loan of \$1.1 million. Amortization of premium on



mortgage loan is computed using a method that approximates the effective interest method over the term of the loan agreement and is included in interest expense in the interim consolidated statements of operations.

- (4) The loan has a term of 30 years, but is callable by the lender after 10 years, and the Trust expects the lender to call the loan at that time. The indicated maturity is based on the date the loan is callable by the lender.

Revolving credit facility

On October 25, 2012, the Trust entered into an amended credit agreement to (1) increase the maximum size of the revolving credit facility from \$200.0 million to \$250.0 million, (2) lower the interest rate to LIBOR plus 1.75% - 2.75% (the spread over LIBOR continues to be based on the Trust's consolidated leverage ratio), and (3) extend the maturity date to April 2016. The amended credit agreement provides for the possibility of further future increases, up to a maximum of \$375.0 million, in accordance with the terms of the amended credit agreement. The amended credit agreement also provides for an extension of the maturity date by one year, subject to satisfaction of certain customary conditions.

The amount that the Trust can borrow under the revolving credit facility is based on the value of the Trust's hotels included in the borrowing base, as defined in the amended credit agreement. As of June 30, 2014, the revolving credit facility was secured by nine hotels providing borrowing availability of \$250.0 million, of which \$200.0 million remained available.

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The amended credit agreement contains standard financial covenants, including certain leverage ratios, coverage ratios, and a minimum tangible net worth requirement.

## Other

Certain of the Trust's mortgage loan agreements contain standard financial covenants relating to coverage ratios and standard provisions that require loan servicers to maintain escrow accounts for certain items, including real estate taxes, insurance premiums, the completion of PIPs, and normal replacements of FF&E.

As of June 30, 2014, the Trust was in compliance with all financial covenants under its borrowing arrangements. As of June 30, 2014, the Trust's weighted-average interest rate on its long-term debt was 4.10%. Future scheduled principal payments of debt obligations as of June 30, 2014 are as follows (in thousands):

Year	Amounts <sup>(1)</sup>
2014	\$64,948
2015	10,271
2016	181,323
2017	8,598
2018	8,952
Thereafter	302,192
	\$576,284

Assumes no exercise of extension options and does not reflect the Trust's entrance into a new loan agreement and the related repayment of the \$60.0 million term loan secured jointly by the Hyatt Herald Square (formerly the (1)Holiday Inn New York City Midtown – 31st Street) and the Hyatt Place New York Midtown South at maturity on July 3, 2014. See Note 11, "Subsequent Event," to our interim consolidated financial statements for additional information.

## 6. Earnings Per Share

The following is a reconciliation of the amounts used in calculating basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income available to common shareholders	\$18,827	\$14,635	\$18,583	\$9,703
Less: Dividends declared on unvested time-based awards	(128)	(90)	(257)	(178)
Less: Undistributed earnings allocated to unvested time-based awards	(35)	(23)	—	—
Net income available to common shareholders, excluding amounts attributable to unvested time-based awards	\$18,664	\$14,522	\$18,326	\$9,525
Denominator:				
Weighted-average number of common shares outstanding—basic and diluted	48,977,876	47,862,652	48,969,761	46,187,216
Net income available per common share—basic and diluted	\$0.38	\$0.30	\$0.37	\$0.21

For the three and six months ended June 30, 2014, 634,178 unvested performance-based awards, and for the three and six months ended June 30, 2013, 344,900 unvested performance-based awards, were excluded from diluted weighted-average common shares outstanding, as the awards had not achieved the specific levels of relative total shareholder return required for vesting at each period or their effect would have been anti-dilutive.

## 7. Shareholders' Equity

Common Shares—The Trust is authorized to issue up to 400,000,000 common shares, \$.01 par value per share. Each outstanding common share entitles the holder to one vote on all matters submitted to a vote of shareholders. Holders of the Trust's common shares are entitled to receive distributions when authorized by the Trust's board of trustees out

of assets legally available for the payment of distributions.

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On February 6, 2013, the Trust completed an underwritten public offering of 8,337,500 common shares at a price of \$20.75 per share, including 1,087,500 shares sold pursuant to the underwriters' exercise of their option to purchase additional shares. After deducting underwriting fees and offering costs, the Trust generated net proceeds of \$165.9 million.

On September 6, 2013, the Trust entered into sales agreements with two sales agents, pursuant to which the Trust may issue and sell up to \$100.0 million in the aggregate of its common shares through a continuous at-the-market offering or other methods (the "ATM program"). For the period from September 6, 2013 through December 31, 2013, the Trust sold 1,012,058 common shares at an average price of \$23.73 per share under the ATM program and generated net proceeds of \$23.5 million after deducting sales commissions and offering costs. The Trust did not sell any common shares under the ATM program during the six months ended June 30, 2014. As of June 30, 2014, \$76.0 million of common shares remained available for issuance under the ATM program.

For the six months ended June 30, 2014, the Trust issued 1,439 unrestricted common shares and 491,564 restricted common shares to its trustees and employees. For the six months ended June 30, 2014, the Trust repurchased 18,104 common shares from employees to satisfy the minimum statutory tax withholding requirements related to the vesting of their previously granted restricted common shares. As of June 30, 2014, the Trust had 50,048,154 common shares outstanding.

For the six months ended June 30, 2014, the Trust paid or its board of trustees declared the following dividends per common share:

	Record Date	Payment Date	Dividend Per Common Share
Fourth Quarter 2013	December 31, 2013	January 15, 2014	\$0.26
First Quarter 2014	March 31, 2014	April 15, 2014	\$0.30
Second Quarter 2014	June 30, 2014	July 15, 2014	\$0.30

Preferred Shares—The Trust is authorized to issue up to 100,000,000 preferred shares, \$.01 par value per share. The Trust's board of trustees is required to set for each class or series of preferred shares the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications, and terms or conditions of redemption. As of June 30, 2014, the Trust had 5,000,000 shares of its 7.75% Series A Cumulative Redeemable Preferred Shares outstanding.

Holders of Series A Cumulative Redeemable Preferred Shares are entitled to receive, when and as authorized by the Trust's board of trustees, out of funds legally available for the payment of dividends, cumulative cash dividends at the rate of 7.75% per annum of the \$25.00 per share liquidation preference, equivalent to \$1.9375 per annum per share. Dividends on the Series A Cumulative Redeemable Preferred Shares are cumulative from the date of original issuance and are payable quarterly in arrears on or about the 15th day of each of January, April, July and October. The Series A Cumulative Redeemable Preferred Shares rank senior to the Trust's common shares with respect to the payment of dividends; the Trust will not declare or pay any dividends, or set aside any funds for the payment of dividends, on its common shares unless the Trust also has declared and either paid or set aside for payment the full cumulative dividends on the Series A Cumulative Redeemable Preferred Shares.

For the six months ended June 30, 2014, the Trust paid or its board of trustees declared the following dividends per preferred share:

	Record Date	Payment Date	Dividend Per Series A Cumulative Redeemable Preferred Share
Fourth Quarter 2013	December 31, 2013	January 15, 2014	\$0.484375
First Quarter 2014	March 31, 2014	April 15, 2014	\$0.484375
Second Quarter 2014	June 30, 2014	July 15, 2014	\$0.484375

The Trust cannot redeem the Series A Cumulative Redeemable Preferred Shares prior to July 17, 2017, except as described below and in certain limited circumstances related to the ownership limitation necessary to preserve the Trust's qualification as a REIT. On and after July 17, 2017, the Trust, at its option, can redeem the Series A Cumulative Redeemable Preferred Shares, in whole or from time to time in part, at a redemption price of \$25.00 per

share, plus any accrued and unpaid dividends. The holders of Series A Cumulative Redeemable Preferred Shares have no voting rights, except in certain limited circumstances.

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Upon the occurrence of a change of control, as defined in the articles supplementary designating the Series A Cumulative Redeemable Preferred Shares, the result of which the Trust's common shares and the common securities of the acquiring or surviving entity are not listed or quoted on the New York Stock Exchange, the NYSE Amex Equities or the NASDAQ Stock Market, or any successor exchanges, the Trust may, at its option, redeem the Series A Cumulative Redeemable Preferred Shares in whole or in part within 120 days following the change of control by paying \$25.00 per share, plus any accrued and unpaid dividends through the date of redemption. If the Trust does not exercise its right to redeem the Series A Cumulative Redeemable Preferred Shares upon a change of control, the holders of the Series A Cumulative Redeemable Preferred Shares have the right to convert some or all of their shares into a number of the Trust's common shares based on a defined formula subject to a share cap. The share cap on each Series A Cumulative Redeemable Preferred Share is 2.9189 common shares.

Universal Shelf—In August 2012, the Trust filed a Registration Statement on Form S-3 with the SEC, registering equity securities with a maximum aggregate offering price of up to \$500.0 million. As of June 30, 2014, equity securities with a maximum aggregate offering price of \$88.7 million remained available to issue under this Registration Statement.

8. Equity Plan

In January 2010, the Trust established the Chesapeake Lodging Trust Equity Plan (the "Plan"), which provides for the issuance of equity-based awards, including restricted shares, unrestricted shares, share options, share appreciation rights, and other awards based on the Trust's common shares. Employees and trustees of the Trust and other persons that provide services to the Trust are eligible to participate in the Plan. The compensation committee of the board of trustees administers the Plan and determines the number of awards to be granted, the vesting period, and the exercise price, if any.

The Trust initially reserved 454,657 common shares for issuance under the Plan at its establishment. In May 2012, the Trust's common shareholders approved an amendment to the Plan such that the number of shares available for issuance under the Plan was increased by 2,750,000. Shares that are issued under the Plan to any person pursuant to an award are counted against this limit as one share for every one share granted. If any shares covered by an award are not purchased or are forfeited, if an award is settled in cash, or if an award otherwise terminates without delivery of any shares, then the number of common shares counted against the aggregate number of shares available under the Plan with respect to the award will, to the extent of any such forfeiture or termination, again be available for making awards under the Plan. As of June 30, 2014, subject to increases that may result in the case of any future forfeiture or termination of currently outstanding awards, 1,559,446 common shares were reserved and available for future issuances under the Plan.

The Trust will make appropriate adjustments to outstanding awards and the number of shares available for issuance under the Plan, including the individual limitations on awards, to reflect share dividends, share splits, spin-offs and other similar events. While the compensation committee can terminate or amend the Plan at any time, no amendment can adversely impair the rights of grantees with respect to outstanding awards. In addition, an amendment will be contingent on approval of the Trust's common shareholders to the extent required by law or if the amendment would materially increase the benefits accruing to participants under the Plan, materially increase the aggregate number of shares that can be issued under the Plan, or materially modify the requirements as to eligibility for participation in the Plan. Unless terminated earlier, the Plan will terminate in January 2020, but will continue to govern unexpired awards. For the six months ended June 30, 2014, the Trust granted 491,564 restricted common shares to certain employees and trustees, of which 158,941 shares were time-based awards and 332,623 shares were performance-based awards (the "2014 Performance-Based Awards"). The time-based awards are generally eligible to vest at the rate of one-third of the number of restricted shares granted commencing on the first anniversary of their issuance. The 2014 Performance-Based Awards are eligible to vest at December 31, 2016. Dividends on the 2014 Performance-Based Awards accrue, but are not paid unless the related shares vest. The fair value of the 2014 Performance-Based Awards was \$8.98 per share and was determined using a Monte Carlo simulation with the following assumptions: volatility of 29.34%; an expected term equal to the requisite service period for the awards; and a risk-free interest rate of 0.72%.

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The actual number of shares under the 2014 Performance-Based Awards that vest will be based on the Trust's total shareholder return ("TSR"), as defined in the restricted share agreements, measured over a three-year performance period ending December 31, 2016, against the total return generated by the SNL US Hotel REIT Index prepared by SNL Financial LC (the "Index"). The payout schedule for the 2014 Performance-Based Awards is as follows, with linear interpolation for performance between 67% and 100%, and between 100% and 133% of the Index:

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Trust TSR as % of Index Total Return	Payout (% of Maximum)
<67%	0%
67%	25%
100%	50%
≥133%	100%

If the Trust's TSR is negative for the performance period, no shares under the 2014 Performance-Based Awards will vest. If the Trust's TSR is positive for the performance period and the total return of the Index is negative, 100% of the shares subject to vesting under the 2014 Performance-Based Awards will vest.

As of June 30, 2014, there was approximately \$12.8 million of unrecognized share-based compensation expense related to restricted common shares. The unrecognized share-based compensation expense is expected to be recognized over a weighted-average period of 2.4 years.

The following is a summary of the Trust's restricted common share activity for the six months ended June 30, 2014:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Restricted common shares as of December 31, 2013	629,855	\$ 18.35
Granted	491,564	\$ 13.83
Vested	(58,958)	) \$ 22.53
Forfeited	(750)	) \$ 23.58
Restricted common shares as of June 30, 2014	1,061,711	\$ 16.02

#### 9. Fair Value Measurements and Derivative Instruments

The Trust's derivative instruments are classified within Level 2 of the fair value hierarchy as they are valued using third-party pricing models which contain inputs that are derived from observable market data. Where possible, the values produced by the pricing models are verified to market prices. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit spreads, measures of volatility, and correlations of such inputs. As of June 30, 2014, the Trust's derivative instruments, which matured on July 3, 2014, had no value.

The Trust's financial instruments, in addition to the derivative instruments discussed above, include cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses, and long-term debt. The carrying values reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued expenses approximate fair value. The Trust estimates the fair value of its fixed rate debt by discounting the future cash flows of each instrument using estimated market rates of debt instruments with similar maturities and credit profiles. These inputs are classified as Level 3 within the fair value hierarchy. As of June 30, 2014, the carrying value reported in the consolidated balance sheet for the Trust's long-term debt approximated its fair value.

#### 10. Commitments and Contingencies

**Management Agreements**—The Trust's hotels operate pursuant to management agreements with various third-party management companies. Each management company receives a base management fee generally between 2% and 4% of hotel revenues. The management companies are also eligible to receive an incentive management fee if hotel operating income, as defined in the management agreements, exceeds certain performance thresholds. The incentive management fee is generally calculated as a percentage of hotel operating income after the Trust has received a priority return on its investment in the hotel.

**Franchise Agreements**—As of June 30, 2014, 12 of the Trust's hotels operated pursuant to franchise agreements with hotel brand companies and eight hotels operated pursuant to management agreements with hotel brand companies that allowed them to operate under their respective brands. Under the 12 franchise agreements, the Trust generally pays a royalty fee ranging from 3% to 6% of room revenues and up to 3% of food and beverage revenues, plus additional fees for marketing, central reservation systems, and other franchisor costs that amount to between 1% and 5% of room



revenues.

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Ground Lease Agreement—The Trust leases the land underlying the Hyatt Regency Mission Bay Spa and Marina pursuant to a lease agreement, which has an initial term ending January 2056. Rent due under the lease agreement is the greater of base rent or percentage rent. Base rent is currently \$2.2 million per year. Base rent resets every three years over the remaining term of the lease equal to 75% of the average of the actual rent paid over the two years preceding the base rent reset year. The next base rent reset year is 2016. Annual percentage rent is calculated based on various percentages of the hotel's various sources of revenue, including room, food and beverage, and marina rentals, earned during the period.

FF&E Reserves—Pursuant to its management, franchise and loan agreements, the Trust is required to establish a FF&E reserve for each hotel to cover the cost of replacing FF&E. Contributions to the FF&E reserve are based on a percentage of gross revenues at each hotel. The Trust is generally required to contribute between 3% and 5% of gross revenues over the term of the agreements.

Litigation—The Trust is not involved in any material litigation nor, to its knowledge, is any material litigation threatened against the Trust.

11. Subsequent Event

On July 3, 2014, the Trust entered into a loan agreement to obtain a \$90.0 million loan, which matures in July 2024 and is secured jointly by the Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street) and the Hyatt Place New York Midtown South. The loan carries a fixed interest rate of 4.30% per annum, with interest-only payments required for the first two years and principal and interest payments thereafter based on a 30-year principal amortization. A portion of the proceeds was used to repay the Trust's previous \$60.0 million term loan secured jointly by the two hotels mentioned previously, which matured on the same date. Excess proceeds from the refinancing were used to repay outstanding borrowings under the Trust's revolving credit facility.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identified by our use of words, such as "intend," "plan," "may," "should," "will," "project," "estimate," "anticipate," "believe," "expect," "continue," "potential," "opportunity," and similar expressions, whether negative or affirmative. We cannot guarantee that we actually will achieve these plans, intentions or expectations. All statements regarding our expected financial position, business and financing plans are forward-looking statements. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to:

- U.S. economic conditions generally and the real estate market and the lodging industry specifically;
- management and performance of our hotels;
- our plans for renovation of our hotels;
- our financing plans and the terms on which capital is available to us;
- supply and demand for hotel rooms in our current and proposed market areas;
- our ability to acquire additional hotels and the risk that potential acquisitions may not be completed or perform in accordance with expectations;
- legislative/regulatory changes, including changes to laws governing taxation of real estate investment trusts; and
- our competition.

These risks and uncertainties, together with the information contained in our Form 10-K for the year ended December 31, 2013 under the caption "Risk Factors," should be considered in evaluating any forward-looking statement contained in this report or incorporated by reference herein. All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are qualified by the cautionary statements in this section. We undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report, except as required by law.

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## Overview

The Trust was organized as a self-advised REIT in the state of Maryland in June 2009, with a focus on investments primarily in upper-upscale hotels in major business and convention markets and, on a selective basis, premium select-service hotels in urban settings or unique locations in the U.S. We completed our IPO in January 2010 and have since acquired the following 20 hotels:

Hotel	Location	Rooms	Acquisition Date
Hyatt Regency Boston	Boston, MA	502	March 18, 2010
Hilton Checkers Los Angeles	Los Angeles, CA	193	June 1, 2010
Courtyard Anaheim at Disneyland Resort	Anaheim, CA	153	July 30, 2010
Boston Marriott Newton	Newton, MA	430	July 30, 2010
Le Meridien San Francisco	San Francisco, CA	360	December 15, 2010
Homewood Suites Seattle Convention Center	Seattle, WA	195	May 2, 2011
W Chicago – City Center	Chicago, IL	403	May 10, 2011
Hotel Indigo San Diego Gaslamp Quarter	San Diego, CA	210	June 17, 2011
Courtyard Washington Capitol Hill/Navy Yard	Washington, DC	204	June 30, 2011
Hotel Adagio San Francisco, Autograph Collection	San Francisco, CA	171	July 8, 2011
Denver Marriott City Center	Denver, CO	613	October 3, 2011
Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street)	New York, NY	122	December 22, 2011
W Chicago – Lakeshore	Chicago, IL	520	August 21, 2012
Hyatt Regency Mission Bay Spa and Marina	San Diego, CA	429	September 7, 2012
The Hotel Minneapolis, Autograph Collection	Minneapolis, MN	222	October 30, 2012
Hyatt Place New York Midtown South	New York, NY	185	March 14, 2013
W New Orleans – French Quarter	New Orleans, LA	97	March 28, 2013
Hotel New Orleans Downtown (formerly the W New Orleans)	New Orleans, LA	410	April 25, 2013
Hyatt Fisherman's Wharf	San Francisco, CA	313	May 31, 2013
Hyatt Santa Barbara	Santa Barbara, CA	200	June 27, 2013
		5,932	

## Hotel Operating Metrics

We believe that the results of operations of our hotels are best explained by three key performance indicators: occupancy, average daily rate ("ADR") and revenue per available room ("RevPAR"), which is room revenue divided by total number of available rooms. RevPAR does not include food and beverage revenues or other ancillary revenues, such as parking, telephone or other guest services provided by the hotel.

Occupancy is a major driver of room revenue, as well as other revenue categories, such as food and beverage and parking. ADR helps to drive room revenue as well; however, it does not have a direct effect on other revenue categories. Fluctuations in occupancy are accompanied by fluctuations in most categories of variable operating costs, such as utility costs and certain labor costs such as housekeeping, resulting in varying levels of hotel profitability. Increases in ADR typically result in higher hotel profitability since variable hotel expenses generally do not increase correspondingly. Thus, increases in RevPAR attributable to increases in occupancy are accompanied by increases in most categories of variable operating costs, while increases in RevPAR attributable to increases in ADR are accompanied by increases in limited categories of operating costs, such as management fees and franchise fees.

## Executive Summary

Our 20-hotel portfolio performed well during the second quarter of 2014 with pro forma RevPAR growth of 3.4% as compared to the second quarter of 2013, driven by a pro forma increase in ADR of 4.6% offset by a pro forma decline in occupancy of 1.0 percentage points. We generated pro forma growth in Adjusted Hotel EBITDA of 7.1% and pro

forma growth in Adjusted Hotel EBITDA Margin of 170 basis points. Excluding our three hotels that have undergone or are undergoing comprehensive renovations during 2014, our 17-hotel portfolio performed even stronger with pro forma RevPAR growth of 7.0% as compared to the second quarter of 2013, driven by a pro forma increase in occupancy of 0.7 percentage points and a pro forma increase in ADR of 6.1%. For the 17-hotel portfolio, we generated pro forma growth in Adjusted Hotel EBITDA of 13.6% and pro forma growth in Adjusted Hotel EBITDA Margin of 250 basis points.

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We continued to see strong demand at our hotels during the second quarter of 2014 as a result of our concentration in the strongest performing markets during the quarter, particularly San Francisco, Boston, Seattle and San Diego. With our high levels of occupancy, our hotel managers were able to exercise pricing power and increase ADR which led to increased profitability. In addition, we saw significant improvements in Adjusted Hotel EBITDA and Adjusted Hotel EBITDA Margin at the hotels acquired in 2013 as a result of operational changes instituted as part of our asset management initiatives.

Our comprehensive renovation of the W Chicago – Lakeshore was completed in the second quarter, within our expected time frame and budgeted costs. During the second quarter, we also commenced a comprehensive renovation of the former W New Orleans to reposition the hotel as the Le Meridien New Orleans and most recently, on August 1, 2014, we closed the former Holiday Inn New York City Midtown – 31st Street and commenced a comprehensive renovation to reposition the hotel as the Hyatt Herald Square.

We continue to expect positive operating trends for our hotel portfolio through the remainder of 2014 as a result of favorable hotel supply and demand fundamentals in our geographic markets, our asset management initiatives, and the completion of the above mentioned major repositioning projects. We also continue to identify and pursue acquisition opportunities to prudently and selectively grow our hotel portfolio.

### Results of Operations

#### Comparison of three months ended June 30, 2014 and 2013

Results of operations for the three months ended June 30, 2014 include the operating activity of 20 hotels for the full period, whereas the results of operations for the three months ended June 30, 2013 include the operating activity of 17 hotels for the full period and three hotels for part of the period. We use the term “comparable hotel portfolio” to refer to those hotels owned for the entirety of the two periods being compared and the term “non-comparable hotel portfolio” to refer to those hotels acquired in either of the two periods being compared. The comparable hotel portfolio for the three months ended June 30, 2014 and 2013 includes 17 of our 20 hotels owned as of June 30, 2014.

Revenues—Total revenue for the three months ended June 30, 2014 was \$128.9 million, of which \$111.1 million was contributed by the comparable hotel portfolio and \$17.8 million was contributed by the non-comparable hotel portfolio. Total revenue for the three months ended June 30, 2013 was \$115.6 million, of which \$108.4 million was contributed by the comparable hotel portfolio and \$7.2 million was contributed by the non-comparable hotel portfolio. The increase in total revenue for the comparable hotel portfolio of \$2.7 million was primarily a result of increased demand for rooms from corporate and leisure transient customers, particularly at our hotels located in San Francisco, Boston, Seattle, San Diego and New York, and from group customers at our hotels located in Boston, which was driven by a favorable convention calendar during the three months ended June 30, 2014 as compared to the three months ended June 30, 2013. Aside from the strong market dynamics of San Francisco, total revenue at the Hotel Adagio San Francisco, Autograph Collection increased also as a result of its re-branding and inclusion in Marriott’s Autograph Collection (previously an independent hotel), which occurred late in the first quarter of 2013. The aforementioned increases in total revenue were offset partially by a decrease in total revenue from the W Chicago – Lakeshore as a result of the comprehensive renovation that was ongoing during the three months ended June 30, 2014, which negatively impacted customer demand at the hotel.

Hotel operating expenses—Total hotel operating expenses for the three months ended June 30, 2014 was \$81.7 million, of which \$69.0 million was incurred in connection with the comparable hotel portfolio and \$12.7 million was incurred in connection with the non-comparable hotel portfolio. Total hotel operating expenses for the three months ended June 30, 2013 was \$73.4 million, of which \$68.5 million was incurred in connection with the comparable hotel portfolio and \$4.9 million was incurred in connection with the non-comparable hotel portfolio. The increase in total hotel operating expenses for the comparable hotel portfolio of \$0.5 million was primarily a result of increases in corresponding total revenue for the comparable hotel portfolio, offset partially by a decrease in total hotel operating expenses at the W Chicago – Lakeshore commensurate with the decrease in total revenue due to the ongoing comprehensive renovation. The increase in total hotel operating expenses associated with the increase in corresponding total revenue for the comparable hotel portfolio, however, was limited as a result of the increase in total revenue being primarily driven by an increase in ADR, which has a lesser corresponding increase in variable hotel

operating expenses than an increase in occupancy. Furthermore, our hotel managers were able to reduce or limit increases in total hotel operating expenses as a result of our asset management initiatives.

Depreciation and amortization—Depreciation and amortization expense for the three months ended June 30, 2014 and 2013 was \$12.5 million and \$10.8 million, respectively. The increase in depreciation and amortization expense was primarily attributable to the three hotels acquired during the three months ended June 30, 2013.

Air rights contract amortization—Air rights contract amortization expense associated with the Hyatt Regency Boston for each of the three months ended June 30, 2014 and 2013 was \$0.1 million.

Corporate general and administrative—Corporate general and administrative expense for the three months ended June 30, 2014 and 2013 was \$3.9 million and \$3.6 million, respectively. Included in corporate general and administrative

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expense for the three months ended June 30, 2014 and 2013 was \$1.5 million and \$1.1 million, respectively, of non-cash share-based compensation expense. The increase in non-cash share-based compensation expense related to restricted common shares granted to employees during the six months ended June 30, 2014.

Hotel acquisition costs—Hotel acquisition costs for the three months ended June 30, 2013 was \$1.2 million. There were no hotel acquisitions during the three months ended June 30, 2014, as compared to three hotel acquisitions during the three months ended June 30, 2013.

Interest expense—Interest expense for the three months ended June 30, 2014 and 2013 was \$6.8 million and \$6.3 million, respectively. The increase in interest expense is directly related to the increase in long-term debt outstanding, reflecting the use of debt to fund the three hotel acquisitions during three months ended June 30, 2013.

Income tax expense—Income tax expense for the three months ended June 30, 2014 and 2013 was \$2.6 million and \$3.0 million, respectively. Income tax expense is directly related to taxable income generated by our TRS during the periods.

Comparison of six months ended June 30, 2014 and 2013

Results of operations for the six months ended June 30, 2014 include the operating activity of 20 hotels for the full period, whereas the results of operations for the six months ended June 30, 2013 include the operating activity of 15 hotels for the full period and five hotels for part of the period. The comparable hotel portfolio for the six months ended June 30, 2014 and 2013 includes 15 of our 20 hotels owned as of June 30, 2014.

Revenues—Total revenue for the six months ended June 30, 2014 was \$223.6 million, of which \$175.3 million was contributed by the comparable hotel portfolio and \$48.3 million was contributed by the non-comparable hotel portfolio. Total revenue for the six months ended June 30, 2013 was \$186.2 million, of which \$170.7 million was contributed by the comparable hotel portfolio and \$15.5 million was contributed by the non-comparable hotel portfolio. The increase in total revenue for the comparable hotel portfolio of \$4.6 million was primarily a result of increased demand for rooms from corporate and leisure transient customers, particularly at our hotels located in San Francisco, Boston, Seattle and San Diego, and from group customers at the Denver Marriott City Center and to a lesser extent, our hotels located in Boston, which was driven by favorable convention calendars for their respective markets during the six months ended June 30, 2014 as compared to the six months ended June 30, 2013. Aside from the strong market dynamics of San Francisco, total revenue at the Hotel Adagio San Francisco, Autograph Collection increased also as a result of its re-branding and inclusion in Marriott's Autograph Collection (previously an independent hotel), which occurred late in the first quarter of 2013. The aforementioned increases in total revenue were offset partially by a decrease in total revenue from the W Chicago – Lakeshore as a result of the comprehensive renovation that was ongoing during the six months ended June 30, 2014, which negatively impacted customer demand at the hotel.

Hotel operating expenses—Total hotel operating expenses for the six months ended June 30, 2014 was \$154.4 million, of which \$120.5 million was incurred in connection with the comparable hotel portfolio and \$33.9 million was incurred in connection with the non-comparable hotel portfolio. Total hotel operating expenses for the six months ended June 30, 2013 was \$128.3 million, of which \$118.8 million was incurred in connection with the comparable hotel portfolio and \$9.5 million was incurred in connection with the non-comparable hotel portfolio. The increase in total hotel operating expenses for the comparable hotel portfolio of \$1.7 million was primarily a result of increases in corresponding total revenue for the comparable hotel portfolio, offset partially by a decrease in total hotel operating expenses at the W Chicago – Lakeshore commensurate with the decrease in total revenue due to the ongoing comprehensive renovation. The increase in total hotel operating expenses associated with the increase in corresponding total revenue for the comparable hotel portfolio, however, was limited as a result of the increase in total revenue being primarily driven by an increase in ADR, which has a lesser corresponding increase in variable hotel operating expenses than an increase in occupancy. Furthermore, our hotel managers were able to reduce or limit increases in total hotel operating expenses as a result of our asset management initiatives.

Depreciation and amortization—Depreciation and amortization expense for the six months ended June 30, 2014 and 2013 was \$25.0 million and \$19.7 million, respectively. The increase in depreciation and amortization expense was primarily attributable to the five hotels acquired in 2013.



Air rights contract amortization—Air rights contract amortization expense associated with the Hyatt Regency Boston for each of the six months ended June 30, 2014 and 2013 was \$0.3 million.

Corporate general and administrative—Corporate general and administrative expense for the six months ended June 30, 2014 and 2013 was \$7.8 million and \$7.0 million, respectively. Included in corporate general and administrative expense for the six months ended June 30, 2014 and 2013 was \$2.8 million and \$2.3 million, respectively, of non-cash share-based compensation expense. The increase in corporate general and administrative expense is primarily related to an increase in non-cash share-based compensation expense, professional services fees, and employee compensation expense.

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Hotel acquisition costs—Hotel acquisition costs for the six months ended June 30, 2013 was \$4.1 million. There were no hotel acquisitions during the six months ended June 30, 2014, as compared to five hotel acquisitions during the six months ended June 30, 2013.

Interest expense—Interest expense for the six months ended June 30, 2014 and 2013 was \$13.5 million and \$11.8 million, respectively. The increase in interest expense is directly related to the increase in long-term debt outstanding, reflecting the use of debt to fund the five hotel acquisitions during 2013.

Income tax benefit (expense)—Income tax benefit for the six months ended June 30, 2014 was \$0.8 million and is directly related to taxable losses generated by our TRS during the period. Income tax expense for the six months ended June 30, 2013 was \$0.7 million and is directly related to taxable income generated by our TRS during the period.

## Hotel operating results

We assess the operating performance of our hotels irrespective of the hotel owner during the periods compared. We use the term "pro forma" to refer to metrics that include, or comparisons of metrics that are based on, the operating results of hotels under previous ownership for either a portion of or the entire period. Since five of our 20 hotels owned as of June 30, 2014 were acquired at various times during 2013, the key operating metrics reflect the pro forma operating results of three of those hotels for the three months ended June 30, 2013 and five of those hotels for the six months ended June 30, 2013. In addition to assessing the operating performance of our 20-hotel portfolio for 2014, we also assess the operating performance of a 17-hotel portfolio, which excludes the W Chicago – Lakeshore, the Hotel New Orleans Downtown (formerly the W New Orleans), and the Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street), as these hotels have undergone or are undergoing comprehensive renovations during 2014. Included in the following table are comparisons of occupancy, ADR, RevPAR, Adjusted Hotel EBITDA, and Adjusted Hotel EBITDA Margin for the 17-hotel portfolio and the 20-hotel portfolio for the three and six months ended June 30, 2014 and 2013 (in thousands, except for ADR and RevPAR):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013 <sup>(1)</sup>	Change	2014	2013 <sup>(1)</sup>	Change
<b>17-Hotel Portfolio<sup>(2)</sup></b>						
Occupancy	87.2	% 86.5	% 70 bps	82.9	% 80.5	% 240 bps
ADR	\$215.52	\$203.08	6.1%	\$198.44	\$187.82	5.7%
RevPAR	\$188.00	\$175.69	7.0%	\$164.58	\$151.21	8.8%
Adjusted Hotel EBITDA	\$41,499	\$36,544	13.6%	\$62,447	\$52,838	18.2%
Adjusted Hotel EBITDA Margin	37.5	% 35.0	% 250 bps	32.2	% 29.5	% 270 bps
<b>20-Hotel Portfolio</b>						
Occupancy	84.6	% 85.6	% (100) bps	79.5	% 79.2	% 30 bps
ADR	\$215.10	\$205.64	4.6%	\$198.08	\$189.79	4.4%
RevPAR	\$181.92	\$175.93	3.4%	\$157.49	\$150.37	4.7%
Adjusted Hotel EBITDA	\$47,104	\$43,977	7.1%	\$69,044	\$62,469	10.5%
Adjusted Hotel EBITDA Margin	36.6	% 34.9	% 170 bps	30.9	% 29.1	% 180 bps

(1)Includes results of operations for certain hotels prior to our acquisition.

Excludes the W Chicago – Lakeshore, the Hotel New Orleans Downtown (formerly the W New Orleans), and the

(2)Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street), as these hotels have undergone or are undergoing comprehensive renovations during 2014.

The pro forma increase in RevPAR of 7.0% for the 17-hotel portfolio for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013 was primarily a result of our concentration in the strongest performing markets during the quarter. ADR increased on a pro forma basis by 6.1% primarily as a result of high levels of occupancy, which increased by 0.7 percentage points on a pro forma basis, at many of our hotels which

allowed our hotel managers to exercise pricing power. The pro forma increases in occupancy and ADR were primarily a result of increased demand for rooms from corporate and leisure transient customers at our hotels located in San Francisco, Boston, Seattle, San Diego, New York and Santa Barbara, and from group customers at our hotels located in Boston, which was driven by a favorable convention calendar during the period. Aside from the strong market dynamics of San Francisco and Santa Barbara during the quarter, RevPAR at the Hotel Adagio San Francisco, Autograph Collection increased also as a result of its re-branding and inclusion in Marriott's Autograph Collection (previously an independent hotel), which occurred late in the first quarter of 2013, and RevPAR at the Hyatt Fisherman's Wharf and the Hyatt Santa Barbara increased on a pro forma basis also as a result of enhanced revenue management as we instituted certain asset management initiatives subsequent to our acquisition of the hotels in May 2013 and June 2013, respectively.

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The pro forma increase in Adjusted Hotel EBITDA of 13.6% and the pro forma increase in Adjusted Hotel EBITDA Margin of 250 basis points for the 17-hotel portfolio for the three months ended June 30, 2014 as compared to the three months ended June 30, 2013 were primarily a result of the pro forma increase in RevPAR of 7.0%. Given the increase in RevPAR was more significantly driven by an increase in ADR, our hotels were able to increase total revenue at a greater percentage than the corresponding percentage increase in total hotel operating expenses. Furthermore, we were able to reduce or limit increases in total hotel operating expenses at several of the hotels acquired in 2013 as a result of operational changes we instituted subsequent to our acquisition of the hotels. The increases in Adjusted Hotel EBITDA and Adjusted Hotel EBITDA Margin during the three months ended June 30, 2014 were negatively impacted, however, by increases in property taxes primarily as a result of increases in the assessed values at several of our hotels acquired in 2013.

The pro forma increase in RevPAR of 8.8% for the 17-hotel portfolio for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013 was primarily a result of our concentration in the strongest performing markets during the quarter. ADR increased on a pro forma basis by 5.7% primarily as a result of high levels of occupancy, which increased by 2.4 percentage points on a pro forma basis, at many of our hotels which allowed our hotel managers to exercise pricing power. The pro forma increases in occupancy and ADR were primarily a result of increased demand for rooms from corporate and leisure transient customers at our hotels located in San Francisco, Boston, Seattle, San Diego and Santa Barbara, and from group customers at the Denver Marriott City Center and to a lesser extent, our hotels located in Boston, which was driven by favorable convention calendars for their respective markets during the period. Aside from the strong market dynamics of San Francisco and Santa Barbara during the period, RevPAR at the Hotel Adagio San Francisco, Autograph Collection increased also as a result of its re-branding and inclusion in Marriott's Autograph Collection (previously an independent hotel), which occurred late in the first quarter of 2013, and RevPAR at the Hyatt Fisherman's Wharf and the Hyatt Santa Barbara increased on a pro forma basis also as a result of enhanced revenue management as we instituted certain asset management initiatives subsequent to our acquisition of the hotels in May 2013 and June 2013, respectively.

The pro forma increase in Adjusted Hotel EBITDA of 18.2% and the pro forma increase in Adjusted Hotel EBITDA Margin of 270 basis points for the 17-hotel portfolio for the six months ended June 30, 2014 as compared to the six months ended June 30, 2013 were primarily a result of the pro forma increase in RevPAR of 8.8%. Given the increase in RevPAR was more significantly driven by an increase in ADR, our hotels were able to increase total revenue at a greater percentage than the corresponding percentage increase in total hotel operating expenses. Furthermore, we were able to reduce or limit increases in total hotel operating expenses at several of the hotels acquired in 2013 as a result of operational changes we instituted subsequent to our acquisition of the hotels. The increases in Adjusted Hotel EBITDA and Adjusted Hotel EBITDA Margin during the six months ended June 30, 2014 were negatively impacted, however, by increases in property taxes primarily as a result of increases in the assessed values at several of our hotels acquired in 2013.

### Non-GAAP Financial Measures

Non-GAAP financial measures are measures of our historical financial performance that are different from measures calculated and presented in accordance with U.S. generally accepted accounting principles. We report the following eight non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: (1) Hotel EBITDA, (2) Adjusted Hotel EBITDA, (3) Adjusted Hotel EBITDA Margin, (4) Corporate EBITDA, (5) Adjusted Corporate EBITDA, (6) Funds from operations (FFO), (7) FFO available to common shareholders, and (8) Adjusted FFO (AFFO) available to common shareholders.

Hotel EBITDA—Hotel EBITDA is defined as total revenues less total hotel operating expenses. We believe that Hotel EBITDA provides investors a useful financial measure to evaluate our hotel operating performance.

Adjusted Hotel EBITDA—We further adjust Hotel EBITDA for certain additional recurring and non-recurring items. Specifically, we adjust for non-cash amortization of intangible assets and liabilities, including ground lease assets and unfavorable contract liabilities, deferred franchise costs, and deferred key money, all of which are recurring items. We believe that Adjusted Hotel EBITDA provides investors with another useful financial measure to evaluate our hotel operating performance.

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Adjusted Hotel EBITDA Margin—Adjusted Hotel EBITDA Margin is defined as Adjusted Hotel EBITDA as a percentage of total revenues. We believe that Adjusted Hotel EBITDA Margin provides investors another useful measure to evaluate our hotel operating performance.

The following table calculates for the 17-hotel portfolio and the 20-hotel portfolio Hotel EBITDA, Adjusted Hotel EBITDA, and Adjusted Hotel EBITDA Margin for the three and six months ended June 30, 2014 and 2013 (in thousands):

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013 <sup>(1)</sup>	2014	2013 <sup>(1)</sup>
<b>17-Hotel Portfolio<sup>(2)</sup></b>				
Total revenue	\$ 110,729	\$ 104,528	\$ 194,138	\$ 178,823
Less: Total hotel operating expenses	69,156	67,904	131,542	125,837
Hotel EBITDA	41,573	36,624	62,596	52,986
Less: Non-cash amortization <sup>(3)</sup>	(74)	(80)	(149)	(148)
Adjusted Hotel EBITDA	\$41,499	\$36,544	\$62,447	\$52,838
Adjusted Hotel EBITDA Margin	37.5	% 35.0	% 32.2	% 29.5
<b>20-Hotel Portfolio</b>				
Total revenue	\$ 128,865	\$ 125,906	\$ 223,639	\$ 214,416
Less: Total hotel operating expenses	81,687	81,849	154,446	151,799
Hotel EBITDA	47,178	44,057	69,193	62,617
Less: Non-cash amortization <sup>(3)</sup>	(74)	(80)	(149)	(148)
Adjusted Hotel EBITDA	\$47,104	\$43,977	\$69,044	\$62,469
Adjusted Hotel EBITDA Margin	36.6	% 34.9	% 30.9	% 29.1

(1) Includes results of operations for certain hotels prior to our acquisition.

Excludes the W Chicago – Lakeshore, the Hotel New Orleans Downtown (formerly the W New Orleans), and the

(2) Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street), as these hotels have undergone or are undergoing comprehensive renovations during 2014.

(3) Includes non-cash amortization of ground lease asset, deferred franchise costs, deferred key money, and unfavorable contract liability.

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

Adjusted Corporate EBITDA—We further adjust Corporate EBITDA for certain additional recurring and non-recurring items. Specifically, we adjust for hotel acquisition costs and non-cash amortization of intangible assets and liabilities, including air rights contracts, ground lease assets and unfavorable contract liabilities, deferred franchise costs, and deferred key money, all of which are recurring items. We believe that Adjusted Corporate EBITDA provides investors with another financial measure of our operating performance that provides for greater comparability of our core operating results between periods.

The following table reconciles net income to Corporate EBITDA and Adjusted Corporate EBITDA for the three and six months ended June 30, 2014 and 2013 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$ 21,249	\$ 17,057	\$ 23,427	\$ 14,547
Add: Depreciation and amortization	12,524	10,838	25,022	19,677
Interest expense	6,828	6,346	13,514	11,787
Income tax expense (benefit)	2,556	2,974	(841)	690
Less: Interest income	—	(25)	—	(243)
Corporate EBITDA	43,157	37,190	61,122	46,458
Add: Hotel acquisition costs	—	1,237	—	4,136
Non-cash amortization <sup>(1)</sup>	56	50	111	112
Adjusted Corporate EBITDA	\$43,213	\$38,477	\$61,233	\$50,706

(1) Includes non-cash amortization of ground lease asset, deferred franchise costs, deferred key money, unfavorable contract liability, and air rights contract.

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

FFO available to common shareholders—We reduce FFO for preferred share dividends and dividends declared on and earnings allocated to unvested time-based awards (consistent with adjustments required by GAAP in reporting net income available to common shareholders and related per share amounts). FFO available to common shareholders provides investors another financial measure to evaluate our operating performance after taking into account the interests of holders of our preferred shares and unvested time-based awards.

AFFO available to common shareholders—We further adjust FFO available to common shareholders for certain additional recurring and non-recurring items that are not in NAREIT's definition of FFO. Specifically, we adjust for hotel acquisition costs and non-cash amortization of intangible assets and liabilities, including air rights contracts, ground lease assets and unfavorable contract liabilities, deferred franchise costs, and deferred key money, all of which are recurring items. We believe that AFFO available to common shareholders provides investors with another financial measure of our operating performance that provides for greater comparability of our core operating results between periods.

The following table reconciles net income to FFO, FFO available to common shareholders, and AFFO available to common shareholders for the three and six months ended June 30, 2014 and 2013 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$ 21,249	\$ 17,057	\$ 23,427	\$ 14,547
Add: Depreciation and amortization	12,524	10,838	25,022	19,677
FFO	33,773	27,895	48,449	34,224
Less: Preferred share dividends	(2,422)	(2,422)	(4,844)	(4,844)
Dividends declared on unvested time-based awards	(128)	(90)	(257)	(178)
Undistributed earnings allocated to unvested time-based awards	(35)	(23)	—	—
FFO available to common shareholders	31,188	25,360	43,348	29,202
Add: Hotel acquisition costs	—	1,237	—	4,136
Non-cash amortization <sup>(1)</sup>	56	50	111	112
AFFO available to common shareholders	\$ 31,244	\$ 26,647	\$ 43,459	\$ 33,450
FFO available per common share—basic and diluted	\$ 0.64	\$ 0.53	\$ 0.89	\$ 0.63
AFFO available per common share—basic and diluted	\$ 0.64	\$ 0.56	\$ 0.89	\$ 0.72

<sup>(1)</sup> Includes non-cash amortization of ground lease asset, deferred franchise costs, deferred key money, unfavorable contract liability, and air rights contract.

None of Hotel EBITDA, Adjusted Hotel EBITDA, Corporate EBITDA, Adjusted Corporate EBITDA, FFO, FFO available to common shareholders, or AFFO available to common shareholders represent cash generated from operating activities as determined by GAAP, nor shall any of these measures be considered as an alternative to GAAP



net income (loss), as an indication of our financial performance, or to GAAP cash flow from operating activities, as a measure of liquidity. In addition, Hotel EBITDA, Adjusted Hotel EBITDA, Corporate EBITDA, Adjusted Corporate EBITDA, FFO, FFO available to common shareholders, and AFFO available to common shareholders are not indicative of funds available to fund cash needs, including the ability to make cash distributions.

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### Sources and Uses of Cash

For the six months ended June 30, 2014, net cash flows from operating activities were \$46.9 million; net cash flows used in investing activities were \$45.5 million, including \$43.4 million for improvements and additions to our hotels; and net cash flows provided by financing activities were \$10.0 million, including borrowings of \$50.0 million under our revolving credit facility, offset by \$32.5 million in dividend payments to common and preferred shareholders, \$4.9 million in scheduled principal payments on mortgage debt, and a \$2.1 million deposit on a loan application. As of June 30, 2014, we had cash and cash equivalents of \$40.0 million.

### Liquidity and Capital Resources

We expect our primary source of cash to meet operating requirements, including payment of dividends in accordance with the REIT requirements of the U.S. federal income tax laws, payment of interest on any borrowings and funding of any capital expenditures, will be from our hotels' results of operations and existing cash and cash equivalent balances. We currently expect that our operating cash flows will be sufficient to fund our continuing operations. We intend to incur indebtedness to supplement our investment capital and to maintain flexibility to respond to industry conditions and opportunities. We are targeting an overall debt level not to exceed 40% of the aggregate value of all of our hotels as calculated in accordance with our revolving credit facility; as of June 30, 2014, our overall debt level was 35.9% under this calculation.

We expect to meet long-term liquidity requirements, such as new hotel acquisitions and scheduled debt maturities, through additional secured and unsecured borrowings and the issuance of equity securities. 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.

We expect to continue declaring distributions to shareholders, as required to maintain our REIT status, although no assurances can be made that we will continue to generate sufficient income to distribute similar aggregate amounts in the future. The per share amounts of future distributions will depend on the number of our common and preferred shares outstanding from time to time and will be determined by our board of trustees following its periodic review of our financial performance and capital requirements, and the terms of our existing borrowing arrangements.

On July 3, 2014, we entered into a loan agreement to obtain a \$90.0 million loan secured jointly by the Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street) and the Hyatt Place New York Midtown South. A portion of the proceeds was used to repay our previous \$60.0 million term loan secured jointly by the two hotels mentioned previously, which matured on the same date. Excess proceeds from the refinancing were used to repay outstanding borrowings under our revolving credit facility.

As of the date of this filing, we have approximately \$32.0 million of cash and cash equivalents, total borrowing availability of \$250.0 million under our revolving credit facility, of which we have \$30.0 million currently outstanding, and two unencumbered hotels. See Note 5, "Long-Term Debt," to our interim consolidated financial statements for additional information relating to our revolving credit facility and other long-term debt.

### Capital Expenditures

We maintain each hotel in good repair and condition and in conformity with applicable laws and regulations and in accordance with the franchisor's standards and the agreed-upon requirements in our management and loan agreements. The cost of all such routine improvements and alterations will be paid out of property improvement reserves, which will be funded by a portion of each hotel's gross revenues. Routine capital expenditures will be administered by the management companies. However, we will have approval rights over the capital expenditures as part of the annual budget process.

From time to time, certain of our hotels may be undergoing renovations as a result of our decision to upgrade portions of the hotels, such as guestrooms, meeting space, and/or restaurants, in order to better compete with other hotels in our markets. In addition, often after we acquire a hotel, we are required to complete a PIP in order to bring the hotel up to the franchisor's standards. If permitted by the terms of the management agreement, funding for a renovation will first come from the FF&E reserve. To the extent that the FF&E reserve is not adequate to cover the cost of the renovation,

we will fund the remaining portion of the renovation with cash and cash equivalents or through borrowings under our revolving credit facility.

We have undergone or are undergoing the following significant renovation or repositioning projects in 2014: W Chicago – Lakeshore—A comprehensive renovation encompassing guestrooms, public spaces, restaurant, bars, and meeting space, which commenced in the third quarter of 2013, was completed in the second quarter of 2014. The current estimated renovation cost is approximately \$38.0 million. As of June 30, 2014, \$33.5 million had been spent and approximately \$4.5 million remained to be spent on final contractor and vendor payments.

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Former W New Orleans—A comprehensive renovation encompassing guestrooms, public spaces, restaurant, bars, and meeting space to reposition the hotel commenced in the second quarter of 2014. In July 2014, we and our hotel manager, Starwood Hotels & Resorts Worldwide, Inc., agreed to remove the W brand from the hotel for the duration of the renovation and rename it the Hotel New Orleans Downtown. Our hotel manager has agreed to guarantee certain levels of gross operating profit, as defined in the agreement, for the expected renovation period. The renovation is expected to be completed in the fourth quarter of 2014, at which time the hotel will be re-branded as the Le Meridien New Orleans. The current estimated renovation cost, subject to adjustments based on continued evaluation, is approximately \$29.0 million, of which \$7.4 million had been spent as of June 30, 2014.

Former Holiday Inn New York City Midtown – 31st Street—A comprehensive renovation encompassing guestrooms, public spaces, restaurant, and bar to reposition the hotel as the Hyatt Herald Square commenced in the third quarter of 2014 with the closure of the hotel on August 1, 2014. We expect the renovation to be completed and the hotel to re-open by October 1, 2014. The current estimated renovation cost, subject to adjustments based on continued evaluation, is approximately \$6.5 million, of which \$2.9 million had been spent as of June 30, 2014.

**Contractual Obligations**

The following table sets forth our contractual obligations as of June 30, 2014, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands). There were no other material off-balance sheet arrangements at June 30, 2014.

Contractual Obligations	Payments Due by Period				
	Total	Less Than One Year	One to Three Years	Three to Five Years	More Than Five Years
Revolving credit facility, including interest <sup>(1)</sup>	\$51,834	\$963	\$50,871	\$—	\$—
Term loan, including interest <sup>(1)(2)</sup>	60,203	60,203	—	—	—
Other mortgage loans, including interest <sup>(2)</sup>	578,147	30,540	175,215	43,144	329,248
Corporate office lease	749	223	466	60	—
Ground leases <sup>(3)</sup>	98,083	2,261	4,522	4,522	86,778
	\$789,016	\$94,190	\$231,074	\$47,726	\$416,026

Assumes no additional borrowings and interest payments are based on the interest rate in effect at June 30, 2014.

(1) Also assumes that no extension options are exercised. See the notes to our interim consolidated financial statements for additional information relating to our revolving credit facility and term loan.

(2) On July 3, 2014, we repaid the \$60.0 million term loan secured jointly by the Hyatt Herald Square (formerly the Holiday Inn New York City Midtown – 31st Street) and the Hyatt Place New York Midtown South at maturity and entered into a new loan agreement. See Note 11, "Subsequent Event," to our interim consolidated financial statements for additional information.

(3) The ground lease for the Hyatt Regency Mission Bay Spa and Marina provides for the greater of base or percentage rent, both subject to potential increases over the term of the lease. Amounts assume only base rent for all periods presented and do not assume any adjustments for potential increases.

**Inflation**

Operators of hotels, in general, possess the ability to adjust room rates daily to reflect the effects of inflation. However, competitive pressures may limit the ability of our management companies to raise room rates.

**Seasonality**

Demand in the lodging industry is affected by recurring seasonal patterns. For non-resort properties, demand is generally lower in the winter months due to decreased travel and higher in the spring and summer months during the peak travel season. For resort properties, demand is generally higher in the winter months. We expect that our

operations will generally reflect non-resort seasonality patterns. Accordingly, we expect that we will have lower revenue, operating income and cash flow in the first and fourth quarters and higher revenue, operating income and cash flow in the second and third quarters. These general trends are, however, expected to be greatly influenced by overall economic cycles.

#### Critical Accounting Policies

Our interim consolidated financial statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of our interim consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While we do

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not believe the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances. All of our critical accounting policies are disclosed in our Form 10-K for the year ended December 31, 2013.

Recent Accounting Pronouncements

See Note 2, "Summary of Significant Accounting Policies," to our interim consolidated financial statements for additional information relating to recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We earn interest income primarily from cash and cash equivalent balances. Based on our cash and cash equivalents as of June 30, 2014, if interest rates increase or decrease by 1.00%, our interest income will increase or decrease by approximately \$0.4 million annually.

Amounts borrowed under our revolving credit facility currently bear interest at variable rates based on LIBOR plus 1.75% - 2.75% (the spread over LIBOR based on our consolidated leverage ratio). If prevailing LIBOR on any outstanding borrowings under our revolving credit facility were to increase or decrease by 1.00%, the increase or decrease in interest expense on our debt would increase or decrease future earnings and cash flows by approximately \$0.5 million annually, assuming that the amount outstanding under our revolving credit facility was to remain at \$50.0 million, the balance at June 30, 2014.

Item 4. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer of the Trust have evaluated the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act, and have concluded that as of the end of the period covered by this report, the Trust's disclosure controls and procedures were effective at a reasonable assurance level.

There was no change in the Trust's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during the Trust's most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed under the caption "Risk Factors" in the Trust's Form 10-K for the year ended December 31, 2013.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6.

Exhibits

The following exhibits are filed as part of this Form 10-Q:

Exhibit Number	Description of Exhibit
31.1	Rule 13a-14(a)/15d-14(a) Certification of President and Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Executive Vice President, Chief Financial Officer and Treasurer
32.1	Section 1350 Certification of President and Chief Executive Officer
32.2	Section 1350 Certification of Executive Vice President, Chief Financial Officer and Treasurer
101.INS XBRL	Instance Document
101.SCH XBRL	Taxonomy Extension Schema Document
101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document
101.DEF XBRL	Taxonomy Extension Definition Linkbase Document
101.LAB XBRL	Taxonomy Extension Label Linkbase Document
101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document



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SIGNATURES

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

CHESAPEAKE LODGING TRUST

Date: August 4, 2014

By: /S/ DOUGLAS W. VICARI  
Douglas W. Vicari  
Executive Vice President, Chief Financial Officer and  
Treasurer  
(Principal Financial Officer)

/S/ GRAHAM J. WOOTTEN  
Graham J. Wootten  
Senior Vice President and Chief Accounting Officer  
(Principal Accounting Officer)