Sunstone Hotel Investors, Inc.
Form 10-Q
November 06, 2018
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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 September 30, 2018

OR

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

For the transition period from to

Commission file number 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	20-1296886 (I.R.S. Employer Identification Number)
200 Spectrum Center Drive, 21st Floor Irvine, California (Address of Principal Executive Offices)	 92618 (Zip Code)

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

120 Vantis, Suite 350
Aliso Viejo, California 92656
(Former Name, Former Address and Former Fiscal Year, if changed since last report)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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

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

228,247,062 shares of Common Stock, $0.01 par value, as of November 1, 2018

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SUNSTONE HOTEL INVESTORS, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended September 30, 2018

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PART I—FINANCIAL INFORMATION

Item 1.Financial Statements

SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 650,691	$ 488,002
Restricted cash	68,794	71,309
Accounts receivable, net	44,330	34,219
Inventories	1,055	1,323
Prepaid expenses	11,790	10,464
Assets held for sale, net	33,312	122,807
Total current assets	809,972	728,124
Investment in hotel properties, net	3,073,622	3,106,066
Deferred financing costs, net	524	1,305
Other assets, net	34,495	22,317
Total assets	$ 3,918,613	$ 3,857,812
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 34,844	$ 31,810
Accrued payroll and employee benefits	21,196	26,687
Dividends and distributions payable	14,620	133,894
Other current liabilities	47,390	44,502
Current portion of notes payable, net	5,913	5,477
Liabilities of assets held for sale	3,459	189
Total current liabilities	127,422	242,559
Notes payable, less current portion, net	972,814	977,282
Capital lease obligations, less current portion	26,956	26,804
Other liabilities	30,981	28,989
Total liabilities	1,158,173	1,275,634
Commitments and contingencies (Note 11)		
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized:		

6.95% Series E Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at September 30, 2018 and December 31, 2017, stated at liquidation preference of $25.00 per share	115,000	115,000
6.45% Series F Cumulative Redeemable Preferred Stock, 3,000,000 shares issued and outstanding at September 30, 2018 and December 31, 2017, stated at liquidation preference of $25.00 per share	75,000	75,000
Common stock, $0.01 par value, 500,000,000 shares authorized, 228,247,062 shares issued and outstanding at September 30, 2018 and 225,321,660 shares issued and outstanding at December 31, 2017	2,282	2,253
Additional paid in capital	2,726,523	2,679,221
Retained earnings	1,106,391	932,277
Cumulative dividends and distributions	(1,313,741)	(1,270,013)
Total stockholders' equity	2,711,455	2,533,738
Noncontrolling interest in consolidated joint venture	48,985	48,440
Total equity	2,760,440	2,582,178
Total liabilities and equity	$ 3,918,613	$ 3,857,812

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
REVENUES				
Room	$ 207,657	$ 215,768	$ 608,237	$ 629,788
Food and beverage	63,911	68,821	217,469	222,943
Other operating	17,740	19,320	52,495	50,717
Total revenues	289,308	303,909	878,201	903,448
OPERATING EXPENSES				
Room	53,928	54,433	159,923	160,282
Food and beverage	46,260	49,262	147,299	150,768
Other operating	4,190	4,256	12,488	12,120
Advertising and promotion	13,593	14,953	41,815	44,810
Repairs and maintenance	10,530	12,882	32,484	34,645
Utilities	8,084	8,331	22,533	22,844
Franchise costs	9,167	9,431	26,981	27,367
Property tax, ground lease and insurance	20,369	21,399	63,658	63,477
Other property-level expenses	31,580	34,511	101,005	105,015
Corporate overhead	7,360	7,233	22,056	21,585
Depreciation and amortization	36,159	39,719	110,181	120,051
Impairment loss	—	34,427	1,394	34,427
Total operating expenses	241,220	290,837	741,817	797,391
Operating income	48,088	13,072	136,384	106,057
Interest and other income	2,592	1,027	7,049	2,597
Interest expense	(11,549)	(17,008)	(31,609)	(41,341)
Loss on extinguishment of debt	—	—	—	(4)
Gain on sale of assets	53,128	—	68,787	45,474
Income (loss) before income taxes and discontinued operations	92,259	(2,909)	180,611	112,783
Income tax (provision) benefit, net	(673)	12,991	692	12,541
Income from continuing operations	91,586	10,082	181,303	125,324
Income from discontinued operations	—	7,000	—	7,000
NET INCOME	91,586	17,082	181,303	132,324
Income from consolidated joint venture attributable to noncontrolling interest	(2,376)	(2,169)	(7,189)	(6,344)
Preferred stock dividends	(3,208)	(3,208)	(9,622)	(9,622)
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ 86,002	$ 11,705	$ 164,492	$ 116,358
Basic and diluted per share amounts:				
	$ 0.38	$ 0.02	$ 0.73	$ 0.49

Income from continuing operations attributable to common stockholders				
Income from discontinued operations	—	0.03	—	0.03
Basic and diluted income attributable to common stockholders per common share	$ 0.38	$ 0.05	$ 0.73	$ 0.52
Basic and diluted weighted average common shares outstanding	227,068	224,142	225,538	221,140
Distributions declared per common share	$ 0.05	$ 0.05	$ 0.15	$ 0.15

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENT OF EQUITY

(In thousands, except share and per share data)

referred Stock eries E umber f hares	Amount	Series F Number of Shares	Amount	Common Stock Number of Shares	Amount	Additional Paid in Capital	Retained Earnings	Cumulative Dividends and Distributions	N I C
600,000	$ 115,000	3,000,000	$ 75,000	225,321,660	$ 2,253	$ 2,679,221	$ 932,277	$ (1,270,013)	$
—	—	—	—	2,590,854	26	44,315	—	—	
—	—	—	—	334,548	3	2,987	—	—	
—	—	—	—	—	—	—	—	(34,106)	
—	—	—	—	—	—	—	—	(5,994)	
—	—	—	—	—	—	—	—	(3,628)	
—	—	—	—	—	—	—	—	—	
—	—	—	—	—	—	—	174,114	—	
600,000	$ 115,000	3,000,000	$ 75,000	228,247,062	$ 2,282	$ 2,726,523	$ 1,106,391	$ (1,313,741)	$

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 181,303	$ 132,324
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	682	503
Gain on sale of assets, net	(68,740)	(52,736)
Loss on extinguishment of debt	—	4
Noncash interest on derivatives and capital lease obligations, net	(4,995)	4,883
Depreciation	108,744	118,069
Amortization of franchise fees and other intangibles	1,468	2,386
Amortization of deferred financing costs	2,240	1,734
Amortization of deferred stock compensation	6,938	6,188
Impairment loss	1,394	34,427
(Gain) loss on hurricane-related damage	(1,100)	201
Deferred income taxes, net	(1,100)	(13,628)
Changes in operating assets and liabilities:		
Accounts receivable	(10,450)	(5,541)
Inventories	73	71
Prepaid expenses and other assets	750	(13)
Accounts payable and other liabilities	6,928	4,387
Accrued payroll and employee benefits	(4,599)	(2,883)
Net cash provided by operating activities	219,536	230,376
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of assets	231,083	150,171
Disposition deposit	3,000	—
Proceeds from property insurance	1,100	—
Acquisitions of hotel property and other assets	(15,147)	(173,917)
Acquisitions of intangible assets	(18,516)	—
Renovations and additions to hotel properties and other assets	(125,854)	(81,470)
Payment for interest rate derivative	—	(19)
Net cash provided by (used in) investing activities	75,666	(105,235)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from common stock offerings	45,125	79,407
Payment of common stock offering costs	(784)	(1,475)
Repurchase of common stock for employee withholding obligations	(4,232)	(3,793)
Proceeds from notes payable	—	240,000
Payments on notes payable	(5,486)	(183,797)
Payments of deferred financing costs	(5)	(13)
Dividends and distributions paid	(163,002)	(148,540)

Distributions to noncontrolling interest	(6,644)	(6,325)
Net cash used in financing activities	(135,028)	(24,536)
Net increase in cash and cash equivalents and restricted cash	160,174	100,605
Cash and cash equivalents and restricted cash, beginning of period	559,311	437,460
Cash and cash equivalents and restricted cash, end of period	$ 719,485	$ 538,065

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Supplemental Disclosure of Cash Flow Information

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

	September 30,	
	2018	2017
Cash and cash equivalents	$ 650,691	$ 466,519
Restricted cash	68,794	71,546
Total cash and cash equivalents and restricted cash shown on the consolidated statements of cash flows	$ 719,485	$ 538,065

The Company paid the following amounts for interest and income taxes, during the nine months ended September 30, 2018 and 2017:

	Nine Months Ended September 30,	
	2018	2017
Cash paid for interest	$ 36,396	$ 32,587
Cash paid for income taxes	$ 571	$ 864

Supplemental Disclosure of Noncash Investing and Financing Activities

The Company’s noncash investing and financing activities during the nine months ended September 30, 2018 and 2017 consisted of the following:

	Nine Months Ended September 30,	
	2018	2017
Increase (decrease) in accounts payable related to renovations and additions to hotel properties and other assets	$ 592	$ (5,891)
Amortization of deferred stock compensation — construction activities	$ 284	$ 356
Dividends and distributions payable	$ 14,620	$ 14,474

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sunstone Hotel Investors, Inc. (the "Company") was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company, 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. The Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company's hotels, in transactions that are intended to generate qualifying income. As of September 30, 2018, the Company had interests in 24 hotels (the "24 hotels"), two of which were considered held for sale, leaving 22 hotels currently held for investment (the "22 hotels"). The Company's third-party managers included the following:

	Number of Hotels	
Subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, "Marriott")	9	
Interstate Hotels & Resorts, Inc.	4	(1)
Highgate Hotels L.P. and an affiliate	3	
Crestline Hotels & Resorts	2	
Hilton Worldwide	2	
Davidson Hotels & Resorts	1	
HEI Hotels & Resorts	1	
Hyatt Corporation	1	
Singh Hospitality, LLC	1	
Total hotels owned as of September 30, 2018	24	

(1) The Hilton North Houston and the Marriott Houston (the "Houston hotels"), both located in Texas, were considered held for sale as of September 30, 2018, and subsequently sold on October 17, 2018.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of September 30, 2018 and December 31, 2017, and for the three and nine months ended September 30, 2018 and 2017, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their controlled subsidiaries. All significant intercompany balances and transactions have been eliminated. If the Company determines that it has an interest in a variable interest entity, the Company will consolidate the entity when it is determined to be the primary beneficiary of the entity.

The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and in conformity with the rules and regulations of the Securities and Exchange Commission. In the Company's opinion, the interim financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim financial statements. These financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission on February 14, 2018. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

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

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

Use of Estimates

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

Earnings Per Share

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

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	$ 91,586	$ 17,082	$ 181,303	$ 132,324
Income from consolidated joint venture attributable to noncontrolling interest	(2,376)	(2,169)	(7,189)	(6,344)
Preferred stock dividends	(3,208)	(3,208)	(9,622)	(9,622)
Distributions paid on unvested restricted stock compensation	(59)	(59)	(177)	(179)
Undistributed income allocated to unvested restricted stock compensation	(385)	(2)	(689)	(440)
Numerator for basic and diluted income attributable to common stockholders	$ 85,558	$ 11,644	$ 163,626	$ 115,739
Denominator:				
Weighted average basic and diluted common shares outstanding	227,068	224,142	225,538	221,140
Basic and diluted income attributable to common stockholders per common share	$ 0.38	$ 0.05	$ 0.73	$ 0.52

The Company’s unvested restricted shares associated with its long-term incentive plan and shares associated with common stock options, as applicable, have been excluded from the above calculation of earnings per share for the three and nine months ended September 30, 2018 and 2017, as their inclusion would have been anti-dilutive.

New Accounting Standards and Accounting Changes

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU No. 2014-09”). The core principle of ASU No. 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an

entity applies a five-step model: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

In March 2016, the FASB clarified the principal versus agent guidance in ASU No. 2014-09 with its issuance of Accounting Standards Update No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)" ("ASU No. 2016-08"). In particular, ASU No. 2016-08 clarifies how an entity should identify the unit of accounting for the principal versus agent evaluation and how it should apply the control principle to certain types of arrangements, such as service transactions by explaining what a principal controls before the specified good or service is transferred to the customer. In addition, ASU No. 2016-08 reframes the indicators to focus on evidence that an entity is acting as a principal rather than as an agent.

In May 2016, the FASB amended ASU No. 2014-09's guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes with its issuance of Accounting Standards Update No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients" ("ASU No. 2016-12"). The amendments clarify that, for a contract to be considered completed at transition, all (or substantially all) of the revenue must have been recognized under legacy GAAP. This clarification is important because entities that use the modified retrospective transition approach need to apply the standard only to contracts that are not complete as of the date of initial application, and entities that use the full retrospective approach may apply certain practical expedients to completed contracts. In addition, ASU No. 2016-12 clarifies that an entity should consider the probability of collecting substantially all of the consideration to which it will be entitled in exchange for goods and services expected to be transferred to the customer rather than the total amount promised for all the goods or services in the contract. ASU No. 2016-12 also clarifies that an entity may consider its ability to manage its exposure to credit risk as part of the collectability assessment, as well as that the fair value of noncash consideration should be measured at contract inception when determining the transaction price. Finally, ASU No. 2016-12 allows an entity to make an accounting policy election to exclude from the transaction price certain types of taxes collected from a customer if it discloses that policy.

The Company adopted ASU No. 2014-09, along with the related clarifications and amendments in ASU No. 2016-08 and ASU No. 2016-12, in January 2018, using the modified retrospective approach to contracts that were not complete as of January 1, 2018. Due to the short-term nature of the Company's revenue streams, the adoption of ASU No. 2014-09 did not have a material impact on the amount and timing of revenue recognized from rooms, food and beverage and other ancillary hotel services. In addition, the Company determined that presenting its revenue streams disaggregated into the categories of rooms, food and beverage, and other on its consolidated statements of operations depicts how the nature, timing and uncertainty of revenue and cash flows are affected by economic factors, and that no further disaggregation is needed. See Revenue Recognition in Note 2 for additional disclosures.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, "Leases (Topic 842)" ("ASU No. 2016-02"), which will require lessees to put most leases on their balance sheets but recognize expenses in the income statement in a manner similar to today's accounting. A lessee will be required to record a right-of-use asset and a lease liability for all leases with a term greater than 12 months regardless of their classification. Leases with a term of 12

months or less will be accounted for similarly to existing guidance for operating leases today. ASU No. 2016-02 also eliminates existing real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. All entities will classify leases to determine how to recognize lease-related revenue and expense. Classification will continue to affect amounts that lessors record on the balance sheet. ASU No. 2016-02 will become effective during the first quarter of 2019, and initially required a modified retrospective approach for leases that exist or are entered into after the date of initial application, with an option to use certain transition relief.

In January 2018, the FASB issued Accounting Standards Update No. 2018-01, "Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842" ("ASU No. 2018-01"), which allows a company to elect a practical expedient regarding land easements. By electing this practical expedient, the Company will not be required to reassess whether a land easement not previously accounted for as a lease would now be a lease.

In July 2018, the FASB issued Accounting Standards Update No. 2018-10, "Codification Improvements to Topic 842, Leases" ("ASU No. 2018-10") and Accounting Standards Update No. 2018-11, "Leases (Topic 842): Targeted Improvements" ("ASU No. 2018-11"), both of which provide practical expedients that the Company intends to adopt. By adopting these practical expedients, the Company will not be required to reassess (i) whether an expired or existing contract meets the definition of a lease; (ii) the lease classification at the adoption date for existing leases; and (iii) whether costs previously capitalized as initial direct costs would continue to be amortized. In addition, the Company intends to adopt the lessor practical expedient provided by ASU No. 2018-11 whereby lessors, by class of underlying asset, will not be required to separate nonlease components from the associated lease component, if certain conditions are met. The Company does not intend to elect the hindsight practical expedient. ASU No. 2018-11 also adds a transition option to the new leases standard that allows entities to apply the transition provisions of the new standard at its adoption date instead of the earliest comparative period presented in its financial statements. The Company is creating an inventory of its leases and is analyzing its current ground lease obligations. The Company is evaluating the impact that ASU No. 2016-02, as well

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as the FASB's transition option, will have on its consolidated financial statements, and, other than the inclusion of operating leases on the Company's balance sheet, such effects have not yet been determined.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)" ("ASU No. 2016-18"), which requires entities to show the changes in total cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the guidance requires a reconciliation of the totals in the statement of cash flows to the related caption in the balance sheet. The Company adopted ASU No. 2016-18 in January 2018. As a result, amounts included in restricted cash on the Company's consolidated balance sheet are included with cash and cash equivalents on the consolidated statement of cash flows. A reconciliation of the totals in the statement of cash flows to the related caption in the balance sheet has been added as a supplemental disclosure to the Company's consolidated statements of cash flows. The adoption of this standard did not change the Company's balance sheet presentation.

In January 2017, the FASB issued Accounting Standards Update No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" ("ASU No. 2017-01"), which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. Under the new guidance, an entity first determines whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the set of transferred assets and activities is not a business. If it is not met, the entity then evaluates whether the set meets the requirement that a business include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The Company adopted ASU No. 2017-01 in January 2018. The Company will analyze future hotel acquisitions and sales to determine if the transaction qualifies as the purchase or disposition of a business or an asset. Transaction costs associated with asset acquisitions will be capitalized, while the same costs associated with a business combination will continue to be expensed as incurred. In addition, asset acquisitions will not be subject to a measurement period, as are business combinations. Depending on the Company's conclusion, ASU No. 2017-01 may have an effect on its consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" ("ASU No. 2017-04"), which eliminates the requirement to calculate the implied fair value of goodwill (i.e., Step 2 of today's goodwill impairment test) to measure a goodwill impairment charge. Under the new guidance, if a reporting unit's carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit. The standard does not change the guidance on completing Step 1 of the goodwill impairment test. An entity will still be able to perform today's optional qualitative goodwill impairment assessment before determining whether to proceed to Step 1. ASU No. 2017-04 will become effective in the first quarter of 2019, with early adoption permitted, and the guidance is to be applied prospectively. The Company elected to early adopt ASU No. 2017-04 in January 2018, with no material impact on its consolidated financial statements.

In May 2017, the FASB issued Accounting Standards Update No. 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU No. 2017-09"), which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance will allow companies to make certain changes to awards without accounting for them as modifications, but it does not change the accounting for modifications. Under ASU No. 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: the award's fair value (or calculated or intrinsic value, if those measurement methods are used); the award's vesting conditions; and the award's classification as an equity or liability instrument. The Company adopted ASU No. 2017-09 in January 2018 with no impact to its consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement" ("ASU No. 2018-13"), which eliminates, adds and modifies certain disclosure requirements for fair value measurements. Entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements in addition to a narrative description of the uncertainty of significant Level 3 fair value measurements as of the reporting date. ASU No. 2018-13 will become effective in the first quarter of 2020, with early adoption permitted of either the entire standard or only the provisions that eliminate or modify the requirements. The guidance on changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 measurements, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty is applied prospectively. All other amendments should be applied retrospectively. The Company adopted ASU No. 2018-13 in its entirety in September 2018 with no impact to its consolidated financial statements.

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Noncontrolling Interest

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

At both September 30, 2018 and December 31, 2017, the noncontrolling interest reported in the Company's financial statements consisted of a third-party's 25.0% ownership interest in the Hilton San Diego Bayfront.

Property and Equipment

Impairment losses are recorded on long-lived assets to be held and used by the Company when indicators of impairment are present and the future undiscounted net cash flows expected to be generated by those assets, based on the Company's expected investment horizon, are less than the assets' carrying amount. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment is recognized. The impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. In computing fair value, the Company uses a discounted cash flow analysis to estimate the fair value of its hotel properties, taking into account each property's expected cash flow from operations, the Company's estimate of how long it will continue to own each property 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.

Revenue Recognition

Revenues are recognized when control of the promised goods or services is transferred to hotel guests, which is generally defined as the date upon which a guest occupies a room and/or utilizes the hotel's services. Room revenue is recognized over a guest's stay at a previously agreed upon daily rate. Additionally, some of the Company's hotel rooms are booked through independent internet travel intermediaries. If the guest pays the independent internet travel intermediary directly, revenue for the room is booked by the Company at the price the Company sold the room to the independent internet travel intermediary, less any discount or commission paid. If the guest pays the Company directly, revenue for the room is booked by the Company on a gross basis. A majority of the Company's hotels

participate in frequent guest programs sponsored by the hotel brand owners whereby the hotel allows guests to earn loyalty points during their hotel stay. The Company expenses charges associated with these programs as incurred, and recognizes revenue at the amount it will receive from the brand when a guest redeems their loyalty points by staying at one of the Company's hotels. In addition, some contracts for rooms or food and beverage services require an advance deposit, which the Company records as deferred revenue (or a contract liability) and recognizes once the performance obligations are satisfied.

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

Additionally, the Company collects sales, use, occupancy and other similar taxes at its hotels, which the Company presents on a net basis (excluded from revenues) in its consolidated statements of operations.

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

	September 30, 2018 (unaudited)	December 31, 2017
Trade receivables, net (1)	$ 20,445	$ 20,773
Contract liabilities (2)	$ 18,700	$ 13,454

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

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(2) Contract liabilities consist of advance deposits, and are included in other current liabilities on the accompanying consolidated balance sheets. Of the amount outstanding at December 31, 2017, approximately $1.0 million and $12.5 million was recognized in revenue during the three and nine months ended September 30, 2018, respectively.

Segment Reporting

The Company considers each of its hotels to be an operating segment, none of which meets the threshold for a separate reportable segment. Currently, the Company operates in one reportable segment, hotel ownership.

3. Investment in Hotel Properties

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

	September 30, 2018 (unaudited)	December 31, 2017
Land	$ 615,641	$ 605,054
Buildings and improvements	3,013,659	3,049,569
Furniture, fixtures and equipment	489,153	484,749
Intangible assets	55,994	48,371
Franchise fees	778	980
Construction in progress	76,041	54,280
Investment in hotel properties, gross	4,251,266	4,243,003
Accumulated depreciation and amortization	(1,177,644)	(1,136,937)
Investment in hotel properties, net	$ 3,073,622	$ 3,106,066

In May 2018, the Company paid $18.4 million, including closing costs, to acquire the exclusive perpetual rights to use portions of the Renaissance Washington DC building that the Company had previously leased from an unaffiliated third party (the “Element”).

In May 2018 and August 2018, the Company paid a total of $0.1 million, including closing costs, to acquire three additional dry boat slips at the Oceans Edge Resort & Marina. Both the dry boat slips and the Element have indefinite useful lives, and, therefore, are not amortized. These non-amortizable intangible assets will be reviewed annually for impairment and more frequently if events or circumstances indicate that the assets may be impaired.

In July 2018, the Company purchased the land underlying the JW Marriott New Orleans for $15.1 million, including closing costs. Prior to this purchase, the Company leased the land from an unaffiliated third party.

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4. Disposals

Held for Sale

The Company classified the Houston hotels as held for sale at September 30, 2018, and subsequently sold the hotels in October 2018 (see Note 12). The sale did not represent a strategic shift that had a major impact on the Company's business plan or its primary markets; therefore, the sale did not qualify as a discontinued operation. The Company classified the assets and liabilities of the Houston hotels as held for sale at September 30, 2018 as follows (in thousands):

	September 30, 2018
Accounts receivable	$ 1,013
Inventories	149
Prepaid expenses	139
Investment in hotel properties, net	31,957
Other assets	54
Assets held for sale, net	$ 33,312
Accounts payable and accrued expenses	$ 628
Accrued payroll and employee benefits	892
Other current liabilities	1,920
Other liabilities	19
Liabilities of assets held for sale	$ 3,459

Disposals

In July 2018, the Company sold the Hyatt Regency Newport Beach, California, for net proceeds of $94.0 million, and recognized a net gain on the sale of $53.1 million. In January 2018, the Company sold the Marriott Philadelphia and the Marriott Quincy, located in Pennsylvania and Massachusetts, respectively, for net proceeds of $137.0 million. The Company recognized a net gain on the sale of $15.7 million. None of these sales qualified as a disposition of a business. In addition, none of the sales represented a strategic shift that had a major impact on the Company's business plan or its primary markets; therefore, none of these sales qualified as a discontinued operation.

The Company classified the assets and liabilities of both the Marriott Philadelphia and the Marriott Quincy as held for sale at December 31, 2017 as follows (in thousands):

	December 31, 2017	
Accounts receivable	$	1,676
Prepaid expenses		193
Investment in hotel properties, net		120,916
Other assets		22
Assets held for sale, net	$	122,807
Accounts payable and accrued expenses	$	69
Other current liabilities		41
Other liabilities		79
Liabilities of assets held for sale	$	189

The following table provides summary unaudited results of operations for the Hyatt Regency Newport Beach, the Marriott Philadelphia and the Marriott Quincy, all of which were sold in the first nine months of 2018, along with the Fairmont Newport Beach and the Marriott Park City, both of which were sold in 2017, which are included in continuing operations for their respective ownership periods (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues	$ 982	$ 24,005	$ 20,975	$ 77,750
Income before income taxes	$ 84	$ 4,391	$ 2,376	$ 13,250
Gain on sale of assets	$ 53,128	$ —	$ 68,787	$ 45,474

5. Fair Value Measurements and Interest Rate Derivatives

Fair Value of Financial Instruments

As of September 30, 2018 and December 31, 2017, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

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

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

As of September 30, 2018 and December 31, 2017, the only financial instruments that the Company measures at fair value on recurring bases are its interest rate derivatives, along with a life insurance policy and a related retirement benefit agreement. The Company estimates the fair value of its interest rate derivatives using Level 2 measurements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. Both the life insurance policy and the related retirement benefit agreement, which are for a former Company associate, are valued using Level 2 measurements.

During the second quarter of 2018, the Company identified indicators of impairment due to continued weakness in the Houston market, and reviewed the Houston hotels for possible impairment. Using Level 3 measurements, including each hotel’s undiscounted cash flow, which took into account each hotel’s expected cash flow from operations, anticipated holding period and estimated proceeds from disposition, the Company determined that neither hotel’s

carrying value was fully recoverable. As such, the Company recorded an impairment charge of $1.4 million on the Houston hotels, which is included in impairment loss on the Company’s consolidated statements of operations for the nine months ended September 30, 2018. The assets and liabilities of the Houston hotels have been classified by the Company as held for sale as of September 30, 2018 due to the sale of the hotels in October 2018 (see Note 12).

The following table presents the Company’s assets measured at fair value on a recurring and nonrecurring basis at September 30, 2018 and December 31, 2017 (in thousands):

		Fair Value Measurements at Reporting Date		
	Total	Level 1	Level 2	Level 3
September 30, 2018 (unaudited):				
Interest rate cap derivatives	$ 1	$ —	$ 1	$ —
Interest rate swap derivatives	8,540	—	8,540	—
Life insurance policy (1)	405	—	405	—
Total assets measured at fair value at September 30, 2018	$ 8,946	$ —	$ 8,946	$ —
December 31, 2017:				
Houston hotels, net	$ 34,473	$ —	—	$ 34,473
Interest rate cap derivatives	4	—	4	—
Interest rate swap derivatives	3,390	—	3,390	—
Life insurance policy (1)	645	—	645	—
Total assets measured at fair value at December 31, 2017	$ 38,512	$ —	$ 4,039	$ 34,473

(1) Includes the split life insurance policy for a former Company associate. 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

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former associate from the related retirement benefit agreement, which is 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 nonrecurring basis at September 30, 2018 and December 31, 2017 (in thousands):

		Fair Value Measurements at Reporting Date		
	Total	Level 1	Level 2	Level 3
September 30, 2018 (unaudited):				
Retirement benefit agreement (1)	$ 405	$ —	$ 405	$ —
Total liabilities measured at fair value at September 30, 2018	$ 405	$ —	$ 405	$ —
December 31, 2017:				
Retirement benefit agreement (1)	$ 645	$ —	$ 645	$ —
Total liabilities measured at fair value at December 31, 2017	$ 645	$ —	$ 645	$ —

(1) Includes the retirement benefit agreement for a former Company associate. The agreement calls for the balance of the retirement benefit to be paid out to the former associate in ten annual installments, beginning in 2011. The Company has paid the former associate a total of $1.6 million through September 30, 2018, which was reimbursed to the Company using funds from the related split life insurance policy noted above. These amounts are included in accrued payroll and employee benefits on the accompanying consolidated balance sheets.

Interest Rate Derivatives

The Company's interest rate derivatives, which are not designated as effective cash flow hedges, consisted of the following at September 30, 2018 (unaudited) and December 31, 2017 (in thousands):

							Estimated Fair Value of Assets	
Hedged Debt	Type	Strike / Capped Rate	Index	Effective Date	Maturity Date	Notional Amount	September 30, 2018	December 31, 2017
Hilton San Diego Bayfront (1)	Cap	4.250 %	1-Month LIBOR	May 1, 2017	May 1, 2019	$ 108,401	$ —	$ —

Hilton San Diego Bayfront (1)	Cap	6.000 %	1-Month LIBOR	November 10, 2017	December 9, 2020	$ 220,000	1	4
$85.0 million term loan (2)	Swap	3.391 %	1-Month LIBOR	October 29, 2015	September 2, 2022	$ 85,000	4,179	2,010
$100.0 million term loan (3)	Swap	3.653 %	1-Month LIBOR	January 29, 2016	January 31, 2023	$ 100,000	4,361	1,380
							$ 8,541	$ 3,394

(1) In November 2017, the Company refinanced the existing loan secured by the Hilton San Diego Bayfront. Coterminous with the loan refinance, the Company purchased a new interest rate cap agreement with a strike rate of 6.0% and an expiration date in December 2020. The fair values of both Hilton San Diego Bayfront cap agreements are included in other assets, net on the accompanying consolidated balance sheets as of both September 30, 2018 and December 31, 2017.
(2) The fair value of the $85.0 million term loan swap agreement is included in other assets, net on the Company's consolidated balance sheets as of both September 30, 2018 and December 31, 2017. The 1-month LIBOR rate was swapped to a fixed rate of 1.591%.
(3) The fair value of the $100.0 million term loan swap agreement is included in other assets, net on the Company's consolidated balance sheets as of both September 30, 2018 and December 31, 2017. The 1-month LIBOR rate was swapped to a fixed rate of 1.853%.

Noncash changes in the fair values of the Company's interest rate derivatives resulted in (decreases) increases to interest expense for the three and nine months ended September 30, 2018 and 2017 as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Noncash interest on derivatives	$ (870)	$ (44)	$ (5,147)	$ 305

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Fair Value of Debt

As of September 30, 2018 and December 31, 2017, 77.7% and 77.8%, respectively, of the Company's outstanding debt had fixed interest rates, including the effects of interest rate swap agreements. The Company uses Level 3 measurements to estimate the fair value of its debt by discounting the future cash flows of each instrument at estimated market rates.

The Company's principal balances and fair market values of its consolidated debt as of September 30, 2018 (unaudited) and December 31, 2017 were as follows (in thousands):

	September 30, 2018		December 31, 2017	
	Carrying Amount (1)	Fair Value	Carrying Amount (1)	Fair Value
Debt	$ 984,916	$ 985,938	$ 990,402	$ 997,922

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

6. Other Assets

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

	September 30, 2018 (unaudited)	December 31, 2017
Property and equipment, net	$ 8,591	$ 584
Goodwill	990	990
Deferred expense on straight-lined third-party tenant leases	3,211	3,351
Deferred income tax asset	10,600	9,492
Interest rate derivatives	8,541	3,394
Other receivables	1,550	3,136
Other	1,012	1,370
Total other assets, net	$ 34,495	$ 22,317

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7. Notes Payable

Notes payable consisted of the following (in thousands):

	September 30, 2018 (unaudited)	December 31, 2017
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.12% to 5.95%; maturing at dates ranging from November 2020 through January 2025. The notes are collateralized by first deeds of trust on four hotel properties at both September 30, 2018 and December 31, 2017.	$ 339,916	$ 345,402
Note payable requiring payments of interest only, bearing a blended rate of one-month LIBOR plus 105 basis points; maturing in December 2020 with three one-year extensions. The note is collateralized by a first deed of trust on one hotel property.	220,000	220,000
Unsecured term loan requiring payments of interest only, with a blended interest rate based on a pricing grid with a range of 180 to 255 basis points over LIBOR, depending on the Company's leverage ratios. LIBOR has been swapped to a fixed rate of 1.591%, resulting in an effective interest rate of 3.391% based on the Company's current leverage (see Note 12). Matures in September 2022.	85,000	85,000
Unsecured term loan requiring payments of interest only, with a blended interest rate based on a pricing grid with a range of 180 to 255 basis points over LIBOR, depending on the Company's leverage ratios. LIBOR has been swapped to a fixed rate of 1.853%, resulting in an effective interest rate of 3.653% based on the Company's current leverage (see Note 12). Matures in January 2023.	100,000	100,000
Unsecured Senior Notes requiring semi-annual payments of interest only, bearing interest at 4.69%; maturing in January 2026.	120,000	120,000
Unsecured Senior Notes requiring semi-annual payments of interest only, bearing interest at 4.79%; maturing in January 2028.	120,000	120,000
Total notes payable	$ 984,916	$ 990,402
Current portion of notes payable	$ 7,857	$ 7,420
Less: current portion of deferred financing costs	(1,944)	(1,943)
Carrying value of current portion of notes payable	$ 5,913	$ 5,477
Notes payable, less current portion	$ 977,059	$ 982,982
Less: long-term portion of deferred financing costs	(4,245)	(5,700)
Carrying value of notes payable, less current portion	$ 972,814	$ 977,282

In October 2018, the Company amended its credit facility and modified the terms of its two unsecured term loans (see Note 12).

Interest Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest expense on debt and capital lease obligations	$ 11,619	$ 11,897	$ 34,364	$ 34,724
Noncash interest on derivatives and capital lease obligations, net	(818)	4,534	(4,995)	4,883
Amortization of deferred financing costs	748	577	2,240	1,734
Total interest expense	$ 11,549	$ 17,008	$ 31,609	$ 41,341

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8. Other Current Liabilities and Other Liabilities

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

	September 30, 2018 (unaudited)	December 31, 2017
Property, sales and use taxes payable	$ 18,973	$ 17,842
Income tax payable	104	160
Accrued interest	4,286	6,746
Advance deposits	18,700	13,454
Management fees payable	786	1,952
Other	4,541	4,348
Total other current liabilities	$ 47,390	$ 44,502

Other liabilities consisted of the following (in thousands):

	September 30, 2018 (unaudited)	December 31, 2017
Deferred revenue	$ 5,404	$ 5,589
Deferred rent	21,986	19,582
Deferred income tax liability	265	257
Other	3,326	3,561
Total other liabilities	$ 30,981	$ 28,989

9. Stockholders’ Equity

Series E Cumulative Redeemable Preferred Stock

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

Series F Cumulative Redeemable Preferred Stock

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

Common Stock

In February 2017, the Company entered into separate "At the Market" Agreements (the "ATM Agreements") with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC and Wells Fargo Securities, LLC. In accordance with the terms of the ATM Agreements, the Company may from time to time offer and sell shares of its common stock having an aggregate offering price of up to $300.0 million. During the second quarter of 2018, the Company issued 2,590,854 shares of its common stock in connection with the ATM Agreements, bringing its total common shares issued under the ATM Agreements to 7,467,709. Through September 30, 2018, the Company has received gross proceeds of $124.5 million from its ATM common stock issuances and paid $2.3 million in costs, leaving $175.5 million available for sale under the ATM Agreements,

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In February 2017, the Company's board of directors authorized a share repurchase plan to acquire up to $300.0 million of the Company's common and preferred stock. As of September 30, 2018, no shares of either the Company's common or preferred stock have been repurchased. Future purchases will depend on various factors, including the Company's capital needs, as well as the Company's common and preferred stock price.

10. Long-Term Incentive Plan

Stock Grants

Restricted shares granted pursuant to the Company's Long-Term Incentive Plan generally vest over periods from three to four years from the date of grant.

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

The Company has elected to account for forfeitures as they occur. The Company's amortization expense and forfeitures related to restricted shares for the three and nine months ended September 30, 2018 and 2017 were as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Amortization expense, including forfeitures	$ 2,073	$ 1,848	$ 6,938	$ 6,188

In addition, the Company capitalizes compensation costs related to restricted shares granted to certain employees whose work is directly related to the Company's capital investment in its hotels. These capitalized costs totaled $0.1 million during both the three months ended September 30, 2018 and 2017, respectively, and $0.3 million and $0.4 million during the nine months ended September 30, 2018 and 2017, respectively.

Stock Options

In April 2008, the Compensation Committee of the Company's board of directors approved a grant of 200,000 non-qualified stock options (the "Options") to one of the Company's former associates. The Options fully vested in April 2009, and expired in April 2018. The Options were not exercised prior to their expiration date, and the Company currently has no outstanding stock options.

11. Commitments and Contingencies

Management Agreements

Management agreements with the Company's third-party hotel managers require the Company to pay between 1.75% and 3.0% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay incentive management fees to certain of its third-party managers. Total basic management fees, net of key money incentives received from third-party hotel managers, along with incentive management fees incurred by the Company during the three and nine months ended September 30, 2018 and 2017 were included in other property-level expenses on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Basic management fees	$ 7,879	$ 8,432	$ 24,225	$ 25,269
Incentive management fees	1,339	1,172	6,187	5,525
Total basic and incentive management fees	$ 9,218	$ 9,604	$ 30,412	$ 30,794

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,

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the operation and maintenance of the hotels which are established by the franchisors to maintain uniformity in the system created by each such franchisor. Such standards generally regulate the appearance of the hotel, quality and type of goods and services offered, signage and protection of trademarks. Compliance with such standards may from time to time require the Company to make significant expenditures for capital improvements.

Total license and franchise fees incurred by the Company during the three and nine months ended September 30, 2018 and 2017 were included in franchise costs on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Franchise assessments (1)	$ 6,501	$ 6,839	$ 19,633	$ 19,941
Franchise royalties	2,666	2,592	7,348	7,426
Total franchise costs	$ 9,167	$ 9,431	$ 26,981	$ 27,367

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

Renovation and Construction Commitments

At September 30, 2018, the Company had various contracts outstanding with third parties in connection with the renovation and repositioning of certain of its hotel properties. The remaining commitments under these contracts at September 30, 2018 totaled $72.9 million.

Capital Leases

The Hyatt Centric Chicago Magnificent Mile is subject to a building lease which expires in December 2097. The Company evaluated the terms of the lease agreement and determined the lease to be a capital lease.

The Company determined that the ground lease at the Courtyard by Marriott Los Angeles is a capital lease due to the lease containing a future bargain purchase right option, which the Company will likely exercise as the economic disincentive for continuing to lease the property would be significant.

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

	September 30, 2018 (unaudited)	December 31, 2017
Gross capital lease asset - buildings and improvements	$ 58,799	$ 58,799
Gross capital lease asset - land	6,605	6,605
Gross capital lease assets	65,404	65,404
Accumulated depreciation	(9,310)	(8,208)
Net capital lease assets	$ 56,094	$ 57,196

Ground, Building and Air Leases

Total rent expense incurred pursuant to ground, building and air lease agreements for the three and nine months ended September 30, 2018 and 2017 was included in property tax, ground lease and insurance on the Company's consolidated statements of operations as follows (unaudited and in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Minimum rent, including straight-line adjustments	$ 1,495	$ 2,124	$ 5,756	$ 6,804
Percentage rent (1)	1,897	1,901	5,537	5,241
Total	$ 3,392	$ 4,025	$ 11,293	$ 12,045

(1) Several of the Company's hotels pay percentage rent, which is calculated on operating revenues above certain thresholds.

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Concentration of Risk

The concentration of the Company's hotels in California, Hawaii, Illinois, Massachusetts, the greater Washington DC area and Florida exposes the Company's business to economic and severe weather conditions, competition and real and personal property tax rates unique to these locales. As of September 30, 2018, 17 of the 22 hotels were geographically concentrated as follows (unaudited):

	Number of Hotels	Percentage of Total Rooms		Trailing 12-Month Total Consolidated Revenue	
California	6	30	%	33	%
Hawaii	1	5	%	10	%
Illinois	3	10	%	8	%
Massachusetts	2	13	%	14	%
Greater Washington DC area	3	16	%	14	%
Florida	2	9	%	9	%

Other

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

At September 30, 2018, the Company had $0.5 million of outstanding irrevocable letters of credit to guarantee the Company's financial obligations related to workers' compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon these letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through September 30, 2018.

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

12. Subsequent Events

On October 17, 2018, the Company sold the Houston hotels to an unaffiliated third-party for gross proceeds of $33.0 million. The hotels were classified as held for sale at September 30, 2018, but did not qualify as a discontinued operation as the sale did not represent a strategic shift that had a major impact on the Company’s business plan or its primary markets.

On October 17, 2018, the Company amended its credit facility agreement and repriced its two unsecured term loans. The amended credit facility agreement provides for a $500 million unsecured revolving credit facility, a $100 million increase from the previous credit facility. In addition, the Company has the right to increase the amount of the revolving credit facility, or to add term loans, up to an aggregate commitment of $800 million. Under the terms of the amendment, the interest rate pricing grid for the credit facility has been reduced from a range of 155 to 230 basis points over LIBOR to a range of 140 to 225 basis points over LIBOR, and the credit facility’s maturity date has been extended from April 2019 to April 2023. The amendment also reprices the term loans, which bear interest pursuant to a leverage-based pricing grid, from the previous range of 1.80% to 2.55% over the applicable LIBOR to a range of 1.35% to 2.20% over the applicable LIBOR. The Company entered into interest rate derivative agreements to fix the applicable LIBOR for the full duration of the loans. The spread to LIBOR may vary depending on the Company’s overall leverage as defined by its credit agreement. Based on the Company’s current leverage, the interest rate of the $85.0 million term loan has been reduced from 3.391% under the previous agreement to 2.941% under the current agreement, and the interest rate of the $100.0 million term loan has been reduced from 3.653% under the previous agreement to 3.203% under the current agreement. The maturity dates for both term loans remain unchanged.

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Cautionary Statement

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. The Company intends such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe the Company's future plans, strategies, opinions and expectations, are generally identifiable by use of the words "anticipate," "believe," "estimate," "expect," "intend," "project," or similar expressions. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond the Company's control, and which could materially affect actual results, performances or achievements. Accordingly, there is no assurance that the Company's expectations will be realized. In evaluating these statements, you should specifically consider the risks outlined in detail in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 14, 2018, under the caption "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q, including but not limited to the following factors:

- general economic and business conditions, including a U.S. recession, changes in the European Union or global economic slowdown, which may diminish the desire for leisure travel or the need for business travel, as well as any type of flu or disease-related pandemic, affecting the lodging and travel industry, internationally, nationally and locally;
- our need to operate as a REIT and comply with other applicable laws and regulations, including new laws, interpretations or court decisions that may change the federal tax laws or the federal income tax consequences of our qualification as a REIT;
- rising hotel operating expenses, including the impact of the Patient Protection and Affordable Care Act or its potential replacement, increases in minimum wages, changes in work rules or additional costs incurred from new or renegotiated labor contracts;
- relationships with, and the requirements and reputation of, our franchisors and hotel brands;
- relationships with, and the requirements, performance and reputation of, the managers of our hotels;
- the ground, building or air leases for five of the 22 hotels held for investment as of September 30, 2018;
- competition for the acquisition of hotels, and our ability to complete acquisitions and dispositions;
- performance of hotels after they are acquired;

· new hotel supply, or alternative lodging options such as timeshare, vacation rentals or sharing services such as Airbnb, in our markets, which could harm our occupancy levels and revenue at our hotels;

· competition from hotels not owned by us;

· the need for renovations, repositionings and other capital expenditures for our hotels;

· the impact, including any delays, of renovations and repositionings on hotel operations;

· changes in our business strategy or acquisition or disposition plans;

· our level of debt, including secured, unsecured, fixed and variable rate debt;

· financial and other covenants in our debt and preferred stock;

· our hotels and related goodwill may become impaired, or our hotels which have previously become impaired may become further impaired, in the future, which may adversely affect our financial condition and results of operations;

· volatility in the capital markets and the effect on lodging demand or our ability to obtain capital on favorable terms or at all;

· potential adverse tax consequences in the event that our operating leases with our taxable REIT subsidiaries are not held to have been made on an arm's-length basis;

· system security risks, data protection breaches, cyber-attacks, including those impacting our hotel managers or other third parties, and systems integration issues; and

· other events beyond our control, including natural disasters, terrorist attacks or civil unrest.

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

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

Overview

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

We own primarily high-quality urban and resort hotels in the United States. As of September 30, 2018, we had interests in 24 hotels, including both the Hilton North Houston and the Marriott Houston (the "Houston hotels") which we classified as held for sale and subsequently sold in October 2018, leaving 22 hotels currently held for investment (the "22 hotels"). Of the 22 hotels, we classify 19 as upper upscale, two as upscale and one as luxury as defined by Smith Travel Research, Inc. All but two (the Boston Park Plaza and the Oceans Edge Resort & Marina) of our 22 hotels are operated under nationally recognized brands such as Marriott, Hilton and Hyatt, which are among the most respected and widely recognized brands in the lodging industry. Our two unbranded hotels are located in top urban and resort markets that have enabled them to build awareness with both group and transient customers. We believe the largest and most stable segment of travelers prefer the consistent service and quality associated with nationally recognized brands and well-known independent hotels.

We seek to own Long-Term Relevant Real Estate, specifically, hotels in urban and resort locations that benefit from significant barriers to entry by competitors and diverse economic drivers. As of September 30, 2018, the hotels comprising our 22 hotel portfolio average 508 rooms in size.

Our mission is to create meaningful value for our stockholders by producing superior long-term returns through the ownership of Long-Term Relevant Real Estate in the hospitality sector. Long-Term Relevant Real Estate consists of hotels that we believe possess unique attributes that are difficult to replicate, and most of all, whose locations are relevant today and will remain relevant for generations to come. Our values include transparency, trust, ethical conduct, honest communication and discipline. As demand for lodging generally fluctuates with the overall economy, we seek to own hotels that will maintain a high appeal with travelers over long periods of time and will generate economic earnings materially in excess of recurring capital requirements. Our strategy is to maximize stockholder value through focused asset management and disciplined capital recycling, which is likely to include selective acquisitions and dispositions, while maintaining balance sheet flexibility and strength. Our goal is to maintain

appropriate leverage and financial flexibility to position the Company to create value throughout all phases of the operating and financial cycles.

2018 Year-To-Date Highlights

In January 2018, we sold the Marriott Philadelphia and the Marriott Quincy, located in Pennsylvania and Massachusetts, respectively, for net proceeds of $137.0 million, and recognized a net gain on the sale of $15.7 million. Neither sale represented a strategic shift that had a major impact on our business plan or our primary markets; therefore, neither of these sales qualified as a discontinued operation.

In May 2018, we paid $18.4 million, including closing costs, to acquire the exclusive perpetual rights to use portions of the Renaissance Washington DC building that we had previously leased from an unaffiliated third party (the “Element”). The acquisition of the Element eliminates approximately $1.3 million of annual space rent.

In May 2018 and August 2018, we paid a total of $0.1 million, including closing costs, to acquire three additional dry boat slips at the Oceans Edge Resort & Marina.

In July 2018, we sold the Hyatt Regency Newport Beach for net proceeds of $94.0 million, and recognized a net gain on the sale of $53.1 million. The sale of the hotel did not represent a strategic shift that had a major impact on our business plan or our primary markets; therefore, the sale did not qualify as a discontinued operation. Also in July 2018, we purchased the land underlying the JW Marriott New Orleans for $15.1 million, including closing costs. Prior to this purchase, we leased the land from an unaffiliated third party. The acquisition of the land eliminates approximately $0.6 million of annual ground lease expense.

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In October 2018, we sold the Houston hotels for gross proceeds of $33.0 million. The sale of the hotels did not represent a strategic shift that had a major impact on our business plan or our primary markets; therefore, the sale did not qualify as a discontinued operation.

Operating Activities

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

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

Expenses. Our expenses consist of the following:

- Room expense, which is primarily driven by occupancy and, therefore, has a significant correlation with room revenue;
- Food and beverage expense, which is primarily driven by food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenue;
- Other operating expense, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities, and franchise costs;
- Property tax, ground lease and insurance expense, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense, however property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality;

- Other property-level expenses, which includes our property-level general and administrative expenses, such as payroll and related costs, contract and professional fees, credit and collection expenses, employee recruitment, relocation and training expenses, consulting fees, management fees and other costs;

- Corporate overhead expense, which includes our corporate-level expenses, such as payroll, benefits and other employee-related costs, amortization of deferred stock compensation, business acquisition and due diligence costs, legal expenses, association, contract and professional fees, board of director costs, entity-level state franchise and minimum taxes, travel expenses, office rent and other customary costs;

- Depreciation and amortization expense, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment (“FF&E”), along with amortization on our franchise fees and certain intangibles. Additionally, this category includes depreciation and amortization related to FF&E for our corporate office; and

- Impairment loss, which includes the charges we have recognized to reduce the carrying values of the Houston hotels on our balance sheet to their fair values in association with our impairment evaluations.

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

- Interest and other income, which includes interest we have earned on our restricted and unrestricted cash accounts, as well as any energy or other rebates or property insurance proceeds we have received, miscellaneous income or any gains or losses we have recognized on sales or redemptions of assets other than real estate investments;

- Interest expense, which includes interest expense incurred on our outstanding fixed and variable rate debt and capital lease obligations, gains or losses on interest rate derivatives, amortization of deferred financing costs, and any loan fees incurred on our debt;

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- Loss on extinguishment of debt, which includes losses recognized on amendments or early repayments of mortgages or other debt obligations from the accelerated amortization of deferred financing costs, along with any costs incurred;

- Gain on sale of assets, which includes the gains we recognized on our sales of the Marriott Philadelphia and the Marriott Quincy in January 2018, the Hyatt Regency Newport Beach in July 2018, the Fairmont Newport Beach in February 2017, and the Marriott Park City in June 2017 as none of these sales qualified as a discontinued operation;

- Income tax (provision) benefit, net, which includes federal and state income taxes related to continuing operations charged to the Company net of any refunds received, any adjustments to our deferred tax assets, liabilities or valuation allowance, and any adjustments to unrecognized tax positions, along with any related interest and penalties incurred;

- Income from discontinued operations, which includes the results of operations for any hotels or other real estate investments sold during the reporting period that qualify as a discontinued operation, along with the gain or loss realized on the sale of these assets and any extinguishments of related debt or income tax provisions;

- Income from consolidated joint venture attributable to noncontrolling interest, which includes net income attributable to a third-party’s 25.0% ownership interest in the joint venture that owns the Hilton San Diego Bayfront; and

- Preferred stock dividends, which includes dividends accrued on our Series E Cumulative Redeemable Preferred Stock (“Series E preferred stock”) and our Series F Cumulative Redeemable Preferred Stock (“Series F preferred stock”).

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

- Occupancy, which is the quotient of total rooms sold divided by total rooms available;

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

- Revenue per available room, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;

- Comparable RevPAR, which we define as the RevPAR generated by hotels we owned as of the end of the reporting period, but excluding those hotels that we classified as held for sale, those hotels that are undergoing a material renovation or repositioning and those hotels whose room counts have materially changed during either the current or prior year. For hotels that were not owned for the entirety of the

comparison periods, comparable RevPAR is calculated using RevPAR generated during periods of prior ownership. We refer to this subset of our hotels used to calculate comparable RevPAR as our “Comparable Portfolio.” Currently, our Comparable Portfolio is comprised of the 22 hotels, and includes both our ownership and prior ownership results for the Oceans Edge Resort & Marina acquired in July 2017. We obtained prior ownership information from the Oceans Edge Resort & Marina’s previous owner during the due diligence period before acquiring the hotel. We performed a limited review of the information as part of our analysis of the acquisition. We caution you not to place undue reliance on the prior ownership information;

· RevPAR index, which is the quotient of a hotel’s RevPAR divided by the average RevPAR of its competitors, multiplied by 100. A RevPAR index in excess of 100 indicates a hotel is achieving higher RevPAR than the average of its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;

· EBITDAre, which is net income (loss) excluding: interest expense; benefit or provision for income taxes, including any changes to deferred tax assets or valuation allowances and income taxes applicable to the sale of assets; depreciation and amortization; gains or losses on disposition of depreciated property (including gains or losses on change in control); and impairment write-downs of depreciated property;

· Adjusted EBITDAre, excluding noncontrolling interest, which is EBITDAre adjusted to exclude: the net income (loss) allocated to a third-party’s 25.0% ownership interest in the joint venture that owns the Hilton San Diego Bayfront, along with the noncontrolling partner’s pro rata share of any EBITDAre components; amortization of deferred stock compensation; the impact of any gain or loss from undepreciated asset sales or property damage from natural disasters; prior year property tax assessments or credits; and any other nonrecurring identified adjustments;

· Funds from operations (“FFO”) attributable to common stockholders, which is net income (loss), excluding: preferred stock dividends and any redemption charges; noncontrolling interests; gains and losses from sales of property; real estate-related depreciation and amortization (excluding amortization of deferred financing costs); and real estate-related impairment losses; and

- Adjusted FFO attributable to common stockholders, which is FFO attributable to common stockholders adjusted to exclude: non-real estate-related impairment losses; gains or losses due to property damage from natural disasters; income tax benefits or provisions associated with any changes to deferred tax assets or valuation allowances, the application of net operating loss carryforwards and uncertain tax positions; and any other nonrecurring identified adjustments.

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

- Demand. The demand for lodging generally fluctuates with the overall economy. In 2017, Comparable Portfolio RevPAR, excluding the Oceans Edge Resort & Marina which opened in January 2017, increased 4.1% as compared to 2016, with a 90 basis point increase in occupancy. Our third quarter and year-to-date Comparable Portfolio RevPAR, which were impacted by renovations at the Hyatt Regency San Francisco, the JW Marriott New Orleans, the Marriott Boston Long Wharf and the Renaissance Los Angeles Airport (the “Four Renovation Hotels”), increased 3.7% and 1.9%, respectively, in 2018 as compared to the same periods in 2017. Occupancy decreased 90 basis points during both the three and nine months ended September 30, 2018 as compared to the same periods in 2017.

- Supply. The addition of new competitive hotels affects the ability of existing hotels to absorb demand for lodging and, therefore, impacts the ability to drive RevPAR and profits. The development of new hotels is largely driven by construction costs and expected performance of existing hotels. In aggregate, we expect the U.S. hotel supply to increase over the near term. On a market-by-market basis, some markets may experience new hotel room openings at or greater than historic levels, including in Boston, Houston, Los Angeles, New York City and Portland where there are currently higher-than-average new hotel room openings. Additionally, an increase in the supply of vacation rental or sharing services such as Airbnb also affects the ability of existing hotels to drive RevPAR and profits.

- Revenues and expenses. We believe that marginal improvements in RevPAR index, even in the face of declining revenues, are a good indicator of the relative quality and appeal of our hotels, and our operators’ effectiveness in maximizing revenues. Similarly, we also evaluate our operators’ effectiveness in minimizing incremental operating expenses in the context of increasing revenues or, conversely, in reducing operating expenses in the context of declining revenues.

With respect to improving RevPAR index, we continue to work with our hotel operators to optimize revenue management initiatives while taking into consideration market demand trends and the pricing strategies of competitor hotels in our markets. We also develop capital investment programs designed to ensure each of our hotels is well renovated and positioned to appeal to groups and individual travelers fitting target guest profiles. Increased capital investment in our properties may lead to short-term revenue disruption and negatively impact RevPAR index. Our revenue management initiatives are generally oriented towards maximizing ADR even if the result may be lower occupancy than may be achieved through lower ADR. Increases in RevPAR attributable to increases in ADR may be accompanied by minimal additional expenses, while increases in RevPAR attributable to higher occupancy may result in higher variable expenses such as housekeeping, guest supplies, labor and utilities expense. Our Comparable

Portfolio RevPAR index increased 30 basis points during the first nine months of 2018 as compared to the same period in 2017. The increase in our Comparable Portfolio RevPAR index was primarily due to increases in the RevPAR index at the Wailea Beach Resort post-repositioning, at the Oceans Edge Resort & Marina as the hotel ramped up after its January 2017 opening, and at the Marriott Tysons Corner due to increased room rates. These increases were partially offset by decreases in the RevPAR index at the Four Renovation Hotels and at the Courtyard by Marriott Los Angeles Airport due to new supply and recently renovated area hotels.

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

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Operating Results. The following table presents our unaudited operating results for our total portfolio for the three months ended September 30, 2018 and 2017, including the amount and percentage change in the results between the two periods.

	Three Months Ended September 30,				
	2018	2017	Change $	Change %	
	(in thousands, except statistical data)				
REVENUES					
Room	$ 207,657	$ 215,768	$ (8,111)	(3.8)	%
Food and beverage	63,911	68,821	(4,910)	(7.1)	%
Other operating	17,740	19,320	(1,580)	(8.2)	%
Total revenues	289,308	303,909	(14,601)	(4.8)	%
OPERATING EXPENSES					
Hotel operating	166,121	174,947	(8,826)	(5.0)	%
Other property-level expenses	31,580	34,511	(2,931)	(8.5)	%
Corporate overhead	7,360	7,233	127	1.8	%
Depreciation and amortization	36,159	39,719	(3,560)	(9.0)	%
Impairment loss	—	34,427	(34,427)	(100.0)	%
Total operating expenses	241,220	290,837	(49,617)	(17.1)	%
Operating income	48,088	13,072	35,016	267.9	%
Interest and other income	2,592	1,027	1,565	152.4	%
Interest expense	(11,549)	(17,008)	5,459	32.1	%
Gain on sale of assets	53,128	—	53,128	100.0	%
Income (loss) before income taxes and discontinued operations	92,259	(2,909)	95,168	3,271.5	%
Income tax (provision) benefit, net	(673)	12,991	(13,664)	(105.2)	%
Income from continuing operations	91,586	10,082	81,504	808.4	%
Income from discontinued operations	—	7,000	(7,000)	(100.0)	%
NET INCOME	91,586	17,082	74,504	436.2	%
Income from consolidated joint venture attributable to noncontrolling interest	(2,376)	(2,169)	(207)	(9.5)	%
Preferred stock dividends	(3,208)	(3,208)	—	—	%
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ 86,002	$ 11,705	$ 74,297	634.7	%

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The following table presents our unaudited operating results for our total portfolio for the nine months ended September 30, 2018 and 2017, including the amount and percentage change in the results between the two periods.

	Nine Months Ended September 30,			
	2018	2017	Change $	Change %
	(in thousands, except statistical data)			
REVENUES				
Room	$ 608,237	$ 629,788	$ (21,551)	(3.4) %
Food and beverage	217,469	222,943	(5,474)	(2.5) %
Other operating	52,495	50,717	1,778	3.5 %
Total revenues	878,201	903,448	(25,247)	(2.8) %
OPERATING EXPENSES				
Hotel operating	507,181	516,313	(9,132)	(1.8) %
Other property-level expenses	101,005	105,015	(4,010)	(3.8) %
Corporate overhead	22,056	21,585	471	2.2 %
Depreciation and amortization	110,181	120,051	(9,870)	(8.2) %
Impairment loss	1,394	34,427	(33,033)	(96.0) %
Total operating expenses	741,817	797,391	(55,574)	(7.0) %
Operating income	136,384	106,057	30,327	28.6 %
Interest and other income	7,049	2,597	4,452	171.4 %
Interest expense	(31,609)	(41,341)	9,732	23.5 %
Loss on extinguishment of debt	—	(4)	4	100.0 %
Gain on sale of assets	68,787	45,474	23,313	51.3 %
Income before income taxes and discontinued operations	180,611	112,783	67,828	60.1 %
Income tax benefit	692	12,541	(11,849)	(94.5) %
Income from continuing operations	181,303	125,324	55,979	44.7 %
Income from discontinued operations	—	7,000	(7,000)	(100.0) %
NET INCOME	181,303	132,324	48,979	37.0 %
Income from consolidated joint venture attributable to noncontrolling interest	(7,189)	(6,344)	(845)	(13.3) %
Preferred stock dividends	(9,622)	(9,622)	—	— %
INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ 164,492	$ 116,358	$ 48,134	41.4 %

Operating Statistics. The following table includes comparisons of the key operating metrics for our Comparable Portfolio.

	Three Months Ended September 30,								
	2018			2017			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Comparable Portfolio	86.1 %	$ 229.31	$ 197.44	87.0 %	$ 218.82	$ 190.37	(90) bps	4.8 %	3.7 %

	Nine Months Ended September 30,								
	2018			2017			Change		
	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR	Occ%	ADR	RevPAR
Comparable Portfolio	84.0 %	$ 227.00	$ 190.68	84.9 %	$ 220.37	$ 187.09	(90) bps	3.0 %	1.9 %

Room revenue. Room revenue decreased $8.1 million, or 3.8%, for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The decrease in room revenue during the third quarter of 2018 as compared to the same period in 2017 was primarily due to our sales of both the Marriott Philadelphia and the Marriott Quincy in January 2018, and the Hyatt Regency Newport Beach in July 2018 (the “Three Sold Hotels”). The sales of the Three Sold Hotels caused room revenue to decrease by $15.2 million in the third quarter of 2018 as compared to the same period in 2017.

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Room revenue generated by the same 23 hotels we owned during both the third quarters of 2018 and 2017 (our "Existing Portfolio") increased $5.4 million during the third quarter of 2018 as compared to the same period in 2017 due to a $9.4 million increase in ADR partially offset by a $4.0 million decrease in occupancy. The overall increase in ADR was primarily driven by increases net of decreases in the average daily rate at the following hotels:

ADR	
Increases	Decreases
Embassy Suites Chicago	Houston hotels
	Los Angeles International
Embassy Suites La Jolla	Airport hotels
Hilton Garden Inn Chicago Downtown/Magnificent Mile	Renaissance Washington DC
Hilton San Diego Bayfront	
Hyatt Centric Chicago Magnificent Mile	
Hyatt Regency San Francisco	
JW Marriott New Orleans	
Marriott Tysons Corner	
Wailea Beach Resort	

The decrease in our Existing Portfolio's occupancy during the third quarter of 2018 as compared to the same period in 2017 was caused by 12,238 fewer group room nights, combined with 5,959 fewer transient room nights. The overall net decreases in room nights occurred primarily at the following hotels:

Group Room Nights	
Increases	Decreases
Embassy Suites La Jolla	Boston Park Plaza
Hilton San Diego Bayfront	Houston hotels
Wailea Beach Resort	Hyatt Regency San Francisco
	Marriott Portland
	Renaissance Washington DC
	Renaissance Westchester

Transient Room Nights	
Increases	Decreases
Boston Park Plaza	Embassy Suites La Jolla
Houston hotels	Hilton San Diego Bayfront
Hyatt Regency San Francisco	JW Marriott New Orleans (1)
	Marriott Tysons Corner

(1) Occupancy was negatively impacted during the third quarter of 2018 as compared to the same period in 2017 by a room renovation at the JW Marriott New Orleans. During the third quarter of 2018, a total of 4,447 room nights

were out of service at the hotel, displacing approximately $0.7 million in room revenue based on the hotel achieving a potential 71.9% occupancy rate and RevPAR of $114.22 without the renovation.

Room revenue generated by the Oceans Edge Resort & Marina, which we purchased in July 2017, increased $1.7 million during the third quarter of 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, room revenue decreased $21.6 million, or 3.4%, as compared to the nine months ended September 30, 2017 as follows:

The decrease in room revenue during the first nine months of 2018 as compared to the same period in 2017 was primarily due to our sales of both the Marriott Philadelphia and the Marriott Quincy in January 2018, the Hyatt Regency Newport Beach in July 2018, the Fairmont Newport Beach in February 2017, and the Marriott Park City in June 2017 (the "Five Sold Hotels"). The sales of the Five Sold Hotels caused room revenue to decrease by $38.1 million in the first nine months of 2018 as compared to the same period in 2017.

Partially offsetting this decrease, the Oceans Edge Resort & Marina increased our room revenue by $9.4 million during the first nine months of 2018 as compared to the same period in 2017.

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In addition, room revenue generated by our Existing Portfolio increased $7.2 million during the first nine months of 2018 as compared to the same period in 2017 due to a $15.1 million increase in ADR partially offset by a $7.9 million decrease in occupancy. The overall increase in ADR was primarily driven by increases net of decreases in the average daily rate at the following hotels:

ADR	
Increases	Decreases
Embassy Suites Chicago	Houston hotels
	Los Angeles International Airport hotels
Embassy Suites La Jolla	Renaissance Washington DC
Hilton Garden Inn Chicago Downtown/Magnificent Mile	
Hilton San Diego Bayfront	
Hilton Times Square	
Hyatt Centric Chicago Magnificent Mile	
Hyatt Regency San Francisco	
Marriott Boston Long Wharf	
Marriott Tysons Corner	
New Orleans hotels	
Wailea Beach Resort	

The decrease in our Existing Portfolio's occupancy during the first nine months of 2018 as compared to the same period in 2017 was caused by 50,043 fewer group room nights, partially offset by 13,764 more transient room nights. The overall net decreases in room nights occurred primarily at the following hotels:

Group Room Nights	
Increases	Decreases
Embassy Suites La Jolla	Boston Park Plaza
Hilton San Diego Bayfront	Houston hotels
Renaissance Orlando at SeaWorld®	Hyatt Regency San Francisco (1)
Wailea Beach Resort	JW Marriott New Orleans (1)
	Marriott Boston Long Wharf (1)
	Renaissance Harborplace
	Renaissance Washington DC

Transient Room Nights	
Increases	Decreases
Boston Park Plaza	Hilton New Orleans
Chicago hotels	Hilton San Diego Bayfront
Hyatt Regency San Francisco (1)	JW Marriott New Orleans (1)

Houston hotels	Marriott Boston Long Wharf (1)
Renaissance Long Beach	Marriott Tysons Corner
Renaissance Westchester	Renaissance Los Angeles Airport (1)
Wailea Beach Resort	Renaissance Orlando at SeaWorld®

(1) Occupancy was negatively impacted during the first nine months of 2018 as compared to the same period in 2017 by the Four Renovation Hotels. During the first nine months of 2018, a total of 36,324 room nights were out of service at these four hotels, displacing approximately $8.0 million in room revenue based on the hotels achieving a combined potential 85.3% occupancy rate and RevPAR of $206.85 without the renovations.

Food and beverage revenue. Food and beverage revenue decreased $4.9 million, or 7.1%, for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The Three Sold Hotels caused food and beverage revenue to decrease by $6.5 million in the third quarter of 2018 as compared to the same period in 2017.

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Food and beverage revenue generated by our Existing Portfolio increased $1.2 million during the third quarter of 2018 as compared to the same period in 2017 primarily due to a net increase in banquet and event technology revenue along with a net increase in outlet revenue at the following hotels:

Banquet and Event Technology Revenue	
Increases	Decreases
Hilton San Diego Bayfront	Boston Park Plaza
Renaissance Orlando at SeaWorld®	Hilton North Houston
Wailea Beach Resort	Hyatt Centric Chicago Magnificent Mile
	Hyatt Regency San Francisco
	JW Marriott New Orleans (1)
	Marriott Boston Long Wharf
	Marriott Portland
	Renaissance Harborplace
	Renaissance Los Angeles Airport

Outlet Revenue	
Increases	Decreases
Hilton San Diego Bayfront	Hyatt Regency San Francisco
Marriott Boston Long Wharf	JW Marriott New Orleans (1)
Renaissance Washington DC	
Wailea Beach Resort	

(1) Renovation-related disruption negatively impacted food and beverage revenue during the third quarter of 2018.

In addition, food and beverage revenue at the Oceans Edge Resort & Marina increased $0.4 million during the third quarter of 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, food and beverage revenue decreased $5.5 million, or 2.5%, as compared to the nine months ended September 30, 2017 as follows:

The Five Sold Hotels caused food and beverage revenue to decrease by $16.3 million in the first nine months of 2018 as compared to the same period in 2017.

Food and beverage revenue generated by our Existing Portfolio increased $9.2 million during the first nine months of 2018 as compared to the same period in 2017 primarily due to a net increase in banquet and event technology revenue along with a net increase in outlet revenue at the following hotels:

Banquet and Event Technology Revenue	
Increases	Decreases
Boston Park Plaza	Hilton North Houston
Hilton San Diego Bayfront	Hyatt Centric Chicago Magnificent Mile
Hyatt Regency San Francisco (1)	JW Marriott New Orleans (1)
Renaissance Los Angeles Airport (1)	Marriott Boston Long Wharf (1)
Renaissance Orlando at SeaWorld®	Renaissance Harborplace
Renaissance Washington DC	
Wailea Beach Resort	

Outlet Revenue	
Increases	Decreases
Hilton North Houston	Hyatt Regency San Francisco (1)
Hilton San Diego Bayfront	JW Marriott New Orleans (1)
Renaissance Long Beach	Marriott Boston Long Wharf (1)
Renaissance Orlando at SeaWorld®	Renaissance Washington DC
Wailea Beach Resort	

(1) Renovation-related disruption negatively impacted food and beverage revenue during the first nine months of 2018.

In addition, the Oceans Edge Resort & Marina increased our food and beverage revenue by $1.6 million during the first nine months of 2018 as compared to the same period in 2017.

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Other operating revenue. Other operating revenue decreased $1.6 million, or 8.2%, for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The Three Sold Hotels caused other operating revenue to decrease by $1.4 million in the third quarter of 2018 as compared to the same period in 2017.

Other operating revenue in our Existing Portfolio decreased $0.9 million during the three months ended September 30, 2018 as compared to the same period in 2017, primarily due to decreased cancellation revenue at the Houston hotels, which collected Hurricane Harvey-related fees in the third quarter of 2017. In addition, other operating revenue in our Existing Portfolio decreased due to reductions in telephone/internet revenue, commissions and other miscellaneous revenues. These decreases were partially offset by increased facility fees, parking revenue, attrition revenue and tenant lease revenue.

Other operating revenue at the Oceans Edge Resort & Marina increased $0.7 million during the third quarter of 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, other operating revenue increased $1.8 million, or 3.5%, as compared to the nine months ended September 30, 2017 as follows:

The Oceans Edge Resort & Marina increased our other operating revenue by $3.6 million during the first nine months of 2018, including $0.8 million in business interruption proceeds recognized during the first quarter related to Hurricane Irma, which negatively impacted the hotel during the third and fourth quarters of 2017.

Other operating revenue in our Existing Portfolio increased $0.6 million during the first nine months of 2018 as compared to the same period in 2017, primarily due to increased facility fees, parking revenue, attrition revenue and tenant lease revenue. These increases were partially offset by decreased cancellation revenue at the Houston hotels as noted above in the discussion regarding the third quarter, along with decreased telephone/internet revenue, commissions and other miscellaneous revenues.

The Five Sold Hotels caused other operating revenue to decrease by $2.4 million in the first nine months of 2018 as compared to the same period in 2017.

Hotel operating expenses. Hotel operating expenses, which are comprised of room, food and beverage, advertising and promotion, repairs and maintenance, utilities, franchise costs, property tax, ground lease and insurance, and other hotel operating expenses decreased $8.8 million, or 5.0%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The Three Sold Hotels caused hotel operating expenses to decrease by $13.2 million in the third quarter of 2018 as compared to the same period in 2017.

Hotel operating expenses in our Existing Portfolio increased $3.8 million during the three months ended September 30, 2018 as compared to the same period in 2017. This increase is primarily related to the corresponding increases in room revenue, and food and beverage revenue. In addition, hotel operating expenses in our Existing Portfolio increased in the third quarter of 2018 as compared to the same period in 2017 due to the following increased expenses: utilities due to increased electricity rates and higher occupancy at some of our hotels; franchise costs due to increased revenues; property taxes due to increased rates and assessments received at several of our hotels; and Hawaii general excise tax due to higher revenue at the Wailea Beach Resort. Slightly offsetting these increases, the following expenses decreased: advertising and promotion, particularly at the Wailea Beach Resort as the hotel incurred additional expenses during the third quarter of 2017 to promote the hotel post-repositioning; repairs and maintenance due to $1.0 million in hurricane-related restoration expenses recorded for the Houston hotels and the Renaissance Orlando at SeaWorld® during the third quarter of 2017; building space rent expense at the Renaissance Washington DC due to our purchase of the Element in May 2018; ground lease expense at the JW Marriott New Orleans due to our purchase of the land underlying the hotel in July 2018; and common area maintenance expense due to a year-over-year reduction in expense at the Hyatt Centric Chicago Magnificent Mile. Our purchases of the Element in May 2018 and the land underlying the JW Marriott New Orleans in July 2018 will decrease our future quarterly ground and building space rent expense by approximately $0.5 million.

In addition, hotel operating expenses at the Oceans Edge Resort & Marina increased $0.6 million during the third quarter of 2018 as compared to the same period in 2017, primarily due to the corresponding increases in room revenue and food and beverage revenue. Partially offsetting the increased hotel operating expenses, repairs and maintenance expense decreased at the Oceans Edge Resort & Marina during the third quarter of 2018 as compared to the same period in 2017 as we recorded $0.7 million in hurricane-related restoration expenses during the third quarter of 2017.

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For the nine months ended September 30, 2018, hotel operating expenses decreased $9.1 million, or 1.8%, as compared to the nine months ended September 30, 2017 as follows:

The Five Sold Hotels caused hotel operating expenses to decrease by $32.7 million in the first nine months of 2018 as compared to the same period in 2017.

Hotel operating expenses in our Existing Portfolio increased $17.2 million during the nine months ended September 30, 2018 as compared to the same period in 2017. This increase is primarily related to the corresponding increases in room revenue, and food and beverage revenue. In addition, hotel operating expenses in our Existing Portfolio increased in the first nine months of 2018 as compared to the same period in 2017 due to the following increased expenses: repairs and maintenance due to increased payroll and related costs in this department as well as increased contract and professional services, employee safety, landscaping, plumbing, heating and waste removal; utilities due to a cold winter affecting our Midwest and East Coast hotels, along with increased electricity rates and higher occupancy at some of our hotels; franchise costs due to increased revenues; property taxes due to increased assessments received at several of our hotels; ground lease percentage rent at the Hilton San Diego Bayfront due to higher revenues at the hotel; and Hawaii general excise tax due to higher revenue at the Wailea Beach Resort. These increases were partially offset by the following decreased expenses: advertising and promotion, particularly at the Wailea Beach Resort as the prior year included additional costs to promote the hotel post-repositioning; hurricane-related restoration expenses included in repairs and maintenance as the prior year included $1.0 million in expenses recorded for the Houston hotels and the Renaissance Orlando at SeaWorld®; building space rent expense at the Renaissance Washington DC due to our purchase of the Element in May 2018; ground lease expense at the JW Marriott New Orleans due to our purchase of the land underlying the hotel in July 2018; and common area maintenance expense due to a year-over-year reduction in expense at the Hyatt Centric Chicago Magnificent Mile. Our purchases of the Element in May 2018 and the land underlying the JW Marriott New Orleans in July 2018 will decrease our future annual ground and building space rent expense by approximately $1.9 million.

The Oceans Edge Resort & Marina increased our hotel operating expenses by $6.4 million during the first nine months of 2018, primarily due to the corresponding increases in room revenue and food and beverage revenue. Partially offsetting the increased hotel operating expenses, repairs and maintenance expense decreased at the Oceans Edge Resort & Marina during the first nine months of 2018 as compared to the same period in 2017 as we recorded $0.1 million in hurricane-related restoration expenses year-to-date in 2018 and $0.7 million in hurricane-related restoration expenses during the same period in 2017.

Other property-level expenses. Other property-level expenses decreased $2.9 million, or 8.5%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The Three Sold Hotels caused other property-level expenses to decrease by $2.8 million in the third quarter of 2018 as compared to the same period in 2017.

Other property-level expenses in our Existing Portfolio decreased $0.4 million in the third quarter of 2018 as compared to the same period in 2017, primarily due to a $1.1 million rebate received from Marriott during the third quarter of 2018 related to its sale of a hospitality procurement supply company, combined with decreased credit and collection expenses. These decreases were partially offset by increases in the following expenses caused by higher revenue: payroll and related costs; basic and incentive management fees; and employee relations, recruitment and training.

Other property-level expenses at the Oceans Edge Resort & Marina increased $0.2 million during the third quarter of 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, other property-level expenses decreased $4.0 million, or 3.8%, as compared to the nine months ended September 30, 2017 as follows:

The Five Sold Hotels caused other property-level expenses to decrease by $6.2 million in the first nine months of 2018 as compared to the same period in 2017.

Other property-level expenses in our Existing Portfolio increased $0.8 million in the first nine months of 2018 as compared to the same period in 2017, primarily due to increases in the following expenses caused by higher revenue: payroll and related costs; basic and incentive management fees; and credit and collection expenses. These increases were partially offset by a decrease in supplies resulting from a $1.1 million rebate received from Marriott during the third quarter of 2018 related to its sale of a hospitality procurement supply company.

The Oceans Edge Resort & Marina increased our other property-level expenses by $1.4 million during the first nine months of 2018 as compared to the same period in 2017.

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Corporate overhead expense. Corporate overhead expense increased $0.1 million during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017, primarily due to increased deferred stock compensation and office rent, partially offset by decreased donations and due diligence costs.

Corporate overhead expense increased $0.5 million, or 2.2%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017, primarily due to increased payroll and related costs, deferred stock compensation and office rent, partially offset by decreased donations, due diligence costs, employee recruitment expenses and sales tax audit expenses.

Depreciation and amortization expense. Depreciation and amortization expense decreased $3.6 million, or 9.0%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 as follows:

The Three Sold Hotels caused depreciation and amortization to decrease by $2.7 million in the third quarter of 2018 as compared to the same period in 2017.

Depreciation and amortization expense in our Existing Portfolio decreased $0.8 million in the third quarter of 2018 as compared to the same period in 2017, due to assets being fully depreciated, along with a write-down of assets at our Houston hotels during the third and fourth quarters of 2017. In addition, intangible assets consisting of advanced deposits related to our purchases of the Boston Park Plaza and the Wailea Beach Resort were fully amortized in June 2018 and July 2018, respectively. These decreases were partially offset by increased depreciation and amortization at our newly renovated hotels.

Depreciation and amortization at the Oceans Edge Resort & Marina remained relatively flat during the third quarter of 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, depreciation and amortization expense decreased $9.9 million, or 8.2%, as compared to the nine months ended September 30, 2017 as follows:

The Five Sold Hotels caused depreciation and amortization to decrease by $7.0 million in the first nine months of 2018 as compared to the same period in 2017.

Depreciation and amortization expense in our Existing Portfolio decreased $4.4 million in the first nine months of 2018 as compared to the same period in 2017, due to the same reasons noted above in the discussion regarding the third quarter.

The Oceans Edge Resort & Marina increased our depreciation and amortization by $1.5 million during the first nine months of 2018 as compared to the same period in 2017.

Impairment loss. Impairment loss totaled zero and $1.4 million for the three and nine months ended September 30, 2018, respectively, and $34.4 million for both the three and nine months ended September 30, 2017. During the second quarter of 2018 and the third quarter of 2017, we recorded impairment losses of $1.4 million and $34.4 million, respectively, on our Houston hotels due to weakness in the Houston market.

Interest and other income. Interest and other income increased $1.6 million, or 152.4%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. During the third quarter of 2018, we recognized $2.6 million in interest and miscellaneous income. During the third quarter of 2017, we recognized $1.0 million in interest and miscellaneous income.

Interest and other income increased $4.5 million, or 171.4%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. During the first nine months of 2018, we recognized $5.8 million in interest and miscellaneous income, along with $1.1 million in insurance proceeds for Hurricane-related property damage at our Houston hotels and $0.1 million in energy rebates due to energy efficient renovations at our hotels. During the first nine months of 2017, we recognized $2.1 million in interest and miscellaneous income, and $0.2 million in energy rebates. In addition, we recognized $0.3 million in earn-out proceeds related to the Royal Palm Miami Beach, which we sold in 2011.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest expense on debt and capital lease obligations	$ 11,619	$ 11,897	$ 34,364	$ 34,724
Noncash interest on derivatives and capital lease obligations, net	(818)	4,534	(4,995)	4,883
Amortization of deferred financing costs	748	577	2,240	1,734
	$ 11,549	$ 17,008	$ 31,609	$ 41,341

Interest expense decreased $5.5 million, or 32.1%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017, and decreased $9.7 million, or 23.5%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 as follows:

Interest expense on our debt and capital lease obligations decreased $0.3 million and $0.4 million during the three and nine months ended September 30, 2018, respectively, as compared to the same periods in 2017 as a result of lower balances due to monthly amortization, a loan repayment during 2017 and lower interest on our variable rate debt. Partially offsetting these decreases, interest expense on our debt and capital lease obligations increased due to our issuance of the Senior Notes in January 2017, as well as due to the cash component of interest on the Courtyard by Marriott Los Angeles ground lease, which we reclassified as a capital lease in the third quarter of 2017.

Noncash interest on derivatives and capital lease obligations, net decreased $5.4 million and $9.9 million during the three and nine months ended September 30, 2018, respectively, as compared to the same periods in 2017. The noncash changes in the fair market values of our derivatives decreased interest expense $0.8 million and $5.5 million during the third quarter and first nine months of 2018, respectively, as compared to the same periods in 2017. In addition, the noncash interest on our capital lease obligations decreased by $4.5 million and $4.4 million during the three and nine months ended September 30, 2018, respectively, due to our reclassification of the Courtyard by Marriott Los Angeles ground lease to a capital lease in the third quarter of 2017.

Finally, amortization of deferred financing costs increased interest expense by $0.2 million and $0.5 million during the third quarter and first nine months of 2018, respectively, as compared to the same periods in 2017 due to additional costs incurred on our refinancing of the debt secured by the Hilton San Diego Bayfront in November 2017.

Our weighted average interest rate per annum, including our variable rate debt obligation, was approximately 4.2% and 4.3% at September 30, 2018 and 2017, respectively. Approximately 77.7% and 77.8% of our outstanding notes payable had fixed interest rates at September 30, 2018 and 2017, respectively.

Loss on extinguishment of debt. Loss on extinguishment of debt totaled zero for both the three months ended September 30, 2018 and 2017, and zero and $4,000 for the nine months ended September 30, 2018 and 2017, respectively. During the first nine months of 2017, we recognized a loss of $4,000 related to our repayment of debt secured by the Marriott Boston Long Wharf.

Gain on sale of assets. Gain on sale of assets totaled $53.1 million and $68.8 million for the three and nine months ended September 30, 2018, respectively, and zero and $45.5 million for the three and nine months ended September 30, 2017, respectively. During the first nine months of 2018, we recognized a $53.1 million net gain on the July 2018 sale of the Hyatt Regency Newport Beach, and a $15.7 million net gain on the January 2018 sale of the Marriott Philadelphia and the Marriott Quincy. During the first nine months of 2017, we recognized a $1.2 million net gain on the June 2017 sale of the Marriott Park City, and a $44.3 million net gain on the February 2017 sale of the Fairmont Newport Beach. None of these sales qualified as a discontinued operation.

Income tax (provision) benefit, net. Income tax (provision) benefit, net totaled a provision of $0.7 million and a benefit of $0.7 million for the three and nine months ended September 30, 2018, respectively. For the three and nine months ended September 30, 2017, income tax (provision) benefit, net totaled benefits of $13.0 million and $12.5 million, respectively. We lease our hotels to the TRS Lessee and its subsidiaries, which are subject to federal and state income taxes. In addition, the REIT and Operating Partnership may also be subject to various state and local income taxes.

Our earnings are seasonal, resulting in quarterly fluctuations in our net operating losses. Accordingly, during the three and nine months ended September 30, 2018, we recognized a deferred income tax provision of $0.7 million and a deferred income tax benefit of $1.1 million, respectively, related to changes primarily in our net operating loss deferred tax assets. In addition, during the third quarter of 2018, we slightly reduced our combined federal and state income tax expense based on 2018 projected taxable income net of operating loss carryforwards for our taxable entities, resulting in $0.4 million of expense recognized during the nine months ended September 30, 2018.

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During the third quarter of 2017, we fully released the $13.6 million valuation allowance primarily related to our federal and state net operating loss carryforwards as we determined it was more likely than not that these deferred tax assets will be realized. In addition, during the third quarter and first nine months of 2017, we recognized combined federal and state income tax expense of $0.6 million and $1.1 million, respectively, based on 2017 projected taxable income net of operating loss carryforwards for our taxable entities.

Income from discontinued operations. Income from discontinued operations totaled zero for both the three and nine months ended September 30, 2018, and $7.0 million for both the three and nine months ended September 30, 2017. During the third quarter of 2017, we recognized an additional $7.0 million gain related to our 2013 sale of four hotels and a laundry facility located in Rochester, Minnesota.

Income from consolidated joint venture attributable to noncontrolling interest. Income from consolidated joint venture attributable to noncontrolling interest totaled $2.4 million and $2.2 million for the three months ended September 30, 2018 and 2017, respectively, and $7.2 million and $6.3 million for the nine months ended September 30, 2018 and 2017, respectively. Our net income for the three and nine months ended September 30, 2018 and 2017 includes 100% of the net income generated by the entity that owns the Hilton San Diego Bayfront. The third-party's 25.0% ownership interest in the entity that owns the Hilton San Diego Bayfront earned net income of $2.4 million and $2.2 million during the third quarters of 2018 and 2017, respectively, and $7.2 million and $6.3 million during the first nine months of 2018 and 2017, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Series E preferred stock	$ 1,998	$ 1,998	5,994	5,994
Series F preferred stock	1,210	1,210	3,628	3,628
	$ 3,208	$ 3,208	$ 9,622	$ 9,622

Non-GAAP Financial Measures. We use the following "non-GAAP financial measures" that we believe are useful to investors as key supplemental measures of our operating performance: earnings before interest expense, taxes, depreciation and amortization for real estate, or EBITDAre; Adjusted EBITDAre, excluding noncontrolling interest; FFO attributable to common stockholders; Adjusted FFO attributable to common stockholders; and Comparable Portfolio revenues. These measures should not be considered in isolation or as a substitute for measures of performance in accordance with GAAP. In addition, our calculation of these measures may not be comparable to other companies that do not define such terms exactly as the Company. These non-GAAP measures are used in addition to and in conjunction with results presented in accordance with GAAP. They should not be considered as alternatives to operating profit, cash flow from operations, or any other operating performance measure prescribed by GAAP. These non-GAAP financial measures reflect additional ways of viewing our operations that we believe, when viewed with

our GAAP results and the reconciliations to the corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. For example, we believe that Comparable Portfolio revenues are useful to both us and investors in evaluating our operating performance by removing the impact of non-hotel results such as the amortization of favorable and unfavorable tenant lease contracts. We also believe that our use of Comparable Portfolio revenues is useful to both us and our investors as it facilitates the comparison of our operating results from period to period by removing fluctuations caused by any acquisitions or dispositions, as well as by those hotels that we classify as held for sale, those hotels that are undergoing a material renovation or repositioning and those hotels whose room counts have materially changed during either the current or prior year. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

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

We make additional adjustments to EBITDAre when evaluating our performance because we believe that the exclusion of certain additional items described below provides useful information to investors regarding our operating performance, and that the presentation of Adjusted EBITDAre, excluding noncontrolling interest, when combined with the primary GAAP presentation of net income, is beneficial to an investor's complete understanding of our operating performance. In addition, we use both EBITDAre and Adjusted EBITDAre, excluding noncontrolling interest as measures in determining the value of hotel acquisitions and dispositions. Our presentation of Adjusted EBITDAre, excluding noncontrolling interest results in a similar metric as our previous disclosure of

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Adjusted EBITDA. We adjust EBITDAre for the following items, which may occur in any period, and refer to this measure as Adjusted EBITDAre, excluding noncontrolling interest:

- Amortization of deferred stock compensation: we exclude the noncash expense incurred with the amortization of deferred stock compensation as this expense is based on historical stock prices at the date of grant to our corporate employees and does not reflect the underlying performance of our hotels.

- Amortization of favorable and unfavorable contracts: we exclude the noncash amortization of the favorable management contract asset recorded in conjunction with our acquisition of the Hilton Garden Inn Chicago Downtown/Magnificent Mile, along with the favorable and unfavorable tenant lease contracts, as applicable, recorded in conjunction with our acquisitions of the Boston Park Plaza, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton New Orleans St. Charles, the Hyatt Regency San Francisco and the Wailea Beach Resort. We exclude the noncash amortization of favorable and unfavorable contracts because it is based on historical cost accounting and is of lesser significance in evaluating our actual performance for the current period.

- Ground rent adjustments: we exclude the noncash expense incurred from straight-lining our ground lease obligations as this expense does not reflect the actual rent amounts due to the respective lessors in the current period and is of lesser significance in evaluating our actual performance for the current period. We do, however, include an adjustment for the cash ground lease expenses recorded on the ground lease at the Courtyard by Marriott Los Angeles and the building lease at the Hyatt Centric Chicago Magnificent Mile. We determined that both of these leases are capital leases, and, therefore, we include a portion of the capital lease payments each month in interest expense. We include an adjustment for ground lease expense on capital leases in order to more accurately reflect the actual rent due to both hotels' lessors in the current period, as well as the operating performance of both hotels.

- Undepreciated asset transactions: we exclude the effect of gains and losses on the disposition of undepreciable assets because we believe that including them in Adjusted EBITDAre, excluding noncontrolling interest is not consistent with reflecting the ongoing performance of our assets.

- Gains or losses from debt transactions: we exclude the effect of finance charges and premiums associated with the extinguishment of debt, including the acceleration of deferred financing costs from the original issuance of the debt being redeemed or retired because, like interest expense, their removal helps investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure.

- Acquisition costs: under GAAP, costs associated with completed acquisitions that meet the definition of a business are expensed in the year incurred. We exclude the effect of these costs because we believe they are not reflective of the ongoing performance of the Company or our hotels.

- Noncontrolling interest: we exclude the noncontrolling partner's pro rata share of the net income (loss) allocated to the Hilton San Diego Bayfront partnership, as well as the noncontrolling partner's pro rata share of any EBITDAre and Adjusted EBITDAre components.

- Cumulative effect of a change in accounting principle: from time to time, the FASB promulgates new accounting standards that require the consolidated statement of operations to reflect the cumulative effect of a change in accounting principle. We exclude these one-time adjustments, which include the accounting impact from prior periods, because they do not reflect our actual performance for that period.

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