Sunstone Hotel Investors, Inc.
Form 10-Q
May 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 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 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	20-1296886 (I.R.S. Employer Identification Number)
120 Vantis, Suite 350 Aliso Viejo, California (Address of Principal Executive Offices)	92656 (Zip Code)

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

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	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

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

183,348,796 shares of Common Stock, $0.01 par value, as of May 1, 2014

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SUNSTONE HOTEL INVESTORS, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended March 31, 2014

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PART I—FINANCIAL INFORMATION

Item 1.Financial Statements

SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	March 31, 2014 (unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 94,792	$ 104,363
Restricted cash	82,748	89,306
Accounts receivable, net	38,891	29,941
Inventories	1,335	1,464
Prepaid expenses	12,626	12,612
Total current assets	230,392	237,686
Investment in hotel properties, net	3,227,779	3,231,382
Deferred financing fees, net	8,483	9,219
Goodwill	9,405	9,405
Other assets, net	20,983	21,106
Total assets	$ 3,497,042	$ 3,508,798
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 31,470	$ 25,116
Accrued payroll and employee benefits	22,322	29,933
Dividends payable	11,467	11,443
Other current liabilities	37,061	30,288
Current portion of notes payable	24,008	23,289
Total current liabilities	126,328	120,069
Notes payable, less current portion	1,374,394	1,380,786
Capital lease obligations, less current portion	15,577	15,586

Other liabilities	40,610	39,958
Total liabilities	1,556,909	1,556,399
Commitments and contingencies (Note 12)		
Equity:		
Stockholders’ equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized.		
8.0% Series D Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at March 31, 2014 and December 31, 2013, stated at liquidation preference of $25.00 per share	115,000	115,000
Common stock, $0.01 par value, 500,000,000 shares authorized, 181,355,803 shares issued and outstanding at March 31, 2014 and 180,858,699 shares issued and outstanding at December 31, 2013	1,814	1,809
Additional paid in capital	2,071,421	2,068,721
Retained earnings	218,642	224,364
Cumulative dividends	(522,911)	(511,444)
Total stockholders’ equity	1,883,966	1,898,450
Non-controlling interest in consolidated joint ventures	56,167	53,949
Total equity	1,940,133	1,952,399
Total liabilities and equity	$ 3,497,042	$ 3,508,798

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share data)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
REVENUES		
Room	$ 168,127	$ 132,623
Food and beverage	59,911	49,628
Other operating	15,445	12,670
Total revenues	243,483	194,921
OPERATING EXPENSES		
Room	48,919	37,454
Food and beverage	42,908	35,096
Other operating	4,995	4,242
Advertising and promotion	12,971	11,265
Repairs and maintenance	10,881	8,374
Utilities	8,289	6,183
Franchise costs	8,077	6,478
Property tax, ground lease and insurance	19,052	18,468
Property general and administrative	28,922	23,606
Corporate overhead	6,559	6,171
Depreciation and amortization	37,615	34,016
Total operating expenses	229,188	191,353
Operating income	14,295	3,568
Interest and other income	716	563
Interest expense	(18,283)	(17,414)
Loss on extinguishment of debt	—	(44)
Loss before income taxes and discontinued operations	(3,272)	(13,327)
Income tax provision	(224)	(6,157)
Loss from continuing operations	(3,496)	(19,484)
Income from discontinued operations	—	48,410
NET INCOME (LOSS)	(3,496)	28,926
Income from consolidated joint venture attributable to non-controlling interest	(2,226)	(297)
Distributions to non-controlling interest	(8)	(8)
Dividends paid on unvested restricted stock compensation	(100)	—
Preferred stock dividends and redemption charge	(2,300)	(10,903)

Undistributed income allocated to unvested restricted stock compensation	—	(218)
INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS	$ (8,130)	$ 17,500
COMPREHENSIVE INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS	$ (8,130)	$ 17,500
Basic and diluted per share amounts:		
Loss from continuing operations attributable to common stockholders	$ (0.04)	$ (0.20)
Income from discontinued operations	—	0.32
Basic and diluted income available (loss attributable) to common stockholders per common share	$ (0.04)	$ 0.12
Basic and diluted weighted average common shares outstanding	181,061	151,076
Dividends declared per common share	$ 0.05	$ —

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED STATEMENT OF EQUITY

(In thousands, except share data)

	Preferred Stock		Common Stock					Non-Controllin Interest in Joint Ventures	
	Number of Shares	Amount	Number of Shares	Amount	Additional Paid in Capital	Retained Earnings	Cumulative Dividends		Tota
Balance at December 31, 2013	4,600,000	$ 115,000	180,858,699	$ 1,809	$ 2,068,721	$ 224,364	$ (511,444)	$ 53,949	$ 1,
Net proceeds from sale of common stock (unaudited)	—	—	99,460	1	1,218	—	—	—	1,
Vesting of restricted common stock (unaudited)	—	—	397,644	4	1,482	—	—	—	1,
Distributions to non-controlling interests (unaudited)	—	—	—	—	—	—	—	(8)	(8
Common stock dividends and dividends payable at $0.05 per share year to date (unaudited)	—	—	—	—	—	—	(9,167)	—	(9
Series D preferred dividends and dividends payable at $0.50 per share year to date (unaudited)	—	—	—	—	—	—	(2,300)	—	(2

Net income (unaudited)	—	—	—	—	—	(5,722)	—	2,226	(3
Balance at March 31, 2014 (unaudited)	4,600,000	$ 115,000	181,355,803	$ 1,814	$ 2,071,421	$ 218,642	$ (522,911)	$ 56,167	$ 1,

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (3,496)	$ 28,926
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Bad debt expense	95	63
Gain on sales of assets	(6)	(51,620)
Loss on extinguishment of debt	—	3,159
Gain on derivatives, net	(109)	(157)
Depreciation	36,934	30,705
Amortization of franchise fees and other intangibles	1,755	4,453
Amortization of deferred financing fees	736	760
Amortization of loan discounts	—	3
Amortization of deferred stock compensation	1,372	1,075
Changes in operating assets and liabilities:		
Restricted cash	6,168	300
Accounts receivable	(9,045)	(4,602)
Inventories	129	1,593
Prepaid expenses and other assets	(289)	541
Accounts payable and other liabilities	12,650	7,551
Accrued payroll and employee benefits	(7,611)	(9,766)
Discontinued operations	—	432
Net cash provided by operating activities	39,283	13,416
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of hotel properties and other assets	7	195,616
Cash proceeds held by accommodator	—	(139,434)
Restricted cash — replacement reserve	390	9,167
Acquisition deposits	—	(6,000)
Renovations and additions to hotel properties	(33,346)	(37,149)
Net cash (used in) provided by investing activities	(32,949)	22,200
CASH FLOWS FROM FINANCING ACTIVITIES		
Redemption of preferred stock	—	(176,250)
Proceeds from common stock offering	1,392	295,251
Payment of common stock offering costs	(173)	(376)
Proceeds from credit facility	—	30,000
Payments on notes payable and credit facility	(5,673)	(119,793)

Payments for costs related to extinguishment of notes payable	—	(3,108)
Dividends paid	(11,443)	(9,787)
Distributions to non-controlling interests	(8)	(457)
Net cash (used in) provided by financing activities	(15,905)	15,480
Net (decrease) increase in cash and cash equivalents	(9,571)	51,096
Cash and cash equivalents, beginning of period	104,363	157,217
Cash and cash equivalents, end of period	$ 94,792	$ 208,313
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	$ 16,428	$ 17,996
NONCASH INVESTING ACTIVITY		
Accounts payable related to renovations and additions to hotel properties	$ 9,077	$ 11,333
Amortization of deferred stock compensation — construction activities	$ 114	$ 93
NONCASH FINANCING ACTIVITY		
Dividends payable	$ 11,467	$ 3,912

See accompanying notes to consolidated financial statements

SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

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

As a REIT, certain tax laws limit the amount of “non-qualifying” income the Company can earn, including income derived directly from the operation of hotels. As a result, the Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company’s hotels. As of March 31, 2014, the Company had interests in 29 hotels (the “29 hotels”) held for investment, and the Company’s third-party managers included the following:

	Number of Hotels
Subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, “Marriott”)	10
Interstate Hotels & Resorts, Inc.	6
Highgate Hotels L.P. and an affiliate	4
Davidson Hotels & Resorts	2
Hilton Worldwide	2
Hyatt Corporation	2
Crestline Hotels & Resorts	1
Dimension Development Company	1
Fairmont Hotels & Resorts (U.S.)	1
Total hotels held for investment	29

In addition, as of March 31, 2014, the Company owned BuyEfficient, LLC ("BuyEfficient"), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of March 31, 2014 and December 31, 2013, and for the three months ended March 31, 2014 and 2013, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company consolidates subsidiaries when it has the ability to direct the activities that most significantly impact the economic performance of the entity. The Company also evaluates its subsidiaries to determine if they should be considered variable interest entities ("VIEs"). Typically, the entity that has the power to direct the activities that most significantly impact economic performance would consolidate the VIE. The Company considers an entity a VIE if equity investors own an interest therein that does not have the characteristics of a controlling financial interest or if such investors do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. In accordance with the Consolidation Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"), the Company reviewed its subsidiaries to determine if (i) they should be considered VIEs, and (ii) whether the Company should change its consolidation determination based on changes in the characteristics of these entities. Based on its review, the Company determined that all of its subsidiaries were properly consolidated as of March 31, 2014 and December 31, 2013, and for the three months ended March 31, 2014 and 2013.

Non-controlling interests at both March 31, 2014 and December 31, 2013 represent the outside equity interests in various consolidated affiliates of the Company.

The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and in conformity with the rules and regulations of the Securities and Exchange Commission. In the

Company's opinion, the interim financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim financial statements. These financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission on February 25, 2014.

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

Use of Estimates

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

Reporting Periods

The results the Company reports in its consolidated statements of operations and comprehensive income (loss) are based on results reported to the Company by its hotel managers, all of whom currently use a standard monthly calendar. Prior to 2013, however, Marriott used a 13-period fiscal calendar with the year ending on the Friday closest to December 31. Since Marriott's 2012 fiscal year ended on December 28, 2012, Marriott's 2013 first quarter and calendar year contain an additional three days, December 29, 2012 through December 31, 2012.

Fair Value of Financial Instruments

As of March 31, 2014 and December 31, 2013, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

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

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

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

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

As discussed in Note 5, at March 31, 2014 and December 31, 2013, the Company held two interest rate cap agreements and one interest rate swap agreement to manage, or hedge, interest rate risks related to its floating rate debt. The Company records interest rate protection agreements on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in the consolidated statements of operations and comprehensive income (loss) as they are not designated as hedges. In accordance with the Fair Value Measurements and Disclosure Topic of the FASB ASC, the Company estimates the fair value of its interest rate protection agreements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. The Company has valued the derivative interest rate cap agreements using Level 2 measurements as an asset of $10,000 and $16,000 as of March 31, 2014 and December 31, 2013, respectively. The interest rate cap agreements are included in other assets, net on the accompanying consolidated balance sheets. The Company has valued the derivative interest rate swap agreement using Level 2 measurements as a liability of $1.0 million and $1.1 million as of March 31, 2014 and December 31, 2013, respectively. The interest rate swap agreement is included in other liabilities on the accompanying consolidated balance sheets.

On an annual basis and periodically when indicators of impairment exist, the Company analyzes the carrying values of its hotel properties and other assets using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. The Company did not identify any properties or other assets with indicators of impairment during the three months ended March 31, 2014 and 2013.

On an annual basis and periodically when indicators of impairment exist, the Company also analyzes the carrying value of its goodwill using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its reporting units. The Company did not identify any properties or other assets with indicators of goodwill impairment during the three months ended March 31, 2014 and 2013.

As of both March 31, 2014 and December 31, 2013, 70.7% of the Company's outstanding debt had fixed interest rates, including the effect of an interest rate swap agreement. The Company's carrying value of its debt totaled $1.4 billion as of both March 31, 2014 and December 31, 2013. Using Level 3 measurements, including the Company's weighted average cost of debt of 5.0%, the Company estimates that the fair market value of its debt totaled $1.4 billion as of both March 31, 2014 and December 31, 2013.

The following table presents the Company's assets measured at fair value on a recurring and non-recurring basis at March 31, 2014 and December 31, 2013 (in thousands):

		Fair Value Measurements at Reporting Date		
	Total	Level 1	Level 2	Level 3
March 31, 2014 (unaudited):				
Interest rate cap derivative agreements	$ 10	$ —	$ 10	$ —
Life insurance policy (1)	1,203	—	1,203	—
Total assets at March 31, 2014	$ 1,213	$ —	$ 1,213	$ —
December 31, 2013:				
Interest rate cap derivative agreements	$ 16	$ —	$ 16	$ —
Life insurance policy (1)	1,385	—	1,385	—
Total assets at December 31, 2013	$ 1,401	$ —	$ 1,401	$ —

(1) Includes the split life insurance policy for one of the Company's former associates, which the Company has valued using Level 2 measurements. These amounts are included in other assets, net on the accompanying consolidated balance sheets, and will be used to reimburse the Company for payments made to the former associate from the related retirement benefit agreement included in accrued payroll and employee benefits on the accompanying consolidated balance sheets.

The following table presents the Company's liabilities measured at fair value on a recurring and non-recurring basis at March 31, 2014 and December 31, 2013 (in thousands):

		Fair Value Measurements at Reporting Date		
	Total	Level 1	Level 2	Level 3
March 31, 2014 (unaudited):				
Interest rate swap derivative agreement	$ 952	$ —	$ 952	$ —
Retirement benefit agreement (1)	1,203	—	1,203	—
Total liabilities at March 31, 2014	$ 2,155	$ —	$ 2,155	$ —
December 31, 2013:				
Interest rate swap derivative agreement	$ 1,066	$ —	$ 1,066	$ —
Retirement benefit agreement (1)	1,385	—	1,385	—
Total liabilities at December 31, 2013	$ 2,451	$ —	$ 2,451	$ —

(1) Includes the retirement benefit agreement for one of the Company's former associates, which the Company has valued using Level 2 measurements. The agreement calls for the balance of the retirement benefit to be paid out to the former associate in 10 annual installments, beginning in 2011. As such, the Company has paid the former associate a total of $0.8 million through March 31, 2014, which was reimbursed to the Company using funds from the related split life insurance policy. These amounts are included in accrued payroll and employee benefits on the accompanying consolidated balance sheets.

Accounts Receivable

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes, among other things, receivables from customers who utilize purchase volume rebates through BuyEfficient, as well as tenants who lease space in the Company’s hotels. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company’s accounts receivable includes an allowance for doubtful accounts of $0.2 million at both March 31, 2014 and December 31, 2013.

Acquisitions of Hotel Properties and Other Entities

Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property, equipment, intangible assets and any capital lease obligations that are assumed as part of the acquisition of a leasehold interest. During 2013, the Company used all available information to make these fair value determinations, and engaged independent valuation specialists to assist in the fair value determination of the long-lived assets acquired and the liabilities assumed in the Company’s purchases of the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco. Due to the inherent subjectivity in determining the estimated fair value of long-lived assets, the Company believes that the recording of acquired assets and liabilities is a critical accounting policy.

Assets Held for Sale

The Company considers a hotel or other asset held for sale if it is probable that the sale will be completed within twelve months and the sale represents a strategic shift that has or will have a major effect on the Company’s operations and financial results, among other requirements. A sale is determined to be probable once the buyer completes its due diligence of the asset, there is an executed purchase and sale agreement between the Company and the buyer, and the Company has received a substantial non-refundable deposit. Depreciation ceases when a property is held for sale. Should an impairment loss be required for assets held for sale, the related assets are adjusted to their estimated fair values, less costs to sell. Once a hotel or other asset is designated as held for sale, the hotel or other asset is included in discontinued operations, and operating results are removed from income from continuing operations and reported as discontinued operations. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations. As of both March 31, 2014 and December 31, 2013, the Company had no hotels or other assets held for sale.

Deferred Financing Fees

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

The Company did not incur or pay any deferred financing fees during either the three months ended March 31, 2014 or 2013.

Total amortization of deferred financing fees for the three months ended March 31, 2014 and 2013 was as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Continuing operations:		
Amortization of deferred financing fees	$ 736	$ 758
Discontinued operations:		
Amortization of deferred financing fees	—	2
Total amortization of deferred financing fees	$ 736	$ 760

Earnings Per Share

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

The Company follows the requirements of the Earnings Per Share Topic of the FASB ASC, which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. For the three months ended March 31, 2014 and 2013, distributed earnings representing nonforfeitable dividends of $0.1 million and zero, respectively, were allocated to the participating securities. For the three months ended March 31, 2014 and 2013, undistributed earnings representing nonforfeitable dividends of zero and $0.2 million, respectively, were allocated to the participating securities.

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

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

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Numerator:		

Net income (loss)	$ (3,496)	$ 28,926
Income from consolidated joint venture attributable to non-controlling interest	(2,226)	(297)
Distributions to non-controlling interest	(8)	(8)
Dividends paid on unvested restricted stock compensation	(100)	—
Preferred stock dividends and redemption charge	(2,300)	(10,903)
Undistributed income allocated to unvested restricted stock compensation	—	(218)
Numerator for basic and diluted earnings available (loss attributable) to common stockholders	$ (8,130)	$ 17,500
Denominator:		
Weighted average basic and diluted common shares outstanding	181,061	151,076
Basic and diluted earnings available (loss attributable) to common stockholders per common share	$ (0.04)	$ 0.12

The Company’s unvested restricted shares associated with its long-term incentive plan and shares associated with common stock options have been excluded from the above calculation of earnings (loss) per share for the three months ended March 31, 2014 and 2013, as their inclusion would have been anti-dilutive. Prior to their redemption in May 2013, shares of the Company’s Series C preferred stock issuable upon conversion were excluded from the above calculation of earnings per share for the three months ended March 31, 2013, as their inclusion would have been anti-dilutive.

Goodwill

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

Non-Controlling Interests

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

At both March 31, 2014 and December 31, 2013, the non-controlling interest reported in the Company's financial statements includes Hilton Worldwide's 25.0% ownership in the partnerships that own the Hilton San Diego Bayfront. In addition, the Company is the sole common stockholder of the captive REIT that owns the Doubletree Guest Suites Times Square; however, there are also preferred investors in the captive REIT whose preferred dividends less administrative fees during the three months ended March 31, 2014 and 2013 are represented as distributions to non-controlling interests on the Company's consolidated statements of operations and comprehensive income (loss).

Segment Reporting

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

3. Investment in Hotel Properties

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

	March 31, 2014 (unaudited)	December 31, 2013
Land	$ 439,304	$ 439,304
Buildings and improvements	2,986,687	2,977,458
Furniture, fixtures and equipment	422,676	414,192
Intangibles	171,889	171,889
Franchise fees	1,346	1,346
Construction in process	51,628	34,643
	4,073,530	4,038,832
Accumulated depreciation and amortization	(845,751)	(807,450)
	$ 3,227,779	$ 3,231,382

The Company acquired three hotels in 2013: the Hilton New Orleans St. Charles in May 2013; the Boston Park Plaza in July 2013; and the Hyatt Regency San Francisco in December 2013. Acquired properties are included in the Company's results of operations and comprehensive income (loss) from the date of acquisition. The following unaudited pro forma results of operations reflect the Company's results as if the acquisitions of the New Orleans St. Charles, the Boston Park Plaza, and the Hyatt Regency San Francisco had occurred on January 1, 2013. In the Company's opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made (in thousands, except per share data):

	Three Months Ended March 31, 2013 (unaudited)
Revenues	$ 227,926
Loss attributable to common stockholders from continuing operations	$ (34,404)
Loss per diluted share attributable to common stockholders from continuing operations	$ (0.23)

4. Discontinued Operations

In January 2013, the Company sold a four-hotel, 1,222-room portfolio (the “Rochester Hotels”) and a commercial laundry facility (together with the Rochester Hotels, the “Rochester Portfolio”) in Rochester, Minnesota, to an unaffiliated third party, for net proceeds of $195.6 million, of which $145.7 million was deposited with an accommodator in order to facilitate tax-deferred exchanges. The Rochester Hotels include the 660-room Kahler Grand, the 271-room Kahler Inn & Suites, the 202-room Marriott Rochester and the 89-room Residence Inn by Marriott Rochester. The Company recognized a net gain on the sale of $51.6 million. The Company retained a $25.0 million preferred equity investment (the “Preferred Equity Investment”) in the Rochester Hotels that yields an 11% dividend, resulting in a deferred gain on the sale of $25.0 million. The $25.0 million gain will be deferred until the Preferred Equity Investment is redeemed. The Preferred Equity Investment is recorded at face value on the Company’s consolidated balance sheets net of the deferred gain, resulting in a net book value of zero on the Company’s consolidated balance sheets as of both March 31, 2014 and December 31, 2013. During the three months ended March 31, 2014 and 2013, the Company recognized $0.7 million and $0.5 million, respectively, in dividends on the Preferred Equity Investment, which are included in interest and other income on the Company’s consolidated statements of operations and comprehensive income (loss). The Company also provided a $3.7 million working cash advance to the buyer, resulting in a deferred gain on the sale of $3.7 million. The $3.7 million gain will be deferred until the Company is repaid from the Rochester Portfolio’s available cash flow. The working cash advance is recorded at face value on the Company’s consolidated balance sheets net of the deferred gain, resulting in a net book value of zero on the Company’s consolidated balance sheets as of both March 31, 2014 and December 31, 2013. In addition, the Company retained a liability not to exceed $14.0 million related to the Rochester Portfolio’s pension plan, which could be triggered in certain circumstances, including termination of the pension plan. The $14.0 million pension plan liability is included in other liabilities on the Company’s consolidated balance sheets as of March 31, 2014 and December 31, 2013. The recognition of the $14.0 million pension plan liability reduced the Company’s gain on the sale of the Rochester Portfolio. The $14.0 million gain will be recognized, if at all, when and to the extent the Company is released from any potential liability related to the Rochester Portfolio’s pension plan. Concurrent with the Rochester Portfolio sale, the Company extinguished the outstanding $26.7 million mortgage secured by the Kahler Grand for a total cost of $29.8 million, prepaid the $0.4 million loan secured by the commercial laundry facility, and recorded a loss on extinguishment of debt of $3.1 million which is included in discontinued operations on the Company’s consolidated statements of operations and comprehensive income (loss). The Company reclassified the Rochester Portfolio’s results of operations for January 2013 to discontinued operations on its consolidated statements of operations and comprehensive income (loss).

The following table sets forth the discontinued operations for the three months ended March 31, 2014 and 2013 for the four hotels and the commercial laundry facility sold in 2013 (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Operating revenues	$ —	$ 3,690
Operating expenses	—	(3,686)
Interest expense	—	(99)
Loss on extinguishment of debt	—	(3,115)
Gain on sale of assets	—	51,620
Income from discontinued operations	$ —	$ 48,410

5. Interest Rate Derivative Agreements

At March 31, 2014 and December 31, 2013, the Company held two interest rate cap agreements and one interest rate swap agreement to manage its exposure to the interest rate risks related to its floating rate debt. The first interest rate cap agreement is on the Hilton San Diego Bayfront mortgage, which mortgage bears an interest rate of 3-month LIBOR plus 325 basis points. The initial interest rate cap agreement, whose strike rate was 3.75%, matured in April 2013. In April 2013, the Company purchased a new interest rate cap agreement on the Hilton San Diego Bayfront mortgage for a cost of $12,000, which extended the maturity date from April

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2013 to April 2015. The new interest rate cap agreement on the Hilton San Diego Bayfront continues to cap the 3-month LIBOR rate at 3.75%. The notional amount of the related debt capped totaled $117.0 million at both March 31, 2014 and December 31, 2013. The second interest rate cap agreement is on the Doubletree Guest Suites Times Square mortgage, which mortgage bears an interest rate of 3-month LIBOR plus 325 basis points. The Doubletree Guest Suites Times Square cap agreement caps the 3-month LIBOR rate at 4.0% until October 2015. The notional amount of the related debt capped totaled $179.1 million and $179.6 million at March 31, 2014 and December 31, 2013, respectively.

The interest rate swap agreement is on the JW Marriott New Orleans mortgage. The interest rate swap agreement caps the LIBOR interest rate on the underlying debt at a total interest rate of 5.45%, and the maturity date is in September 2015. The notional amount of the related debt totaled $39.5 million and $39.8 million at March 31, 2014 and December 31, 2013, respectively.

None of the interest rate derivative agreements qualify for effective hedge accounting treatment. Accordingly, changes in the fair value of the Company’s interest rate derivative agreements resulted in a net gain of $0.1 million for the three months ended March 31, 2014, and a net gain of $0.2 million for the three months ended March 31, 2013, which are reflected as decreases in interest expense for the three months ended March 31, 2014 and 2013. As of March 31, 2014 and December 31, 2013, the fair values of the interest rate cap agreements totaled an asset of $10,000 and $16,000, respectively. The interest rate cap agreements are included in other assets, net on the Company’s consolidated balance sheets. The fair value of the interest rate swap agreement was a liability of $1.0 million and $1.1 million as of March 31, 2014 and December 31, 2013, respectively, and is included in other liabilities on the Company’s consolidated balance sheets.

6. Other Assets

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

	March 31, 2014 (unaudited)	December 31, 2013
Property and equipment, net	$ 2,366	$ 2,478
Land held for development	188	188
Intangibles, net	7,127	7,277
Interest rate cap derivative agreements	10	16

Cash trap receivables	—	4,443
Interest receivable	237	—
Other receivables	8,391	3,942
Other	2,664	2,762
	$ 20,983	$ 21,106

Property and equipment, net consisted of the following (in thousands):

	March 31, 2014 (unaudited)	December 31, 2013
Property and equipment cost basis	$ 11,058	$ 10,933
Accumulated depreciation	(8,692)	(8,455)
Property and equipment, net	$ 2,366	$ 2,478

The Company’s other assets, net as of March 31, 2014 and December 31, 2013, include BuyEfficient’s intangible assets totaling $7.1 million and $7.3 million, respectively, net of accumulated amortization related to certain trademarks, customer and supplier relationships and intellectual property related to internally developed software. These intangibles are amortized using the straight-line method over their useful lives ranging between seven and 20 years. Accumulated amortization totaled $1.9 million and $1.8 million at March 31, 2014 and December 31, 2013, respectively, and amortization expense totaled $0.1 million for both the three months ended March 31, 2014 and 2013.

As of December 31, 2013, $4.4 million of the Company’s cash remained trapped by the lender associated with the mortgage secured by the Hilton Del Mar, which the Company sold in 2012, and whose mortgage was assumed by the buyer. In February 2014, the lender released the cash, and the entire $4.4 million was returned to the Company.

In January 2014, the Company was notified of its successful appeal of the real estate valuation for the Hilton San Diego Bayfront with the San Diego County Assessor's office. During the first quarter 2014, the Company recorded a receivable of approximately $4.4 million related to current and prior year real estate taxes based on current property tax rates.

7. Notes Payable

Notes payable consisted of the following (in thousands):

	March 31, 2014 (unaudited)	December 31, 2013
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.4% to 6.6%; maturing at dates ranging from May 2015 through May 2021. The notes are collateralized by first deeds of trust on 14 hotel properties at both March 31, 2014, and December 31, 2013.	$ 988,889	$ 993,164
Note payable requiring payments of interest and principal, bearing a blended rate of 3-month LIBOR plus 325 basis points; maturing in April 2016. The note is collateralized by a first deed of trust on one hotel property.	230,602	231,451
Note payable requiring payments of interest only through October 2013, and interest and principal thereafter, with a blended interest rate of 3-month LIBOR plus 325 basis points; maturing in October 2018. The note is collateralized by a first deed of trust on one hotel property.	178,911	179,460
Total notes payable	1,398,402	1,404,075
Less: current portion	(24,008)	(23,289)
Notes payable, less current portion	$ 1,374,394	$ 1,380,786

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

	Three Months	Three Months

	Ended March 31, 2014 (unaudited)	Ended March 31, 2013 (unaudited)
Interest expense on debt and capital lease obligations	$ 17,656	$ 16,810
Gain on derivatives, net	(109)	(157)
Accretion of Senior Notes	—	3
Amortization of deferred financing fees	736	758
	$ 18,283	$ 17,414

8. Other Current Liabilities and Other Liabilities

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

	March 31, 2014 (unaudited)	December 31, 2013
Property, sales and use taxes payable	$ 16,648	$ 14,482
Income tax payable	212	—
Accrued interest	4,224	3,078
Advance deposits	11,534	8,259
Management fees payable	769	1,077
Other	3,674	3,392
	$ 37,061	$ 30,288

Other liabilities consisted of the following (in thousands):

	March 31, 2014 (unaudited)	December 31, 2013
Deferred gain on sale of asset	$ 14,000	$ 14,000
Interest rate swap derivative agreement	952	1,066
Accrued income tax	1,503	1,491
Deferred revenue	6,791	6,918
Deferred rent	12,973	12,270
Deferred incentive management fees	1,837	1,714
Other	2,554	2,499
	$ 40,610	$ 39,958

In conjunction with the Rochester Portfolio sale, the Company retained a $14.0 million liability related to the Rochester Portfolio's pension plan, which could be triggered in certain circumstances, including termination of the pension plan. Accordingly, the Company has deferred $14.0 million of gain on the sale of the Rochester Portfolio, which $14.0 million in gain will be recognized, if at all, when and to the extent the Company is released from any potential liability related to the Rochester Portfolio's pension plan.

The Company's current liabilities include income tax payable of $0.2 million and zero as of March 31, 2014 and December 31, 2013, respectively. During the first quarter of 2014, the Company recognized combined federal and state income tax expense of $0.2 million based on 2014 projected taxable income net of operating loss carryforwards for its taxable entities, which is included in the Company's consolidated statement of operations and comprehensive income (loss).

The Company's other liabilities include accrued income tax of $1.5 million as of both March 31, 2014 and December 31, 2013. Based on the Company's ongoing evaluations of its uncertain tax positions related to the years ended December 31, 2013 and 2012, the Company adjusted for an unrecognized tax benefit of $1.5 million during the first quarter of 2013, which is included in the Company's consolidated statements of operations and comprehensive income (loss). During the first quarter of 2014, the Company accrued additional interest of $12,000 on its unrecognized tax benefit, which is included in the Company's consolidated statements of operations and comprehensive income (loss).

9. Series C Cumulative Convertible Redeemable Preferred Stock

In May 2013, the Company redeemed all 4,102,564 shares of its Series C preferred stock for an aggregate redemption price of $101.1 million, including $1.1 million in accrued dividends. In accordance with the FASB's Emerging Issues Task Force Topic D-42, an additional redemption charge of $0.1 million was recognized related to the original issuance costs of the Series C preferred stock, which were previously included in additional paid in capital. The Company redeemed the Series C preferred shares using cash received from its February 2013 common stock offering. After the redemption date, the Company has no outstanding shares of Series C preferred stock, and all rights of the holders of such shares were terminated.

10. Stockholders' Equity

Series A Cumulative Redeemable Preferred Stock

In March 2013, the Company redeemed all 7,050,000 shares of its 8.0% Series A Cumulative Redeemable Preferred Stock ("Series A preferred stock") for an aggregate redemption price of $178.6 million, including $2.3 million in accrued dividends. In accordance with the FASB's Emerging Issues Task Force Topic D-42, an additional redemption charge of $4.6 million was recognized related to the original issuance costs of the Series A preferred stock, which were previously included in additional paid in capital. The Company redeemed the Series A preferred shares using cash received from its February 2013 common stock offering. After the redemption date, the Company has no outstanding shares of Series A preferred stock, and all rights of the holders of such shares were terminated. Because the redemption of the Series A preferred stock was a redemption in full, trading of the Series A preferred stock on the New York Stock Exchange ceased after the redemption date.

Series D Cumulative Redeemable Preferred Stock

The Company's 4,600,000 shares of 8.0% Series D Cumulative Redeemable Preferred Stock ("Series D preferred stock") have a liquidation preference of $25.00 per share. On or after April 6, 2016, the Series D preferred stock will be redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of $25.00 per share, plus accrued and unpaid dividends up to, but not including, the redemption date. Upon the occurrence of a change of control of the Company, (i) the Company may, at its option, redeem the Series D preferred stock in whole or in part and within 120 days after the first date on which such change of control occurred, by paying $25.00 per share, plus any accrued and unpaid dividends to, but not including, the redemption date, and (ii) holders of Series D preferred stock will have the right (unless, prior to the change of control conversion date, the Company has provided or provides notice of its election to redeem the Series D preferred stock) to convert some or all of their shares of Series D preferred stock into shares of the Company's common stock. Holders of Series D preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series D preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series D preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company's board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series D preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. The Series D preferred stock has no maturity date and the Company is not required to redeem the Series D preferred stock at any time, unless the Company decides, at its option, to exercise its redemption right or, under circumstances where the holders of Series D preferred stock decide to convert the Series D preferred stock. If the Company does not exercise its right to redeem the Series D preferred stock upon a change of control, holders of the Series D preferred stock have the right to convert some or all of their shares into a number of the Company's common shares based on a defined formula subject to a cap of 22,571,280 common shares.

Common Stock

In February 2014, the Company entered into separate Equity Distribution Agreements (the "Agreements") with Wells Fargo Securities, LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Managers"). Under the terms of the Agreements, the Company may issue and sell from time to time through or to the Managers, as sales agents and/or principals, shares of the Company's common stock having an aggregate offering amount of up to $150.0 million. During the three months ended March 31, 2014, the Company received $1.2 million in net proceeds from the issuance of 99,460 shares of its common stock in connection with the Agreements.

In February 2013, the Company issued 25,300,000 shares of its common stock, including the underwriters' over-allotment of 3,300,000 shares, for net proceeds of approximately $294.9 million. The Company used $279.7 million of these proceeds to redeem all of its Series A preferred stock in March 2013, and all of its Series C preferred stock in May 2013, including accrued dividends, and used portions of the remaining proceeds towards the acquisitions of the Hilton New Orleans St. Charles in May 2013, and the Boston Park Plaza in July 2013.

In November 2013, the Company issued 20,000,000 shares of its common stock for net proceeds of $270.9 million. The Company used the net proceeds from this offering to purchase the Hyatt Regency San Francisco, and will use the remaining proceeds for potential future acquisitions, capital investment in the Company's portfolio and other general corporate purposes, including working capital.

11. Long-Term Incentive Plan

Stock Grants

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

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

The Company’s compensation expense and forfeitures related to these restricted shares and performance awards for the three months ended March 31, 2014 and 2013 were as follows (in thousands):

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	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Compensation expense, including forfeitures	$ 2,036	$ 1,602

The Company’s total compensation expense differs from the vesting of restricted common stock amount presented in the Company’s consolidated statement of equity due to the Company withholding and using a portion of its restricted shares granted pursuant to its LTIP for purposes of remitting withholding and payroll taxes in connection with the release of restricted common shares to plan participants (“net-settle”). In addition, the Company capitalizes all restricted shares granted to certain of those employees who work on the design and construction of its hotels. The Company’s total compensation expense in relation to its vesting of restricted common stock presented in the Company’s consolidated statement of equity for the three months ended March 31, 2014 is as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)
Compensation expense, including forfeitures	$ 2,036
Net-settle adjustment	(664)
Amortization related to shares issued to design and construction employees (1)	114
Vesting of restricted stock presented on statement of equity	$ 1,486

(1) Amortization related to shares issued to design and construction employees is not included in compensation expense because the Company capitalizes all restricted shares granted to certain of those employees who work on the design and construction of its hotels.

12. Commitments and Contingencies

Management Agreements

Management agreements with the Company's third-party hotel managers require the Company to pay between 2% and 3.5% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. Total basic management fees incurred by the Company during the three months ended March 31, 2014 and 2013 were included in the Company's consolidated statements of operations and comprehensive income (loss) as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Continuing operations — property general and administrative expense, and corporate overhead expense	$ 6,713	$ 5,355
Discontinued operations	—	65
	$ 6,713	$ 5,420

In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers. Total incentive management fees incurred by the Company during the three months ended March 31, 2014 and 2013 were included in the Company's consolidated statements of operations and comprehensive income (loss) as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Continuing operations — property general and administrative expense	$ 1,032	$ 804

License and Franchise Agreements

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

Total license and franchise costs incurred by the Company during the three months ended March 31, 2014 and 2013 were included in the Company’s consolidated statements of operations and comprehensive income (loss) as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Continuing operations — franchise costs	$ 8,077	$ 6,478
Discontinued operations	—	73
	$ 8,077	$ 6,551

Total license and franchise costs included royalties of $2.5 million and $2.2 million incurred by the Company during the three months ended March 31, 2014 and 2013, respectively. The remaining costs included advertising, reservation and priority club assessments.

Renovation and Construction Commitments

At March 31, 2014, the Company had various contracts outstanding with third parties in connection with the renovation of certain of its hotel properties aimed at maintaining the appearance and quality of its hotels. The remaining commitments under these contracts at March 31, 2014 totaled $49.5 million.

Capital Leases

The Hyatt Chicago Magnificent Mile is subject to a building lease which expires in December 2097. Upon acquisition of the hotel in June 2012, the Company evaluated the terms of the lease agreement and determined the lease to be a capital lease pursuant to the Leases Topic of the FASB ASC.

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

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

	March 31, 2014 (unaudited)	December 31, 2013
Buildings and improvements	$ 58,799	$ 58,799
Furniture, fixtures and equipment	104	104
	58,903	58,903
Accumulated depreciation	(2,627)	(2,356)
	$ 56,276	$ 56,547

Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of March 31, 2014 are as follows (in thousands):

2014	$ 1,437
2015	1,403
2016	1,403
2017	1,403
2018	1,403
Thereafter	110,465
Total minimum lease payments (1)	117,514
Less: Amount representing interest (2)	(101,902)
Present value of net minimum lease payments (3)	$ 15,612

(1)Minimum lease payments do not include percentage rent which may be paid under the Hyatt Chicago Magnificent Mile building lease on the basis of 4.0% of the hotel's gross room revenues over a certain threshold. No percentage rent was due for the three months ended March 31, 2014 and 2013.

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

(3)The present value of net minimum lease payments are presented on the Company's consolidated balance sheets as current obligations of $35,000 and as long term obligations of $15.6 million as of both March 31, 2014 and December 31, 2013. The current obligations are included in accounts payable and accrued expenses, and the long-term obligations are included in capital lease obligations, less current portion.

Ground, Building and Air Leases

Total rent expense incurred pursuant to ground, building and air lease agreements for the three months ended March 31, 2014 and 2013 was included in the Company's consolidated statements of operations and comprehensive income (loss) as follows (in thousands):

	Three Months Ended March 31, 2014 (unaudited)	Three Months Ended March 31, 2013 (unaudited)
Continuing operations — property tax, ground lease and insurance	$ 4,456	$ 4,231

Rent expense incurred pursuant to leases on the corporate facility totaled $0.1 million for both the three months ended March 31, 2014 and 2013, and was included in corporate overhead expense.

Concentration of Risk

The concentration of the Company's hotels in California, New York, Illinois, Massachusetts and the greater Washington DC area exposes the Company's business to economic conditions, competition and real and personal property tax rates unique to these locales. As of March 31, 2014, the Company's 29 hotels were concentrated in California, New York, Illinois, Massachusetts and the greater Washington DC area as follows:

	California	Greater Washington DC