Summit Hotel Properties, Inc.
Form 10-Q
October 30, 2018

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

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FORM 10-Q

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ý 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
o 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: 001-35074

SUMMIT HOTEL PROPERTIES, INC.
(Exact name of registrant as specified in its charter)

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| | |
|---|---|
| Maryland | 27-2962512 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

13215 Bee Cave Parkway, Suite B-300
Austin, TX 78738
(Address of principal executive offices, including zip code)

(512) 538-2300
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405) of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ý Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | o |
| Non-accelerated filer | o | Smaller reporting company | o |
| | | Emerging growth company | o |
| 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. | | | o |

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

As of October 22, 2018, the number of outstanding shares of common stock of Summit Hotel Properties, Inc. was 104,760,836.

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Condensed Consolidated Balance Sheets
(in thousands, except share amounts)

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Investment in hotel properties, net | $ 2,082,605 | $ 2,059,492 |
| Investment in hotel properties under development | — | 23,793 |
| Land held for development | 2,942 | 2,942 |
| Assets held for sale, net | 1,193 | 1,193 |
| Investment in real estate loans, net | 29,387 | 12,356 |
| Cash and cash equivalents | 60,533 | 36,545 |
| Restricted cash | 31,567 | 29,462 |
| Trade receivables, net | 23,969 | 16,985 |
| Prepaid expenses and other | 6,254 | 9,454 |
| Deferred charges, net | 4,854 | 5,221 |
| Other assets | 19,627 | 12,431 |
| Total assets | $ 2,262,931 | $ 2,209,874 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Debt, net of debt issuance costs | $ 969,146 | $ 868,236 |
| Accounts payable | 5,200 | 7,774 |
| Accrued expenses and other | 71,350 | 56,488 |
| Total liabilities | 1,045,696 | 932,498 |
| Commitments and contingencies (Note 8) | | |
| Equity: | | |
| Preferred stock, $0.01 par value per share, 100,000,000 shares authorized: | | |
| 7.125% Series C - 3,400,000 shares issued and outstanding at December 31, 2017 (aggregate liquidation preference of $85,522 at December 31, 2017) | — | 34 |
| 6.45% Series D - 3,000,000 shares issued and outstanding at September 30, 2018 and December 31, 2017 (aggregate liquidation preference of $75,403 and $75,417 at September 30, 2018 and December 31, 2017, respectively) | 30 | 30 |
| 6.25% Series E - 6,400,000 shares issued and outstanding at September 30, 2018 and December 31, 2017 (aggregate liquidation preference of $160,833 and $160,861 at September 30, 2018 and December 31, 2017, respectively) | 64 | 64 |
| Common stock, $0.01 par value per share, 500,000,000 shares authorized, 104,745,710 and 104,287,128 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively | 1,047 | 1,043 |
| Additional paid-in capital | 1,183,694 | 1,262,679 |
| Accumulated other comprehensive income | 8,033 | 1,451 |
| Retained earnings | 21,648 | 9,201 |
| Total stockholders’ equity | 1,214,516 | 1,274,502 |
| Non-controlling interests in operating partnership | 2,719 | 2,874 |
| Total equity | 1,217,235 | 1,277,376 |
| Total liabilities and equity | $ 2,262,931 | $ 2,209,874 |

See Notes to the Condensed Consolidated Financial Statements

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Summit Hotel Properties, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)
(in thousands, except per share amounts)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Revenues: | | | | |
| Room | $131,429 | $127,246 | $401,651 | $358,110 |
| Food and beverage | 5,817 | 5,465 | 18,663 | 15,718 |
| Other | 5,094 | 3,876 | 14,447 | 9,804 |
| Total revenues | 142,340 | 136,587 | 434,761 | 383,632 |
| Expenses: | | | | |
| Room | 30,854 | 28,976 | 90,972 | 80,435 |
| Food and beverage | 4,684 | 4,444 | 14,790 | 12,277 |
| Other hotel operating expenses | 40,437 | 38,284 | 121,473 | 106,721 |
| Property taxes, insurance and other | 10,220 | 10,189 | 32,250 | 27,371 |
| Management fees | 4,188 | 4,177 | 14,928 | 13,969 |
| Depreciation and amortization | 24,941 | 23,594 | 75,141 | 62,052 |
| Corporate general and administrative | 4,852 | 4,550 | 17,079 | 14,998 |
| Hotel property acquisition costs | — | — | — | 354 |
| Total expenses | 120,176 | 114,214 | 366,633 | 318,177 |
| Operating income | 22,164 | 22,373 | 68,128 | 65,455 |
| Other income (expense): | | | | |
| Interest expense | (10,848) | (7,768) | (30,579) | (21,486) |
| Gain on disposal of assets, net | 24,826 | 7,725 | 42,114 | 43,531 |
| Other income (expense), net | 1,327 | (116) | 5,586 | 2,847 |
| Total other income (expense) | 15,305 | (159) | 17,121 | 24,892 |
| Income from continuing operations before income taxes | 37,469 | 22,214 | 85,249 | 90,347 |
| Income tax benefit (expense) (Note 10) | 532 | 231 | 120 | (613) |
| Net income | 38,001 | 22,445 | 85,369 | 89,734 |
| Non-controlling interest in Operating Partnership | (100) | (55) | (204) | (289) |
| Net income attributable to Summit Hotel Properties, Inc. | 37,901 | 22,390 | 85,165 | 89,445 |
| Preferred dividends | (3,710) | (4,200) | (12,962) | (12,600) |
| Premium on redemption of preferred stock | — | — | (3,277) | — |
| Net income attributable to common stockholders | $34,191 | $18,190 | $68,926 | $76,845 |
| Earnings per share: | | | | |
| Basic | $0.33 | $0.18 | $0.66 | $0.78 |
| Diluted | $0.33 | $0.17 | $0.66 | $0.78 |
| Weighted average common shares outstanding: | | | | |
| Basic | 103,666 | 103,253 | 103,603 | 98,105 |
| Diluted | 103,821 | 103,632 | 103,868 | 98,471 |

See Notes to the Condensed Consolidated Financial Statements

Summit Hotel Properties, Inc.
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)
(in thousands)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | $38,001 | $22,445 | $85,369 | $89,734 |
| Other comprehensive income, net of tax: | | | | |
| Changes in fair value of derivative financial instruments | 2,495 | 157 | 6,601 | 680 |
| Comprehensive income | 40,496 | 22,602 | 91,970 | 90,414 |
| Comprehensive income attributable to non-controlling interests: | | | | |
| Less - Comprehensive income attributable to non-controlling interest in Operating Partnership | (107) | (56) | (223) | (292) |
| Comprehensive income attributable to Summit Hotel Properties, Inc. | 40,389 | 22,546 | 91,747 | 90,122 |
| Preferred dividends | (3,710) | (4,200) | (12,962) | (12,600) |
| Premium on redemption of preferred stock | — | — | (3,277) | — |
| Comprehensive income attributable to common stockholders | $36,679 | $18,346 | $75,508 | $77,522 |

See Notes to the Condensed Consolidated Financial Statements

Summit Hotel Properties, Inc.
Condensed Consolidated Statements of Changes in Equity
For the Nine Months Ended September 30, 2018 and 2017
(Unaudited)
(in thousands, except share amounts)

| | Shares of Preferred Stock | Preferred Stock | Shares of Common Stock | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Deficit) and Distributions | Total Stockholders' Equity | Non-controlling Interests in Operating Partnership | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2017 | 12,800,000 | $128 | 104,287,128 | $1,043 | $1,262,679 | $1,451 | $9,201 | $1,274,502 | $2,874 | $1,277,3 |
| Redemption of preferred stock | (3,400,000) | (34) | — | — | (81,689) | — | (3,277) | (85,000) | — | (85,000 |
| Common stock redemption of common units | — | — | 25,839 | — | 227 | — | — | 227 | (227) | — |
| Dividends | — | — | — | — | — | — | (69,441) | (69,441) | (167) | (69,608 |
| Equity-based compensation | — | — | 620,593 | 6 | 5,345 | — | — | 5,351 | 16 | 5,367 |
| Shares acquired for employee withholding requirements | — | — | (187,850) | (2) | (2,722) | — | — | (2,724) | — | (2,724 |
| Other | — | — | — | — | (146) | — | — | (146) | — | (146 |
| Other comprehensive income | — | — | — | — | — | 6,582 | — | 6,582 | 19 | 6,601 |
| Net income | — | — | — | — | — | — | 85,165 | 85,165 | 204 | 85,369 |
| Balance at September 30, 2018 | 9,400,000 | $94 | 104,745,710 | $1,047 | $1,183,694 | $8,033 | $21,648 | $1,214,516 | $2,719 | $1,217,2 |
| | | | | | | | | | | |
| Balance at December 31, 2016 | 9,400,000 | $94 | 93,525,469 | $935 | $1,011,412 | $(977) | $(1,422) | $1,010,042 | $3,428 | $1,013,4 |
| Net proceeds from sale of common stock | — | — | 10,350,000 | 104 | 163,516 | — | — | 163,620 | — | 163,620 |
| Common stock redemption of common units | — | — | 52,808 | 1 | 466 | — | — | 467 | (467) | — |
| Dividends | — | — | — | — | — | — | (63,240) | (63,240) | (184) | (63,424 |
| Equity-based compensation | — | — | 397,421 | 4 | 4,462 | — | — | 4,466 | 17 | 4,483 |
| Shares acquired for employee withholding requirements | — | — | (59,111) | (1) | (960) | — | — | (961) | — | (961 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Other comprehensive income | — | — | — | — | — | 677 | — | 677 | 3 | 680 |
| Net income | — | — | — | — | — | — | 89,445 | 89,445 | 289 | 89,734 |
| Balance at September 30, 2017 | 9,400,000 | $94 | 104,266,587 | $1,043 | $1,178,896 | $(300 ) | $24,783 | $1,204,516 | $3,086 | $1,207,60 |

See Notes to the Condensed Consolidated Financial Statements

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Summit Hotel Properties, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

| | For the Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income | $85,369 | $89,734 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 75,141 | 62,052 |
| Amortization of deferred financing costs | 1,495 | 1,553 |
| Equity-based compensation | 5,367 | 4,483 |
| Realization of deferred gain | — | (15,000) |
| Gain on disposal of assets, net | (42,114) | (28,531) |
| Other | (1,386) | 51 |
| Changes in operating assets and liabilities: | | |
| Trade receivables, net | (7,054) | (9,140) |
| Prepaid expenses and other | 2,729 | 1,817 |
| Accounts payable | (627) | (233) |
| Accrued expenses and other | 10,040 | 9,780 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 128,960 | 116,566 |
| INVESTING ACTIVITIES | | |
| Acquisitions of hotel properties | (71,002) | (424,734) |
| Investment in hotel properties under development | (12,208) | (15,954) |
| Improvements to hotel properties | (49,523) | (25,252) |
| Proceeds from asset dispositions, net of closing costs | 103,587 | 120,901 |
| Funding of real estate loans | (15,245) | — |
| Proceeds from collection of real estate loans | — | 32,500 |
| NET CASH USED IN INVESTING ACTIVITIES | (44,391) | (312,539) |
| FINANCING ACTIVITIES | | |
| Proceeds from issuance of debt | 470,000 | 485,000 |
| Principal payments on debt | (369,147) | (365,087) |
| Proceeds from equity offerings, net of issuance costs | — | 163,620 |
| Redemption of preferred stock | (85,000) | — |
| Dividends paid | (69,755) | (63,148) |
| Financing fees on debt and other issuance costs | (1,850) | (1,642) |
| Repurchase of common shares for withholding requirements | (2,724) | (961) |
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (58,476) | 217,782 |
| Net change in cash, cash equivalents and restricted cash | 26,093 | 21,809 |
| CASH, CASH EQUIVALENTS AND RESTRICTED CASH | | |
| Beginning of period | 66,007 | 59,575 |
| End of period | $92,100 | $81,384 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash payments for interest | $29,038 | $20,242 |
| Accrued acquisition costs and improvements to hotel properties | $7,853 | $3,482 |
| Capitalized interest | $446 | $172 |
| Cash payments for income taxes, net of refunds | $749 | $600 |

See Notes to the Condensed Consolidated Financial Statements

SUMMIT HOTEL PROPERTIES, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - DESCRIPTION OF BUSINESS

Summit Hotel Properties, Inc. (the “Company”) is a self-managed hotel investment company that was organized on June 30, 2010 as a Maryland corporation. The Company holds both general and limited partnership interests in Summit Hotel OP, LP (the “Operating Partnership”), a Delaware limited partnership also organized on June 30, 2010. Unless the context otherwise requires, “we,” “us,” and “our” refer to the Company and its consolidated subsidiaries.

We focus on owning primarily premium-branded, select-service hotels. At September 30, 2018, our portfolio consisted of 77 hotels with a total of 11,659 guestrooms located in 26 states. We have elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes. To qualify as a REIT, we cannot operate or manage our hotels. Accordingly, all of our hotels are leased to subsidiaries (“TRS Lessees”) of our taxable REIT subsidiary (“TRS”). We indirectly own 100% of the outstanding equity interests in all of our TRS Lessees.

NOTE 2 - BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements of the Company consolidate the accounts of the Company and all entities that are controlled by the Company’s ownership of a majority voting interest in such entities, as well as variable interest entities for which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in the Condensed Consolidated Financial Statements.

We prepare our Condensed Consolidated Financial Statements in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Act of 1934 (the “Exchange Act”). Accordingly, the Condensed Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation in accordance with GAAP have been included. Results for the three and nine months ended September 30, 2018 may not be indicative of the results that may be expected for the full year of 2018. For further information, please read the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017.

Investment in Hotel Properties

The Company allocates the purchase price of acquired hotel properties based on the fair value of the acquired land, land improvements, building, furniture, fixtures and equipment, identifiable intangible assets or liabilities, other assets and assumed liabilities. Intangible assets may include certain value associated with the on-going operations of the hotel business being acquired as part of the hotel property acquisition. We determine the acquisition-date fair values of all assets and assumed liabilities using methods similar to those used by independent appraisers, including using a discounted cash flow analysis that uses appropriate discount or capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including historical operating results, known and anticipated trends, and market and economic conditions.

If substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset or group of similar identifiable assets, the asset or asset group is not considered a business. When we conclude that an acquisition meets this threshold, acquisition costs will be capitalized as part of our allocation of the purchase price of the acquired hotel properties.

Our hotel properties and related assets are recorded at cost, less accumulated depreciation. We capitalize hotel development costs and the costs of significant additions and improvements that materially upgrade, increase the value or extend the useful life of the property. These costs may include hotel development, refurbishment, renovation, and remodeling expenditures, as well as certain indirect internal costs related to construction projects. If an asset requires a period of time in which to carry out the activities necessary to bring it to the condition necessary for its intended use, the interest cost incurred during that period as a result of expenditures for the asset is capitalized as part of the cost of the asset. We expense the cost of repairs and maintenance as incurred.

We monitor events and changes in circumstances for indicators that the carrying value of a hotel property or land held for development may be impaired. Additionally, we perform at least annual reviews to monitor the factors that could trigger an impairment. Factors that we consider for an impairment analysis include, among others: i) significant underperformance relative to historical or anticipated operating results, ii) significant changes in the manner of use of a property or the strategy of our overall business, including changes in the estimated holding periods for hotel properties and land parcels, iii) a significant increase in competition, iv) a significant adverse change in legal factors or regulations, and v) significant negative industry or economic trends. When such factors are identified, we prepare an estimate of the undiscounted future cash flows of the specific property and determine if the carrying amount of the asset is recoverable. If an impairment is identified, we estimate the fair value of the property based on discounted cash flows or sales price if the property is under contract and an adjustment is made to reduce the carrying value of the property to its estimated fair value.

In certain circumstances, we provide loan financing to developers of hotel properties for development projects. We record these loans as Investment in real estate loans, net unless we determine that we are the primary beneficiary of a variable interest entity through the loan provisions or other agreements. If we are the primary beneficiary of a variable interest entity, then the loan is recorded in Investment in hotel properties under development in our Condensed Consolidated Balance Sheets. If classified as Investment in hotel properties under development, no interest income is recognized on the loan and interest expense is capitalized as part of our investment in the hotel property during the construction period.

Cash and Cash Equivalents

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. At times, cash on deposit may exceed the federally insured limit. We maintain our cash with high credit quality financial institutions.

Restricted Cash

Restricted cash consists of certain funds maintained in escrow for property taxes, insurance, and certain capital expenditures. Funds may be disbursed from the account upon proof of expenditures and approval from the lender or other party requiring the restricted cash reserves.

On January 1, 2018, we adopted ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. As a result, we report changes in cash, cash equivalents and restricted cash on our Condensed Consolidated Statement of Cash Flows.

Revenue Recognition

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers. In accordance with ASU No. 2014-09, revenues from the operation of our hotels are recognized when guestrooms are occupied, services have been rendered or fees have been earned. Revenues are recorded net of any discounts and sales and other taxes collected from customers. Revenues consist of room sales, food and beverage sales, and other hotel revenues and are presented on a disaggregated basis on our Condensed Consolidated Statements of Operations.

Room revenue is generated through short-term contracts with customers whereby customers agree to pay a daily rate for the right to occupy hotel rooms for one or more nights. Our performance obligations are fulfilled at the end of each night that the customers have the right to occupy the rooms. Room revenues are recognized daily at the contracted room rate in effect for each room night.

Food and beverage revenues are generated when customers purchase food and beverage at a hotel's restaurant, bar or other facilities. Our performance obligations are fulfilled at the time that food and beverage is purchased and provided to our customers.

Other revenues such as for parking, meeting space or telephone services are recognized at the point in time or over the time period that the associated good or service is provided. Ancillary services such as parking at certain hotels are provided by third parties and we assesses whether we are the principal or agent in such arrangements. If we are determined to be the agent, revenue is recognized based upon the commission paid to us by the third party for the services rendered to our customers. If we are determined to be the principal, revenues are recognized based upon the gross contract price of the service provided. Certain of our hotels have retail spaces, restaurants or other spaces that we lease to third parties. Lease revenues are recognized on a straight– line basis over the respective lease terms and are included in Other income on our Condensed Consolidated Statement of Operations.

Cash received prior to customer arrival is recorded as an advance deposit from the customer and is recognized as revenue at the time of occupancy.

Equity-Based Compensation

Our 2011 Equity Incentive Plan, which was amended and restated effective June 15, 2015 (as amended, the "Equity Plan"), provides for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, dividend equivalent rights, and other stock-based awards. We account for the stock options granted upon completion of our IPO at fair value using the Black-Scholes option-pricing model and we account for all other awards of equity, including time-based and performance-based stock awards, using the grant date fair value of those equity awards. Restricted stock awards with performance-based vesting conditions are market-based awards tied to total stockholder return and are valued using a Monte Carlo simulation model in accordance with ASC Topic 718, Compensation — Stock Compensation. We expense the fair value of awards under the Equity Plan ratably over the vesting period and market-based awards are not adjusted for performance. The amount of stock-based compensation expense may be subject to adjustment in future periods due to a change in forfeiture assumptions or modification of previously granted awards.

On January 1, 2018, we adopted ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. As such, we account for certain changes to share-based payment awards using modification accounting, which may result in incremental stock-based compensation expense based on the remeasurement of the award on the modification date.

Derivative Financial Instruments and Hedging

We use interest rate derivatives to hedge our risks on variable-rate debt. Interest rate derivatives could include swaps, caps and floors. We assess the effectiveness of each hedging relationship by comparing changes in fair value or cash flows of the derivative financial instrument with the changes in fair value or cash flows of the designated hedged item or transaction. All derivative financial instruments are recorded at fair value as a net asset or liability in our Condensed Consolidated Balance Sheets.

During 2017, we adopted ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. Accordingly, beginning in 2017, the change in the fair value of the hedging instruments is recorded in Other comprehensive income. Amounts deferred in Other comprehensive income will be reclassified to Interest expense in our Condensed Consolidated Statements of Operations in the period in which the hedged item affects earnings.

Income Taxes

We have elected to be taxed as a REIT under certain provisions of the Internal Revenue Code. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute annually to our stockholders at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, which does not necessarily equal net income as calculated in accordance with GAAP. As a REIT, we generally will not be subject to federal income tax (other than taxes paid by our TRS at regular corporate income tax rates) to the extent we distribute 100% of our REIT taxable income to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate income tax rates and generally will be unable to re-elect REIT status until the fifth calendar year after the year in which we failed to qualify as a REIT, unless we satisfy certain relief provisions.

Fair Value Measurement

Fair value measures are classified into a three-tiered fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

| | |
|---|---|
| Level 1: | Observable inputs such as quoted prices in active markets. |
| Level 2: | Directly or indirectly observable inputs, other than quoted prices in active markets. |
| Level 3: | Unobservable inputs in which there is little or no market information, which require a reporting entity to develop its own assumptions. |

Assets and liabilities measured at fair value are based on one or more of the following valuation techniques:

| | |
|---|---|
| Market approach: | Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. |
| Cost approach: | Amount required to replace the service capacity of an asset (replacement cost). |
| Income approach: | Techniques used to convert future amounts to a single amount based on market expectations (including present-value, option-pricing, and excess-earnings models). |

Our estimates of fair value were determined using available market information and appropriate valuation methods. Considerable judgment is necessary to interpret market data and develop estimated fair value. The use of different market assumptions or estimation methods may have a material effect on the estimated fair value amounts. We classify assets and liabilities in the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement.

On January 1, 2018, we adopted ASU No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Accordingly, we have elected a measurement alternative for equity investments, such as our purchase options, that do not have readily determinable fair values. Under the alternative, our purchase options are measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer, if any.

Use of Estimates

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

Reclassifications

Certain amounts reported in the Condensed Consolidated Statements of Operations in previous periods have been disaggregated and reclassified to conform to the current period presentation. Revenues have been disaggregated into Rooms, Food and beverage, and Other. Direct and Indirect expense has been reclassified into Room, Food and beverage, and Other hotel operating expenses. Property taxes, insurance and other, and Management expenses are also separately reported.

We have also reclassified certain intangible assets related to our acquisitions of hotel properties from Other assets to Investment in hotel properties, net, on the Condensed Consolidated Balance Sheet. See "Note 3 - Investment in Hotel Properties, net" for further details.

These reclassifications, made at September 30, 2018 and for the three and nine months then ended, had no net effect on the previously reported financial position or results of operations.

New Accounting Standards

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which enhances the reporting requirements for the measurement of financial instruments and requires equity securities to be measured at fair value with changes in the fair value recognized through net income for the period. We adopted ASU No. 2016-01 for our fiscal year commencing on January 1, 2018. The adoption of ASU No. 2016-01 did not have a material effect on our consolidated financial position or our results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which changes lessee accounting to reflect the financial liability and right-of-use assets that are inherent to leasing an asset on the balance sheet. ASU No. 2016-02 is effective for our fiscal year commencing on January 1, 2019, but early adoption is permitted. We anticipate that we will adopt ASU No. 2016-02 for our fiscal year commencing on January 1, 2019. We expect to apply the modified retrospective approach such that we will account for leases that commenced before the effective date of ASU No. 2016-02 in accordance with previous GAAP unless the lease is modified, except we will recognize right-of-use assets and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. We are currently in the process of analyzing our leases. We expect that the adoption of ASU No. 2016-02 will result in the recognition of right-of-use assets and related lease liability accounts on the consolidated balance sheet but is not expected to have a material effect on our consolidated financial position or our results of operations.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses the Statement of Cash Flows classification and presentation of certain cash transactions. We adopted ASU No. 2016-15 for our fiscal year commencing on January 1, 2018. The effect of this amendment has been applied retrospectively. The adoption of ASU No. 2016-15 did not have a material effect on our consolidated financial position or our results of operations.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which clarifies how companies should present restricted cash and restricted cash equivalents in the Statement of Cash Flows. This guidance requires companies to show the changes in the total of cash, cash equivalents and restricted cash in the Statement of Cash Flows. We retrospectively adopted ASU No. 2016-18 for our fiscal year commencing on January 1, 2018. The adoption of ASU No. 2016-18 did not have a material effect on our consolidated financial position or our results of operations.

In May 2017, the FASB issued ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in accordance with ASC No. 718, Compensation - Stock Compensation. We adopted ASC No. 2017-09 for our fiscal year commencing on January 1, 2018. This guidance is to be applied prospectively to an award modified on or after the adoption date. We applied the requirements of ASU No. 2017-09 to the modification of certain stock awards as described in "Note 9 - Equity-Based Compensation."

In February 2018, the FASB issued ASU No. 2018-03, Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which clarifies how an entity should measure certain equity securities. ASU 2018-03 is effective for our fiscal year commencing on January 1, 2019, but we have early adopted ASU No. 2018-03 for our fiscal year commencing on January 1, 2018. The adoption of ASU No. 2018-03 did not have a material effect on our consolidated financial position or results of operations.

NOTE 3 - INVESTMENT IN HOTEL PROPERTIES, NET

Investment in Hotel Properties, net

Investment in hotel properties, net at September 30, 2018 and December 31, 2017 is as follows (in thousands):

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Land | $ 290,782 | $ 272,932 |
| Hotel buildings and improvements | 1,899,906 | 1,868,273 |
| Intangible assets | 22,064 | 22,764 |
| Construction in progress | 20,219 | 12,464 |
| Furniture, fixtures and equipment | 189,457 | 174,126 |
| | 2,422,428 | 2,350,559 |
| Less - accumulated depreciation and amortization | (339,823) | (291,067) |
| | $ 2,082,605 | $ 2,059,492 |

Recently Developed Properties

We completed the development and commenced operations of the new 168-guestroom Hyatt House Across From Orlando Universal Resort™ on June 27, 2018. The total construction cost for this hotel was $32.7 million, excluding land that we acquired in a prior-year transaction. The carrying amount for this hotel includes internal capitalized costs of $1.6 million. Total costs of $37.1 million, including the carrying amount of the land, were reclassified as Investment in hotel properties, net upon completion of construction.

Asset Sales

On September 28, 2018, we sold the Hyatt Place in Fort Myers, FL and adjacent land for $16.5 million. The sale of this property resulted in the realization of a net gain of $2.2 million during the three and nine months ended September 30, 2018.

On July 24, 2018, we completed the sale of three hotel properties, the Hilton Garden Inn - Smyrna, TN, the Hampton Inn & Suites - Smyrna, TN, and the Hyatt Place Phoenix North - Phoenix, AZ, for an aggregate sales price of $46.5 million. The sales of these three properties resulted in the realization of an aggregate net gain of $23.0 million during the three and nine months ended September 30, 2018. The proceeds from these sales were used to complete a 1031 Exchange, which resulted in the deferral of taxable gains of $22.2 million.

On June 29, 2018, we sold the Holiday Inn Express & Suites in Sandy, UT and the Hampton Inn in Provo, UT, for an aggregate selling price of $19.0 million. On June 29, 2018 we also sold the Holiday Inn in Duluth, GA and the Hilton Garden Inn in Duluth, GA for an aggregate selling price of $24.9 million. The sales of these four properties resulted in the realization of an aggregate net gain of $17.4 million during the nine months ended September 30, 2018. We provided seller financing of $3.6 million, on the sale of the Holiday Inn in Duluth, GA and the Hilton Garden Inn in Duluth, GA, under two three-and-a-half-year second mortgage notes with a blended interest rate of 7.38%.

On July 21, 2017, we completed the sale of three hotel properties in Fort Worth, TX for an aggregate sales price of $27.8 million, resulting in a net gain of $8.1 million during the three and nine months ended September 30, 2017. The proceeds from this sale were used to complete a 1031 Exchange, which resulted in the deferral of taxable gains of $8.6 million.

On June 2, 2017, we completed the sale of the Courtyard by Marriott in El Paso, TX for $11.2 million. The sale of this property resulted in the realization of a net gain of $0.4 million during the nine months ended September 30, 2017.

On April 27, 2017, we completed the sale of seven hotels to Hospitality Investors Trust, Inc. ("HIT") for a total purchase price of $66.8 million, resulting in a net gain of $16.0 million during the nine months ended September 30, 2017.

On March 30, 2017, we completed the sale of the Hyatt Place in Atlanta, GA for $14.5 million and repaid a related mortgage loan totaling $6.5 million. The sale of this property resulted in the realization of a net gain of $4.8 million during the nine months ended September 30, 2017.

Dispositions to Affiliates of Hospitality Investors Trust, Inc. (formerly American Realty Capital Hospitality Trust, Inc.)

On June 8, 2015, we entered into multiple sales agreements with affiliates of HIT for the sale of a portfolio of hotels to HIT. The agreements were modified on various occasions between 2015 and 2017 such that we sold 23 hotels containing 2,448 guestrooms to HIT in three tranches over that time period for a combined price of approximately $325.1 million (collectively, the “HIT Sale”) as follows (dollars in thousands):

| Tranche | Closing Date | Hotels Sold | Sales Price |
|---|---|---|---|
| 1 | October 2015 | 10 | $150,000 |
| 2 | February 2016 | 6 | 108,300 |
| 3 | April 2017 | 7 | 66,800 |
| | | 23 | $325,100 |

In connection with the HIT Sale, the Operating Partnership entered into a loan agreement with HIT, as borrower, which provided for a loan by us to HIT in the amount of $27.5 million (the “Loan”). The proceeds of the Loan were applied by HIT as follows: (i) $20.0 million was applied toward the payment of a portion of the $108.3 million purchase price for six hotels acquired in the second tranche; and (ii) the remaining $7.5 million was applied by HIT to fund the escrow deposit required for the purchase of hotels in the third tranche. We deferred $20.0 million of gain from the sale of the hotels in the second tranche as a result of the Loan structure. We recognized the deferred gain as principal payments on the Loan were received, and we recognized the final $15.0 million of gain when the Loan was paid in full on March 31, 2017.

Hotel Property Acquisitions

A summary of the hotel properties acquired during the nine months ended September 30, 2018 and 2017 is as follows (in thousands):

| Date Acquired | Franchise/Brand | Location | Guestrooms | Purchase Price | |
|---|---|---|---|---|---|
| For the nine months ended September 30, 2018 | | | | | |
| September 12, 2018 | Residence Inn by Marriott | Boston (Watertown), MA | 150 | $71,000 | |
| | | | 150 | $71,000 | (1) |
| For the nine months ended September 30, 2017 | | | | | |
| March 1, 2017 | Homewood Suites | Aliso Viejo (Laguna Beach), CA | 129 | $38,000 | |
| March 30, 2017 | Hyatt Place | Phoenix (Mesa), AZ | 152 | 22,200 | |
| May 23, 2017 | Courtyard by Marriott | Fort Lauderdale, FL | 261 | 85,000 | |
| June 9, 2017 | Courtyard by Marriott | Charlotte, NC | 181 | 56,250 | |
| June 21, 2017 | Courtyard by Marriott | Fort Worth, TX | 203 | 40,000 | |
| June 21, 2017 | Courtyard by Marriott | Kansas City, MO | 123 | 24,500 | |
| June 21, 2017 | Courtyard by Marriott | Pittsburgh, PA | 182 | 42,000 | |
| June 21, 2017 | Hampton Inn & Suites | Baltimore, MD | 116 | 18,000 | |
| June 21, 2017 | Residence Inn by Marriott | Baltimore, MD | 188 | 38,500 | |
| July 13, 2017 | AC Hotel by Marriott | Atlanta, GA | 255 | 57,500 | |
| | | | 1,790 | $421,950 | (2) |

(1) The net assets acquired totaled $71.0 million due to the purchase at settlement of $0.1 million of net working capital liabilities and capitalized transaction costs of $0.1 million.
(2) The net assets acquired totaled $424.8 million due to the purchase at settlement of $0.6 million of net working capital assets and capitalized transaction costs of $2.2 million.

The allocation of the aggregate purchase prices to the fair value of assets and liabilities acquired for the above acquisitions is as follows (in thousands):

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| Land | $25,083 | $63,339 |
| Hotel buildings and improvements | 42,676 | 328,395 |
| Intangible assets | — | 16,162 |
| Furniture, fixtures and equipment | 3,300 | 16,294 |
| Other assets | 185 | 1,937 |
| Total assets acquired | 71,244 | 426,127 |
| Less - other liabilities assumed | (242 ) | (1,354 ) |
| Net assets acquired | $71,002 | $424,773 |

All hotel purchases completed in 2018 and 2017 were deemed to be the acquisition of assets. Therefore, acquisition costs related to these transactions have been capitalized as part of the recorded amount of the acquired assets.

The results of operations of acquired hotel properties are included in the Condensed Consolidated Statements of Operations beginning on their respective acquisition dates. The following unaudited pro forma information includes operating results for 77 hotels owned as of September 30, 2018 as if all such hotels had been owned by us since January 1, 2017. For hotels acquired by us after January 1, 2017 (the "Acquired Hotels"), we have included in the pro forma information the financial results of each of the Acquired Hotels for the period from January 1, 2017 to the date the Acquired Hotels were purchased by us (the "Preacquisition Period"). The financial results for the Pre-Acquisition Period were provided by the third-party owner of such Acquired Hotel prior to purchase by us and such information has not been audited or reviewed by our auditors or adjusted by us. For hotels sold by us between January 1, 2017 and September 30, 2018 (the "Disposed Hotels"), the unaudited pro forma information excludes the financial results, including gains on disposal of assets, of each of the Disposed Hotels for the period of ownership by us from January 1, 2017 through the date that the Disposed Hotels were sold by us. The unaudited pro forma information is included to enable comparison of results for the current reporting period to results for the comparable period of the prior year and is not indicative of what actual results of operations would have been had the hotel acquisitions and dispositions taken place on or before January 1, 2017. The pro forma amounts exclude the gain or loss on the sale of hotel properties during the three and nine months ended September 30, 2017 and 2018, respectively. This information does not purport to be indicative of or represent results of operations for future periods.

The unaudited condensed pro forma financial information for the 77 hotel properties owned at September 30, 2018 for the three and nine months ended September 30, 2018 and 2017 is as follows (in thousands, except per share):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Revenues | $143,609 | $140,582 | $424,745 | $414,604 |
| Income from hotel operations | $53,423 | $53,515 | $158,869 | $158,756 |
| Net income (1) | $14,142 | $17,539 | $43,113 | $64,416 |
| Net income attributable to common stockholders, net of amount allocated to participating securities (1) (2) | $10,280 | $13,225 | $26,546 | $51,317 |
| Basic and diluted net income per share attributable to common stockholders (1) (2) | $0.10 | $0.13 | $0.26 | $0.52 |

(1) Pro forma amounts include depreciation expense, property tax expense, interest expense, income tax expense, and other corporate expenses totaling $48.0 million and $43.4 million for the three months ended September 30, 2018 and 2017, respectively, and $145.2 million and $118.5 million for the nine months ended September 30, 2018 and 2017, respectively.

(2) Pro forma amounts for the nine months ended September 30, 2018 include the effect of the premium on redemption of preferred stock of $3.3 million.

Assets Held for Sale

Assets held for sale at September 30, 2018 and December 31, 2017 included land parcels in Spokane, WA and Flagstaff, AZ. The land in Spokane, WA is under contract for sale and is expected to close in the fourth quarter of 2018.

NOTE 4 - DEBT

At September 30, 2018, our indebtedness was comprised of borrowings under our $450.0 million senior unsecured revolving credit and term loan facility (described below), the 2018 Term Loan (as defined below), the 2017 Term Loan (as defined below), and indebtedness secured by first priority mortgage liens on various hotel properties. At December 31, 2017, our indebtedness was comprised of borrowings under our $450.0 million senior unsecured credit and term loan facility, the 2017 Term Loan (as defined below), the 2015 Term Loan (as defined below), and indebtedness secured by first priority mortgage liens on various hotel properties. The weighted average interest rate, after giving effect to our interest rate derivatives, for all borrowings was 4.31% at September 30, 2018 and 3.89% at December 31, 2017.

Debt, net of debt issuance costs, is as follows (in thousands):

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Revolving debt | $ 65,000 | $ 15,000 |
| Term loans | 600,000 | 515,000 |
| Mortgage loans | 308,962 | 343,109 |
| | 973,962 | 873,109 |
| Unamortized debt issuance costs | (4,816 ) | (4,873 ) |
| Debt, net of debt issuance costs | $ 969,146 | $ 868,236 |

We have entered into five interest rate swaps to partially fix the interest rates on a portion of our variable interest rate unsecured indebtedness and term loans. See "Note 5- Derivative Financial Instruments and Hedging" to the Condensed Consolidated Financial Statements for additional information. Our total fixed-rate and variable-rate debt, after considering our interest rate derivative agreements that are currently effective, is as follows (in thousands):

| | September 30, 2018 (1) | Percentage | December 31, 2017 | Percentage |
|---|---|---|---|---|
| Fixed-rate debt | $ 627,833 | 64% | $ 386,313 | 44% |
| Variable-rate debt | 346,129 | 36% | 486,796 | 56% |
| | $ 973,962 | | $ 873,109 | |

(1) Excludes the effect of a $125 million interest rate swap agreement that becomes effective December 31, 2018.

Information about the fair value of our fixed-rate debt that is not recorded at fair value is as follows (in thousands):

| | September 30, 2018 | | December 31, 2017 | | |
|---|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value | Valuation Technique |
| Fixed-rate debt | $277,833 | $272,177 | $311,313 | $310,535 | Level 2 - Market approach |

At September 30, 2018 and December 31, 2017, we had $350.0 million and $75.0 million, respectively, of debt with variable interest rates that had been converted to fixed interest rates through derivative financial instruments which are carried at fair value. Differences between carrying value and fair value of our fixed-rate debt are primarily due to changes in interest rates. Inherently, fixed-rate debt is subject to fluctuations in fair value as a result of changes in the current market rate of interest on the valuation date. For additional information on our use of derivatives as interest rate hedges, refer to "Note 5 — Derivative Financial Instruments and Hedging."

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$450 Million Senior Unsecured Credit and Term Loan Facility

On January 15, 2016, the Operating Partnership, as borrower, the Company, as parent guarantor, and each party executing the loan documentation as a subsidiary guarantor, entered into a $450.0 million senior unsecured revolving credit and term loan facility (the "2016 Unsecured Credit Facility"). The 2016 Unsecured Credit Facility is comprised of a $300.0 million revolving credit facility (the "$300 Million Revolver") and a $150.0 million term loan (the "$150 Million Term Loan"). At September 30, 2018, the maximum amount of borrowing provided by the 2016 Unsecured Credit Facility was $450.0 million, of which we had borrowed $150.0 million under the $150 Million Term Loan and $65.0 million under the $300 Million Revolver and we had $235.0 million available to borrow.

The 2016 Unsecured Credit Facility has an accordion feature which will allow the Company to increase the total commitments by an aggregate of up to $150.0 million. The $300 Million Revolver will mature on March 31, 2020 and can be extended to March 31, 2021 at the Company's option, subject to certain conditions. The $150 Million Term Loan will mature on March 31, 2021.

The Company pays interest on revolving credit advances at varying rates based upon, at the Company's option, either (i) 1-, 2-, 3- or 6-month LIBOR, plus a margin of between 1.50% and 2.25%, depending upon the Company's leverage ratio (as defined in the 2016 Unsecured Credit Facility agreement), or (ii) the applicable base rate, which is the greatest of the administrative agent's prime rate, the federal funds rate plus 0.50%, and 1-month LIBOR plus 1.00%, plus a base rate margin of between 0.50% and 1.25%, depending upon the Company's leverage ratio. The interest rate at September 30, 2018 was 4.06%.

Financial and Other Covenants. We are required to comply with a series of financial and other covenants to borrow under this credit facility. At September 30, 2018, we were in compliance with all required covenants.

Unencumbered Assets. The 2016 Unsecured Credit Facility is unsecured. However, borrowings under the 2016 Unsecured Credit Facility are limited by the value of hotel assets that qualify as unencumbered assets. At September 30, 2018, the Company had 47 unencumbered hotel properties (the "Unencumbered Properties") supporting the 2016 Unsecured Credit Facility. In addition, the Company has one other hotel with a total of 150 guestrooms unencumbered by mortgage debt that is available to be used as collateral for future loans.

Unsecured Term Loans

2018 Term Loan

On February 15, 2018, our Operating Partnership, as borrower, the Company, as parent guarantor, and each party executing the term loan documentation as a subsidiary guarantor, entered into a new $225.0 million unsecured term loan (the "2018 Term Loan") with KeyBank National Association, as administrative agent, and a syndicate of lenders listed in the loan documentation. The 2018 Term Loan has an accordion feature that allows us to increase the total commitments by $150.0 million prior to the maturity date of February 14, 2025, subject to certain conditions. At closing, we drew $140.0 million of the $225.0 million available under the 2018 Term Loan and used the proceeds to pay off and replace the 2015 Term Loan. On May 16, 2018, we drew the remaining $85.0 million available under the 2018 Term Loan and used the proceeds to pay down the $300 Million Revolver.

We pay interest on advances at varying rates, based upon, at our option, either (i) 1-, 2-, 3-, or 6-month LIBOR, plus a LIBOR margin between 1.80% and 2.55%, depending upon our leverage ratio (as defined in the loan documents), or (ii) the applicable base rate, which is the greatest of the administrative agent's prime rate, the federal funds rate plus 0.50%, and 1-month LIBOR plus 1.00%, plus a base rate margin between 0.80% and 1.55%, depending upon our leverage ratio. We are required to pay other fees, including customary arrangement and administrative fees. The interest rate at September 30, 2018 was 4.31%.

Financial and Other Covenants.  We are required to comply with a series of financial and other covenants to draw and maintain borrowings under the 2018 Term Loan. At September 30, 2018, we were in compliance with all financial covenants.

Unencumbered Assets.  The 2018 Term Loan is unsecured.  However, borrowings under the term loan are limited by the value of the assets that qualify as unencumbered assets.  At September 30, 2018, the Unencumbered Properties also supported the 2018 Term Loan.

2017 Term Loan

On September 26, 2017, our Operating Partnership, as borrower, the Company, as parent guarantor, and each party executing the term loan documentation as a subsidiary guarantor, entered into a $225.0 million unsecured term loan (the "2017 Term Loan") with KeyBank National Association, as administrative agent, and a syndicate of lenders listed in the loan documentation.

The 2017 Term Loan has an accordion feature which allows us to increase the total commitments by an aggregate of $175.0 million prior to the maturity date, subject to certain conditions. The 2017 Term Loan matures on November 25, 2022.

We pay interest on advances at varying rates, based upon, at our option, either (i) 1-, 2-, 3-, or 6-month LIBOR, plus a LIBOR margin between 1.45% and 2.20%, depending upon our leverage ratio (as defined in the loan documents), or (ii) the applicable base rate, which is the greatest of the administrative agent’s prime rate, the federal funds rate plus 0.50%, and 1-month LIBOR plus 1.00%, plus a base rate margin between 0.45% and 1.20%, depending upon our leverage ratio. We are required to pay other fees, including customary arrangement and administrative fees. The interest rate at September 30, 2018 was 4.01%.

Financial and Other Covenants. We are required to comply with a series of financial and other covenants to draw and maintain borrowings under the 2017 Term Loan. At September 30, 2018 we were in compliance with all financial covenants.

Unencumbered Assets. The 2017 Term Loan is unsecured. However, borrowings under the term loan are limited by the value of the assets that qualify as unencumbered assets. At September 30, 2018, the Unencumbered Properties also supported the 2017 Term Loan.

2015 Term Loan

On April 7, 2015, our Operating Partnership, as borrower, the Company, as parent guarantor, and each party executing the term loan documentation as a subsidiary guarantor, entered into an unsecured term loan (the “2015 Term Loan”), with an original principal amount of $125.0 million, that was later increased to $140.0 million, upon exercise of an accordion feature.

On February 15, 2018, we repaid the $140.0 million outstanding balance with funds received from the 2018 Term Loan.

Metabank Loan

On June 30, 2017, we entered into a $47.6 million secured, non-recourse loan with MetaBank (the "MetaBank Loan"). As of December 31, 2017, we had drawn the entire $47.6 million balance available under the loan and used the proceeds to pay down the principal balance of our $300 Million Revolver. The MetaBank Loan provides for a fixed interest rate of 4.44% and interest-only payments for 18 months following the closing date. After this 18 month period, the loan is amortized over 25-years through the maturity date of July 1, 2027. The MetaBank Loan is secured by the Residence Inn in Salt Lake City, UT, the Four Points by Sheraton Hotel & Suites in South San Francisco, CA, and the Hyatt Place in Mesa, AZ.

Mortgage and Term Loans

On April 2, 2018, we repaid four mortgage loans with Western Alliance Bank totaling $23.9 million that had a blended interest rate of 5.39%. There were no prepayment penalties associated with the repayment of these loans. The properties that secured the mortgage loans are now unencumbered and have been added to our unencumbered pool to support our 2016 Unsecured Credit Facility, 2017 Term Loan and 2018 Term Loan.

At September 30, 2018, we had $909.0 million in secured mortgage loans and unsecured term loans outstanding (including the 2018 Term Loan, the 2017 Term Loan, and the $150 Million Term Loan). Term loans totaling $309.0 million, including the Metabank Loan, are secured primarily by first mortgage liens on certain hotel properties.

NOTE 5 - DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

Information about our derivative financial instruments at September 30, 2018 and December 31, 2017 is as follows (dollars in thousands):

| | | | Notional Amount | | Fair Value | |
|---|---|---|---|---|---|---|
| Contract date | Effective Date | Expiration Date | September 30, 2018 | December 31, 2017 | September 30, 2018 | December 31, 2017 |
| September 5, 2013 | January 2, 2014 | October 1, 2018 | $75,000 (1) | $75,000 (1) | $— | $ (190 ) |
| October 2, 2017 | January 29, 2018 | January 31, 2023 | 100,000 (2) | 100,000 | 3,707 | 722 |
| October 2, 2017 | January 29, 2018 | January 31, 2023 | 100,000 (2) | 100,000 | 3,779 | 787 |
| June 11, 2018 | September 28, 2018 | September 30, 2024 | 75,000 (3) | — | 180 | — |
| June 11, 2018 | December 31, 2018 | December 31, 2025 | 125,000 (4) | — | 254 | — |
| | | | $475,000 | $275,000 | $7,920 | $ 1,319 |

(1) Interest rate swap is related to a portion of our 2016 Unsecured Credit Facility and converts LIBOR from a floating rate to an average annual fixed rate of 2.04%.
(2) Interest rate swap partially fixes the interest rate on a portion of our variable interest rate unsecured indebtedness and converts LIBOR from a floating rate to an average annual fixed rate of 1.98%.
(3) Interest rate swap partially fixes the interest rate on a portion of our variable interest rate unsecured indebtedness and converts LIBOR from a floating rate to an average annual fixed rate of 2.87%.
(4) Interest rate swap partially fixes the interest rate on a portion of our variable interest rate unsecured indebtedness and converts LIBOR from a floating rate to an average annual fixed rate of 2.93%.

Our interest rate swaps have been designated as cash flow hedges and are valued using a market approach, which is a Level 2 valuation technique. At September 30, 2018, all of our interest rate swaps were in an asset position. At December 31, 2017, two of our interest rate swaps were in an asset position and one was in a liability position. We are not required to post any collateral related to these agreements and are not in breach of any financial provisions of the agreements.

Changes in the fair value of the hedging instruments are deferred in Other comprehensive income and are reclassified to Interest expense in our Condensed Consolidated Statements of Operations in the period in which the hedged item affects earnings. In the next twelve months, we estimate that $0.9 million will be reclassified from Other comprehensive income and recorded as a reduction to Interest expense.

The table below details the location in the financial statements of the gain or loss recognized on derivative financial instruments designated as cash flow hedges (in thousands):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Gain recognized in Other comprehensive income on derivative financial instruments | $2,555 | $2 | $6,401 | $92 |
| Gain (loss) reclassified from Other comprehensive income to Interest expense | $60 | $(155) | $(200 ) | $(588) |

NOTE 6 - EQUITY

Common Stock

The Company is authorized to issue up to 500,000,000 shares of common stock, $0.01 par value per share. Each outstanding share of our common stock entitles the holder to one vote on all matters submitted to a vote of stockholders, including the election of directors and, except as may be provided with respect to any other class or series of stock, the holders of such shares possess the exclusive voting power.

On May 9, 2017, the Company and the Operating Partnership entered into an underwriting agreement relating to the issuance and sale of 9,000,000 shares of the Company's common stock, $0.01 par value per share, at a public offering price of $16.50 per share, less an underwriting discount of $0.66 per share. Pursuant to the terms of the underwriting agreement, the Company granted the underwriters a 30-day option to purchase up to an additional 1,350,000 shares of common stock on the same terms, which the underwriters exercised in full on May 10, 2017. The closing of the offering occurred on May 15, 2017 for net proceeds of $163.8 million, after the underwriting discount and offering-related expenses of $7.0 million.

On May 25, 2017, the Company filed a prospectus supplement to sell up to $200.0 million in common shares under a new "at the market" offering program (the "2017 ATM program"). At the same time, the Company terminated its prior ATM program. To date, we have not sold any shares of our common stock under the 2017 ATM Program.

Changes in common stock during the nine months ended September 30, 2018 and 2017 were as follows:

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | 2018 | 2017 |
| Beginning common shares outstanding | 104,287,128 | 93,525,469 |
| Stock offering | — | 10,350,000 |
| Grants under the Equity Plan | 583,738 | 366,679 |
| Common Unit redemptions | 25,839 | 52,808 |
| Annual grants to independent directors | 34,130 | 28,426 |
| Common stock issued for director fees | 3,543 | 3,553 |
| Forfeitures | (818) | (1,237) |
| Shares retained for employee tax withholding requirements | (187,850) | (59,111) |
| Ending common shares outstanding | 104,745,710 | 104,266,587 |

Preferred Stock

The Company is authorized to issue up to 100,000,000 shares of preferred stock, $0.01 par value per share, of which 90,600,000 is currently undesignated, 3,000,000 shares have been designated as 6.45% Series D Cumulative Redeemable Preferred Stock (the "Series D preferred shares") and 6,400,000 shares have been designated as 6.25% Series E Cumulative Redeemable Preferred Stock (the "Series E preferred shares").

On March 20, 2018, the Company paid $85.3 million to redeem all 3,400,000 of its outstanding 7.125% Series C Cumulative Redeemable Preferred Stock at a redemption price of $25 per share plus accrued and unpaid dividends.

The Company's outstanding shares of preferred stock (collectively, "Preferred Shares") rank senior to our common stock and on parity with each other with respect to the payment of dividends and distributions of assets in the event of a liquidation, dissolution, or winding up. The Preferred Shares do not have any maturity date and are not subject to mandatory redemption or sinking fund requirements. The Company may not redeem the Series D or Series E preferred shares prior to June 28, 2021 and November 13, 2022, respectively, except in limited circumstances relating to the Company's continuing qualification as a REIT or in connection with certain changes in control. After those dates, the Company may, at its option, redeem the applicable Preferred Shares, in whole or from time to time in part, by payment of $25 per share, plus any accumulated, accrued and unpaid distributions up to, but not including, the date of redemption. If the Company does not exercise its rights to redeem the Preferred Shares upon certain changes in control, the holders of the Preferred Shares have the right to convert some or all of their shares into a number of the Company's common shares based on a defined formula, subject to a share cap, or alternative consideration. The share cap on each Series D preferred share is 3.9216 shares of common stock and each Series E preferred share is 3.1686 shares of common stock, all subject to certain adjustments.

The Company pays dividends at an annual rate of $1.6125 for each Series D preferred share and $1.5625 for each Series E preferred share. Dividend payments are made quarterly in arrears on or about the last day of February, May, August and November of each year.

Non-controlling Interests in Operating Partnership

Pursuant to the limited partnership agreement of our Operating Partnership, the unaffiliated third parties who hold common units of limited partnership interest ("Common Units") in our Operating Partnership have the right to cause us to redeem their Common Units in exchange for cash based upon the fair value of an equivalent number of our shares of common stock at the time of redemption; however, the Company has the option to redeem Common Units with shares of our common stock on a one-for-one basis. The number of shares of our common stock issuable upon redemption of Common Units may be adjusted upon the occurrence of certain events such as share dividend payments, share subdivisions or combinations.

At September 30, 2018 and December 31, 2017, unaffiliated third parties owned 297,552 and 323,391 Common Units of the Operating Partnership, respectively, representing less than a 1% limited partnership interest in the Operating Partnership for each period.

We classify outstanding Common Units held by unaffiliated third parties as non-controlling interests in the Operating Partnership, a component of equity in the Company’s Condensed Consolidated Balance Sheets. The portion of net income allocated to these Common Units is reported on the Company’s Condensed Consolidated Statement of Operations as net income attributable to non-controlling interests of the Operating Partnership.

NOTE 7 - FAIR VALUE MEASUREMENT

The following table presents information about our financial instruments measured at fair value on a recurring basis at September 30, 2018 and December 31, 2017. In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, we classify assets and liabilities based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Disclosures concerning financial instruments measured at fair value are as follows (in thousands):

| | Fair Value Measurements at September 30, 2018 using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Interest rate swaps | $ — | $ 7,920 | $ — | $ 7,920 |
| Purchase options related to real estate loans | — | — | 6,120 | 6,120 |

| | Fair Value Measurements at December 31, 2017 using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Interest rate swaps | $ — | $ 1,509 | $ — | $ 1,509 |
| Purchase options related to real estate loans | — | — | 6,078 | 6,078 |
| Liabilities: | | | | |
| Interest rate swaps | — | 190 | — | 190 |

We are a mezzanine lender on three construction loans to fund up to an aggregate of $29.6 million for the development of three hotel properties. The three real estate loans closed in the fourth quarter of 2017 and each has a stated interest rate of 8% and an initial term of approximately three years. As of September 30, 2018, we have funded the full amount of $29.6 million. We have separate options related to each loan (each the "Initial Option") to purchase a 90% interest in each joint venture that owns the respective hotel upon completion of construction. We also have the right to purchase the remaining interests in each joint venture at future dates, generally five years after we exercise our Initial Option. We have recorded the aggregate estimated fair values of the Initial Options totaling $6.1 million in Other assets and as a discount to the related real estate loans. The discount will be amortized as a component of interest income over the term of the real estate loans using the straight-line method, which approximates the interest method. We recorded amortization of the discount of $0.5 million during the three months ended September 30, 2018 and $1.5 million during the nine months ended September 30, 2018.

Our purchase options do not have readily determinable fair values. The fair value of each purchase option was estimated using a binomial lattice model. The estimated fair values of the purchase options were based on unobservable inputs for which there is little or no market information available and required us to develop our own assumptions as follows (dollar amounts in thousands):

| | Real Estate Loan 1 | Real Estate Loan 2 | Real Estate Loan 3 |
|---|---|---|---|
| Exercise price | $ 15,143 | $ 17,377 | $ 5,503 |
| First option exercise date | 12/31/2018 | 3/31/2019 | 5/31/2019 |
| Last option exercise date | 11/1/2020 | 12/5/2020 | 12/1/2020 |
| Expected volatility | 32.0 % | 38.0 % | 37.0 % |
| Risk free rate | 1.7 % | 1.8 % | 1.9 % |
| Expected annualized equity dividend yield | 6.8 % | 9.9 % | 6.5 % |

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Restricted Cash

The Company maintains reserve funds for property taxes, insurance, capital expenditures and replacement or refurbishment of furniture, fixtures and equipment at some of our hotel properties in accordance with management, franchise or mortgage loan agreements. These agreements generally require us to reserve cash ranging from 3% to 5% of the revenues of the individual hotel in restricted cash escrow accounts. Any unused restricted cash balances revert to us upon the termination of the underlying agreement or may be released to us from the restricted cash escrow accounts upon proof of expenditures and approval from the lender or other party requiring the restricted cash reserves. At September 30, 2018 and December 31, 2017, approximately $31.6 million and $29.5 million, respectively, was available in restricted cash reserve funds for property taxes, insurance, capital expenditures and replacement or refurbishment of furniture, fixtures and equipment at our hotel properties.

Ground Leases

At September 30, 2018 and December 31, 2017, we had two prepaid ground leases for two hotel properties in Portland, OR which expire in June 2084. These ground leases had prepaid balances of approximately $3.2 million at both September 30, 2018 and December 31, 2017. We have one option to extend these leases for an additional 14 years. We lease land for one hotel property in Houston (Galleria Area), TX under the terms of an operating ground lease agreement with an initial termination date of April 20, 2053 and one option to extend for an additional 10 years. We lease land for one hotel property in Austin, TX with an initial lease termination date of May 31, 2050. We lease land for one hotel property in Baltimore (Hunt Valley), MD with a lease termination date of December 31, 2019 and twelve remaining options to extend for five additional years per extension. At December 31, 2017, we had an additional ground lease for one hotel property in Duluth, GA. The hotel property was sold on June 29, 2018 and the ground lease was transferred to the buyer. See "Note 3 - Investment in Hotel Properties, net" to the Condensed Consolidated Financial Statements for additional information.

Total rent expense for ground leases for each of the three months ended September 30, 2018 and 2017 was $0.4 million. Total rent expense for ground leases for each of the nine months ended September 30, 2018 and 2017 was $1.3 million.

In addition, we lease land for one hotel property in Garden City, NY under a PILOT (payment in lieu of taxes) lease. We pay a reduced amount of property tax each year of the lease as rent. The lease expires on December 31, 2019.

Upon expiration of the lease, we expect to exercise our right to acquire a fee simple interest in the hotel for nominal consideration.

Franchise Agreements

During the three months ended September 30, 2018 and 2017, we expensed fees related to our franchise agreements of \$11.7 million and \$11.4 million, respectively. During the nine months ended September 30, 2018 and 2017, we expensed fees related to our franchise agreements of \$36.2 million and \$30.8 million, respectively.

Management Agreements

Our hotel properties operate pursuant to management agreements with various professional third-party management companies. We pay base management fees that are a percentage of gross room revenues and incentive management fees based on achievement of certain financial targets pursuant to contracts that generally have remaining terms of less than five years.

Litigation

We are involved from time to time in litigation arising in the ordinary course of business. There are currently no pending legal actions that we believe would have a material effect on our financial position or results of operations.

NOTE 9 - EQUITY-BASED COMPENSATION

Our currently outstanding equity-based awards were issued under the Equity Plan which provides for the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, dividend equivalent rights, and other equity-based awards or incentive awards.

Stock options granted may be either incentive stock options or non-qualified stock options. Vesting terms may vary with each grant, and stock option terms are generally five to ten years. We have outstanding equity-based awards in the form of stock options and restricted stock awards. All of our outstanding equity-based awards are classified as equity awards.

The Company's former Chief Financial Officer retired on March 31, 2018. In connection with his retirement, the Company recorded $1.0 million of additional stock-based compensation expense during the nine months ended September 30, 2018 related to the modification of certain stock award agreements.

Stock Options Granted Under our Equity Plan

As of September 30, 2018, we had 235,000 outstanding and exercisable stock options with a weighted average exercise price of $9.75 per share, weighted average contractual term of 2.4 years and an aggregate intrinsic value of $0.9 million.

Time-Based Restricted Stock Awards Made Pursuant to Our Equity Plan

The following table summarizes time-based restricted stock award activity under our Equity Plan for the nine months ended September 30, 2018:

| | Number of Shares | Weighted Average Grant Date Fair Value (per share) | Aggregate Current Value (in thousands) |
|---|---|---|---|
| Non-vested at December 31, 2017 | 391,477 | $ 13.52 | $ 5,962 |
| Granted | 185,930 | 13.15 | |
| Vested | (205,619) | 13.41 | |
| Forfeited | (818) | 12.84 | |
| Non-vested at September 30, 2018 | 370,970 | $ 13.40 | $ 5,019 |

The awards granted to our non-executive employees generally vest over a four-year period based on continuous service (20% on the first, second and third anniversary of the grant date and 40% on the fourth anniversary of the grant date).

The awards granted to our executive officers generally vest over a three-year period based on continuous service (25% on the first and second anniversary of the grant date and 50% on the third anniversary of the grant date) or in certain circumstances upon a change in control.

The holders of these awards have the right to vote the related shares of common stock and receive all dividends declared and paid whether or not vested. The fair value of time-based restricted stock awards granted is calculated based on the market value of our common stock on the date of grant.

Performance-Based Restricted Stock Awards Made Pursuant to Our Equity Plan

The following table summarizes performance-based restricted stock activity under the Equity Plan for the nine months ended September 30, 2018:

| | Number of Shares | Weighted Average Grant Date Fair Value (1) (per share) | Aggregate Current Value (in thousands) |
|---|---|---|---|
| Non-vested at December 31, 2017 | 619,429 | $ 16.16 | $ 9,434 |
| Granted | 397,808 | 15.69 | |
| Vested | (309,010) | 18.78 | |
| Non-vested at September 30, 2018 | 708,227 | $ 14.75 | $ 9,582 |

(1) The amounts included in this column represent the expected future value of the performance-based restricted stock awards calculated using the Monte Carlo simulation valuation model.

Our performance-based restricted stock awards are market-based awards and are accounted for based on the fair value of our common stock on the grant date. The fair value of the performance-based restricted stock awards granted was estimated using a Monte Carlo simulation valuation model. These awards generally vest over a three-year period based on our percentile ranking within the SNL U.S. REIT Hotel Index at the end of the period or upon a change in control. The awards require continued service during the measurement period and are subject to the other conditions described in the Equity Plan or award document.

The number of shares the executive officers may earn under these awards range from zero shares to twice the number of shares granted based on our percentile ranking within the index at the end of the measurement period. In addition, a portion of the performance-based shares may be earned based on the Company's absolute total shareholder return calculated during the performance period. The holders of these grants have the right to vote the granted shares of common stock and any dividends declared will be accumulated and will be subject to the same vesting conditions as the awards. Further, if additional shares are earned based on our percentile ranking within the index, dividend payments will be issued as if the additional shares had been held throughout the measurement period.

Equity-Based Compensation Expense

Equity-based compensation expense included in Corporate general and administrative expenses in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 and 2017 was as follows (in thousands):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Time-based restricted stock | $518 | $541 | $1,870 | $1,607 |
| Performance-based restricted stock | 784 | | | |