Pebblebrook Hotel Trust
Form 10-Q
April 26, 2012

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

FORM 10-Q

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2012
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 001-34571

PEBBLEBROOK HOTEL TRUST
(Exact Name of Registrant as Specified in Its Charter)

Maryland (State of Incorporation or Organization)	27-1055421 (I.R.S. Employer Identification No.)
2 Bethesda Metro Center, Suite 1530 Bethesda, Maryland (Address of Principal Executive Offices)	20814 (Zip Code)

(240) 507-1300
(Registrant's telephone number, including area code)

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. R Yes ¨ No

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

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

Large accelerated filer	R	Accelerated filer	¨
Non-accelerated filer	¨ (do not check if a smaller reporting company)	Smaller reporting company	¨

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

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

Class	Outstanding at April 23, 2012
Common shares of beneficial interest ($0.01 par value per share)	52,484,196

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
Pebblebrook Hotel Trust
Consolidated Balance Sheets
(In thousands, except share data)

	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Investment in hotel properties, net	$1,133,851	$1,127,484
Investment in joint venture	168,170	171,765
Ground lease asset, net	10,448	10,502
Cash and cash equivalents	36,364	65,684
Restricted cash	8,815	9,469
Hotel receivables (net of allowance for doubtful accounts of $60 and $71, respectively)	15,199	11,312
Deferred financing costs, net	3,660	3,487
Prepaid expenses and other assets	18,869	16,929
Total assets	$1,395,376	$1,416,632
LIABILITIES AND SHAREHOLDERS' EQUITY		
Senior unsecured revolving credit facility	$—	$—
Mortgage debt	211,062	251,539
Accounts payable and accrued expenses	31,770	33,333
Advance deposits	6,142	4,380
Accrued interest	929	1,000
Distribution payable	10,206	10,032
Total liabilities	260,109	300,284
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred shares of beneficial interest, $.01 par value (liquidation preference of $225,000 at March 31, 2012 and December 31, 2011), 100,000,000 shares authorized; 9,000,000 shares issued and outstanding at March 31, 2012 and at December 31, 2011	90	90
Common shares of beneficial interest, $.01 par value, 500,000,000 shares authorized; 52,219,193 issued and outstanding at March 31, 2012 and 50,769,024 issued and outstanding at December 31, 2011	522	508
Additional paid-in capital	1,175,102	1,142,905
Accumulated deficit and distributions	(43,781)	(30,252)
Total shareholders' equity	1,131,933	1,113,251
Non-controlling interests	3,334	3,097
Total equity	1,135,267	1,116,348
Total liabilities and equity	$1,395,376	$1,416,632

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

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Pebblebrook Hotel Trust
Consolidated Statements of Operations
(In thousands, except share and per-share data)
(Unaudited)

	For the three months ended March 31,	
	2012	2011
Revenues:		
Room	$46,855	$25,559
Food and beverage	25,524	14,787
Other operating	5,095	2,319
Total revenues	77,474	42,665
Expenses:		
Hotel operating expenses:		
Room	13,493	7,641
Food and beverage	19,703	10,860
Other direct	2,751	1,161
Other indirect	22,146	13,076
Total hotel operating expenses	58,093	32,738
Depreciation and amortization	9,689	4,797
Real estate taxes, personal property taxes and property insurance	4,007	1,923
Ground rent	420	246
General and administrative	3,600	2,286
Hotel acquisition costs	238	1,726
Total operating expenses	76,047	43,716
Operating income (loss)	1,427	(1,051)
Interest income	6	473
Interest expense	(3,257)	(2,856)
Equity in loss of joint venture	(3,596)	—
Income (loss) before income taxes	(5,420)	(3,434)
Income tax (expense) benefit	2,583	390
Net income (loss)	(2,837)	(3,044)
Net income (loss) attributable to non-controlling interests	(46)	—
Net income (loss) attributable to the Company	(2,791)	(3,044)
Distributions to preferred shareholders	(4,456)	(547)
Net income (loss) attributable to common shareholders	$(7,247)	$(3,591)
Net income (loss) per share attributable to common shareholders, basic and diluted	$(0.14)	$(0.09)
Weighted-average number of common shares, basic	51,009,904	39,827,551
Weighted-average number of common shares, diluted	51,009,904	39,827,551

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

Pebblebrook Hotel Trust
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	For the three months ended March 31, 2012	2011
Operating activities:		
Net income (loss)	$(2,837)	$(3,044)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,689	4,797
Share-based compensation	853	613
Amortization of deferred financing costs	421	330
Amortization of ground lease	54	55
Equity in loss from joint venture	3,596	—
Deferred income tax benefit	2,673	(452)
Other	62	—
Changes in assets and liabilities:		
Restricted cash, net	372	355
Hotel receivables	(3,876)	(4,112)
Prepaid expenses and other assets	(1,842)	(219)
Accounts payable and accrued expenses	(332)	1,322
Advance deposits	1,762	538
Net cash provided by (used in) operating activities	10,595	183
Investing activities:		
Acquisition of hotel properties	—	(37,193)
Improvements and additions to hotel properties	(17,005)	(9,644)
Deposit on hotel properties	(3,000)	(13,500)
Purchase of corporate office equipment, computer software, and furniture	—	(13)
Restricted cash, net	282	(2,085)
Net cash used in investing activities	(19,723)	(62,435)
Financing activities:		
Gross proceeds from issuance of common shares	32,421	—
Gross proceeds from issuance of preferred shares	—	125,000
Payment of offering costs — common and preferred shares	(548)	(4,023)
Payment of deferred financing costs	(594)	(722)
Contributions from non-controlling interest	—	95
Borrowings under senior credit facility	70,000	—
Repayments under senior credit facility	(70,000)	—
Proceeds from mortgage debt	93,000	67,000
Repayments of mortgage debt	(133,477)	(180)
Repurchase of common shares	(319)	(140)
Distributions — common shares/units	(6,219)	(4,908)
Distributions — preferred shares	(4,456)	—
Net cash (used in) provided by financing activities	(20,192)	182,122
Net change in cash and cash equivalents	(29,320)	119,870
Cash and cash equivalents, beginning of year	65,684	220,722
Cash and cash equivalents, end of period	$36,364	$340,592

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

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PEBBLEBROOK HOTEL TRUST
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Organization

Pebblebrook Hotel Trust (the "Company") was formed as a Maryland real estate investment trust on October 2, 2009 to opportunistically acquire and invest in hotel properties located primarily in major United States cities, with an emphasis on major gateway coastal markets.

As of March 31, 2012, the Company owned interests in 20 hotels, including 14 wholly owned hotels, with a total of 3,812 guest rooms and a 49% joint venture interest in six hotels with 1,733 guest rooms. The hotels are located in the following markets: Atlanta (Buckhead), Georgia; Bethesda, Maryland; Boston, Massachusetts; Miami, Florida; Minneapolis, Minnesota; New York, New York; Philadelphia, Pennsylvania; San Diego, California; San Francisco, California; Santa Monica, California; Seattle, Washington; Stevenson, Washington; Washington, D.C.; and West Hollywood, California.

Substantially all of the Company's assets are held by, and all of the operations are conducted through, Pebblebrook Hotel, L.P., (the "Operating Partnership"). The Company is the sole general partner of the Operating Partnership. At March 31, 2012, the Company owned 98.3 percent of the common limited partnership units issued by the Operating Partnership ("common units"). The remaining 1.7 percent of the common units are owned by the other limited partners of the Operating Partnership. For the Company to qualify as a real estate investment trust ("REIT") under the Internal Revenue Code, it cannot operate the hotels it owns. Therefore, its Operating Partnership and its subsidiaries lease the hotel properties to subsidiaries of Pebblebrook Hotel Lessee, Inc. (collectively, "PHL"), the Company's taxable REIT subsidiary ("TRS"), which in turn engages third-party eligible independent contractors to manage the hotels. PHL is consolidated into the Company's financial statements.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and in conformity with the rules and regulations of the Securities and Exchange Commission ("SEC") applicable to interim financial information. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations of the SEC. These unaudited consolidated financial statements include all adjustments considered necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows for the periods presented. Interim results are not necessarily indicative of full-year performance, as a result of the impact of seasonal and other short-term variations and the acquisitions of hotel assets. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The consolidated financial statements include all of the accounts of the Company and its wholly owned subsidiaries in accordance with U.S. GAAP. All intercompany balances and transactions have been eliminated in consolidation. Investments in entities that the Company does not control, but has the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method.

The Company's comprehensive income (loss) equals its net income (loss) available to common shareholders and the Company had no items classified as accumulated other comprehensive income (loss) for the three months ended March 31, 2012 and 2011.

Use of Estimates

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and revenues and expenses. These estimates are prepared using management's best judgment, after considering past, current and expected events and economic conditions. Actual results could differ from these estimates.

Fair Value Measurements

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 are as follows:

1. Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

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2. Level 2 – Inputs include quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-derived valuations whose inputs are observable.
3. Level 3 – Model-derived valuations with unobservable inputs.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

Investment in Hotel Properties

Upon acquisition of hotel properties, the Company allocates the purchase price 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. Identifiable intangible assets or liabilities typically arise from contractual arrangement terms that are above or below market compared to an estimated market agreement at the acquisition date. Acquisition-date fair values of assets and assumed liabilities are determined based on replacement costs, appraised values, and estimated fair values using methods similar to those used by independent appraisers and that use appropriate discount and/or capitalization rates and available market information.

Acquisition costs are expensed as incurred.

Hotel renovations and replacements of assets that improve or extend the life of the asset are recorded at cost and depreciated over their estimated useful lives. Furniture, fixtures and equipment under capital leases are recorded at the present value of the minimum lease payments. Repair and maintenance costs are expensed as incurred.

Hotel properties are recorded at cost and depreciated using the straight-line method over an estimated useful life of 10 to 40 years for buildings, land improvements, and building improvements and one to 10 years for furniture, fixtures and equipment. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets. Intangible assets arising from contractual arrangements are typically amortized over the life of the contract. The Company is required to make subjective assessments as to the useful lives and classification of properties for purposes of determining the amount of depreciation expense to reflect each year with respect to the assets. These assessments may impact the Company’s results of operations.

The Company reviews its investments in hotel properties for impairment whenever events or changes in circumstances indicate that the carrying value of the hotel properties may not be recoverable. Events or circumstances that may cause a review include, but are not limited to, when a hotel property experiences a current or projected loss from operations, when it becomes more likely than not that a hotel property will be sold before the end of its useful life, adverse changes in the demand for lodging at the properties due to declining national or local economic conditions and/or new hotel construction in markets where the hotels are located. When such conditions exist, the Company performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel exceed its carrying value. If the estimated undiscounted future cash flows are less than the carrying value of the asset, an adjustment to reduce the carrying value to the related hotel’s estimated fair market value is recorded and an impairment loss recognized. In the evaluation of impairment of its hotel properties, the Company makes many assumptions and estimates including projected cash flows both from operations and eventual disposition, expected useful life and holding period, future required capital expenditures, and fair values, including consideration of capitalization rates, discount rates, and comparable selling prices. The Company will adjust its assumptions with respect to the remaining useful life of the hotel property when circumstances change or it is more likely than not that the hotel property will be sold prior to its previously expected useful life.

The Company will classify a hotel as held for sale when a binding agreement to purchase the property has been signed under which the buyer has committed a significant amount of nonrefundable cash, no significant financing contingencies exist, and the sale is expected to close within one year. If these criteria are met and if the fair value less costs to sell is lower than the carrying value of the hotel, the Company will record an impairment loss and will cease recording depreciation expense. The Company will classify the loss, together with the related operating results, as discontinued operations on the statements of operations and classify the assets and related liabilities as held for sale on the balance sheet.

Revenue Recognition

Revenue consists of amounts derived from hotel operations, including the sales of rooms, food and beverage, and other ancillary amenities. Revenue is recognized when rooms are occupied and services have been rendered. The Company collects sales, use, occupancy and similar taxes at its hotels which are presented on a net basis on the statement of operations.

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Income Taxes

To qualify as a REIT for federal income tax purposes, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90 percent of its adjusted taxable income to its shareholders. As a REIT, the Company generally will not be subject to federal corporate income tax on that portion of its taxable income that is currently distributed to shareholders. The Company is subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income. In addition, PHL, which leases the Company's hotels from the Operating Partnership, is subject to federal and state income taxes. The Company accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Valuation allowances are provided if, based upon the weight of the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Share-based Compensation

The Company has adopted an equity incentive plan that provides for the grant of common share options, share awards, share appreciation rights, performance units and other equity-based awards. Equity-based compensation is measured at the fair value of the award on the date of grant and recognized as an expense on a straight line basis over the vesting period. The determination of fair value of these awards is subjective and involves significant estimates.

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing the net income (loss) attributable to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income (loss) attributable to common shareholders as adjusted for potentially dilutive securities, by the weighted-average number of common shares outstanding plus potentially dilutive securities. Any anti-dilutive securities are excluded from the diluted per-share calculation.

Note 3. Acquisition of Hotel Properties

The Company had no hotel acquisitions during the quarter ended March 31, 2012. The following unaudited pro forma financial information presents the results of operations of the Company for the three months ended March 31, 2012 and 2011 as if the hotels and the interest in the joint venture acquired in 2011 were acquired on January 1, 2010. The pro forma results below excluded acquisition costs of $1.7 million for the three months ended March 31, 2011. The unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of either the results of operations that would have actually occurred had these transactions occurred on January 1, 2010 or the future results of operations (in thousands, except per-share data).

	For the three months ended March 31,	
	2012	2011
	(Unaudited)	
Total revenues	$77,474	$73,112
Operating income (loss)	1,427	1,360
Net income (loss) attributable to common shareholders	(7,247)	(5,909)
Net income (loss) per share attributable to common shareholders — basic and diluted	$(0.14)	$(0.12)

Note 4. Investment in Hotel Properties

Investment in hotel properties as of March 31, 2012 and December 31, 2011 consisted of the following (in thousands):

	March 31, 2012	December 31, 2011
Land	$190,197	$190,197
Buildings and improvements	896,210	887,217

Furniture, fixtures and equipment	92,972	86,138
Investment in hotel properties	$1,179,379	$1,163,552
Less: Accumulated depreciation	(45,528)	(36,068)
Investment in hotel properties, net	$1,133,851	$1,127,484

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Note 5. Investment in Joint Venture

On July 29, 2011, the Company acquired a 49% interest in a joint venture (the “Manhattan Collection joint venture”), which owns six properties in New York, New York. The Company accounts for this investment using the equity method. As of March 31, 2012, the joint venture reported approximately $537.6 million in total assets. The joint venture total liabilities and members' deficit include approximately $572.6 million in existing first mortgage and mezzanine debt which matures in February of 2013 and approximately $76.6 million of preferred capital which may be distributed after the later of 27 months from July 29, 2011 or the date on which the joint venture refinances, modifies, or extends its debt. The Company is not a guarantor of any existing debt of the joint venture except for limited customary carve-outs related to fraud or misapplication of funds.

At the time of the Company’s investment, the estimated fair value of the hotel properties owned by the Manhattan Collection joint venture exceeded the carrying value. This basis difference between the Company’s investment in the joint venture and the Company’s proportionate 49% interest in these depreciable assets held by the joint venture is amortized over the estimated life of the underlying assets and recognized as a component of equity in earnings of joint venture (referred to as the basis adjustment in the table below).

The summarized results of operations of the Company’s investment in the Manhattan Collection joint venture for the three months ended March 31, 2012 are presented below (in thousands):

	Three months ended March 31, 2012	
Revenues	$32,200	
Total expenses	38,596	
Net income (loss)	$(6,396	)
Company’s 49% interest of net income (loss)	(3,134	)
Basis adjustment	(462	)
Equity in earnings (losses) in joint venture	$(3,596	)

Note 6. Debt

Senior Unsecured Revolving Credit Facility

The Company is party to a $200.0 million senior unsecured revolving credit facility. The credit facility matures on June 3, 2014, and the Company has a one-year extension option. The Company has the ability to increase the credit facility borrowings up to $400.0 million with lender approval. Borrowings on the credit facility bear interest at LIBOR plus 2.5% to 3.5%, depending on the Company’s leverage ratio. Additionally, the Company is required to pay an unused commitment fee at an annual rate of 0.35% or 0.50% of the unused portion of the senior credit facility, depending on the amount of borrowings outstanding. The credit facility contains certain financial covenants including a maximum leverage ratio, a maximum debt service coverage ratio, a minimum fixed charge coverage ratio, and minimum net worth. As of March 31, 2012 and December 31, 2011, the Company had no outstanding borrowings under the credit facility. As of March 31, 2012, the Company was in compliance with the credit facility debt covenants. For both quarters ended March 31, 2012 and 2011, the Company incurred unused commitment fees of $0.2 million.

Mortgage Debt

Each of the Company’s mortgage loans is secured by a first mortgage lien or by leasehold interests under the ground lease on the underlying property. The mortgages are non-recourse to the Company except for fraud or misapplication of funds.

On January 11, 2012, the Company obtained a $46.0 million first mortgage loan secured by the Company's leasehold interest under the ground lease on the Monaco Washington DC hotel. A portion of the proceeds from this loan was used to repay the existing $35.0 million mortgage on this property. The loan has a term of five years, bears interest at 4.36% and requires monthly principal and interest payments of $0.2 million.

On January 11, 2012, the Company repaid the $42.0 million loan on the Argonaut hotel with cash on hand and borrowings from the Company's senior unsecured revolving credit facility. On February 15, 2012, the Company obtained a $47.0 million first-mortgage loan secured by the Company's leasehold interest under the ground lease on the Argonaut hotel. The loan has a term of five years, bears interest at 4.25% and requires monthly principal and interest payments of $0.3 million.

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On February 1, 2012, the Company repaid the $56.1 million first mortgage loan on the Sofitel Philadelphia hotel. Mortgage debt as of March 31, 2012 and December 31, 2011 consisted of the following (in thousands):

				Balance Outstanding as of	
	Interest Rate		Maturity Date	March 31, 2012	December 31, 2011
Sofitel Philadelphia	Floating	[1]	February 2012	$—	$56,070
InterContinental Buckhead	4.88	%	January 2016	51,609	51,805
Skamania Lodge	5.44	%	February 2016	30,561	30,664
DoubleTree by Hilton Bethesda-Washington DC	5.28	%	February 2016	35,954	36,000
Monaco Washington DC	4.36	%	February 2017	45,938	35,000
Argonaut Hotel	4.25	%	March 2017	47,000	42,000
				$211,062	$251,539

[1] Mortgage debt interest rate is LIBOR plus 1.3%. The interest rate as of December 31, 2011 was 1.57%.

The Company estimates the fair value of its fixed rate debt by discounting the future cash flows of each instrument at estimated market rates, taking into consideration general market conditions and maturity of the debt with similar credit terms and is classified within level 2 of the fair value hierarchy. The estimated fair value of the Company’s debt as of March 31, 2012 and December 31, 2011 was $212.0 million and $251.2 million, respectively.

The Company was in compliance with all debt covenants as of March 31, 2012.

Note 7. Equity

Common Shares

The Company is authorized to issue up to 500,000,000 common shares of beneficial interest, $.01 par value per share (“common shares”). Each outstanding common share entitles the holder to one vote on each matter submitted to a vote of shareholders. Holders of the Company’s common shares are entitled to receive dividends when authorized by the Company’s board of trustees.

On March 16, 2012, the Company issued 264,276 common shares at an average price of $23.06 per share under its at the market offering ("ATM") program and raised $6.0 million, net of commissions.

On March 19, 2012, the Company issued 1,142,803 common shares at an average price of $23.04 per share under its ATM program and raised $25.9 million, net of commissions.

Common Dividends

The Company paid or will pay the following dividends on common shares/units for the three months ended March 31, 2012:

Dividend per Share/Unit	For the quarter ended	Record Date	Payable Date
$0.12	March 31, 2012	March 30, 2012	April 16, 2012

Preferred Shares

The Company is authorized to issue up to 100,000,000 preferred shares of beneficial interest, $.01 par value per share (“preferred shares”).

As of March 31, 2012 and December 31, 2011, the Company had 5,600,000 shares of its 7.875% Series A Cumulative Redeemable Preferred Shares ("Series A Preferred Shares") and 3,400,000 shares of its 8.00% Series B Cumulative Redeemable Preferred Shares ("Series B Preferred Shares") outstanding.

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The Series A Preferred Shares and the Series B Preferred Shares (collectively, the “Preferred Shares”) rank senior to the common shares of beneficial interest and on parity with each other with respect to payment of distributions. The Preferred Shares are cumulative redeemable preferred shares. The outstanding Preferred Shares do not have any maturity date and are not subject to mandatory redemption. The Company may not optionally redeem the Series A Preferred Shares or Series B Preferred Shares prior to March 11, 2016 and September 21, 2016, respectively, except in limited circumstances relating to the Company’s continuing qualification as a REIT or as discussed below. After those dates, the Company may, at its option, redeem the Preferred Shares, in whole or from time to time in part, by payment of $25.00 per share, plus any accumulated, accrued and unpaid distributions through the date of redemption. Upon the occurrence of a change of control, as defined in the Company's declaration of trust, the result of which the Company’s common shares of beneficial interest and the common securities of the acquiring or surviving entity are not listed on the New York Stock Exchange, the NYSE Amex or NASDAQ, or any successor exchanges, the Company may, at its option, redeem the Preferred Shares in whole or in part within 120 days after the change of control occurred by paying $25.00 per share, plus any accrued and unpaid distributions through the date of redemption. If the Company does not exercise its right to redeem the Preferred Shares upon a change of 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. The share cap on each Series A Preferred Share is 2.3234 common shares and the share cap on each Series B Preferred Share is 3.4483 common shares.

Preferred Dividends

The Company paid or will pay the following dividends on preferred shares for the three months ended March 31, 2012:

Security Type	Dividend per Share/Unit	For the quarter ended	Record Date	Payable Date
7.875% Series A	$0.49	March 31, 2012	March 30, 2012	April 16, 2012
8.00% Series B	$0.50	March 31, 2012	March 30, 2012	April 16, 2012

Non-controlling Interest of Common Units in Operating Partnership

Holders of Operating Partnership units have certain redemption rights that enable the unit holders to cause the Operating Partnership to redeem their units in exchange for, at the Company’s option, cash per unit equal to the market price of the Company’s common shares at the time of redemption or for the Company’s common shares on a one-for-one basis. The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of share splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of our limited partners or our shareholders.

As of March 31, 2012 and December 31, 2011, the Operating Partnership had 929,099 long-term incentive partnership units (“LTIP units”) outstanding, all of which have reached parity with other common Operating Partnership units. As of March 31, 2012, 371,640 of these LTIP units have vested. Only vested LTIP units may be converted to common units of the Operating Partnership which in turn can be redeemed for an equal number of common shares in the Company. As of March 31, 2012, no LTIP units have been converted to common shares.

Note 8. Share-Based Compensation Plan

The Company maintains the 2009 Equity Incentive Plan to attract and retain independent trustees, executive officers and other key employees and service providers. The plan provides for the grant of options to purchase common shares, share awards, share appreciation rights, performance units and other equity-based awards. Share awards under this plan generally vest over three to five years. The Company pays dividends on unvested shares. All share awards are subject to full or partial accelerated vesting upon a change in control and upon death or disability or certain other employment termination events as set forth in the award agreements. As of March 31, 2012, there were 44,888 common shares available for issuance under the 2009 Equity Incentive Plan.

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Service Condition Share Awards

The following table provides a summary of restricted share activity as of March 31, 2012:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at January 1, 2012	128,664	$21.59
Granted	52,545	$23.15
Vested	(48,324)	$21.55
Forfeited	—	$—
Unvested at March 31, 2012	132,885	$22.22

The fair value of each restricted share award is determined based on the closing price of the Company's common shares on the grant date. For the three months ended March 31, 2012 and 2011, the Company recognized approximately $0.3 million and $0.2 million, respectively, of share-based compensation expense related to these restricted shares in the consolidated statements of operations. As of March 31, 2012, there was $2.7 million of total unrecognized share-based compensation expense related to unvested restricted shares. The unrecognized share-based compensation expense is expected to be recognized over the weighted-average remaining vesting period of 3.5 years.

Performance-Based Equity Awards

Performance-based equity awarded to officers and employees cliff vest after three years if certain performance measurements are met. These awards also require continued employment and are subject to full or partial accelerated vesting upon a change in control and upon death or disability or certain other employment termination events as set forth in the award agreements. The actual number of common shares that ultimately vest will be determined in 2015 based on certain share price and operating performance metrics for the period from January 1, 2012 through December 31, 2014. Performance-based equity awards granted to certain officers are subject to a maximum award cap; however, there is no maximum or cap of the number of shares which may vest on the employee awards.

The performance measurements include share price and operating metrics consist of (1) the Company's total shareholder return relative to the total shareholder return of seven companies in a designated peer group ("Relative TSR"); (2) the Company's total shareholder return to established total shareholder return thresholds ("Absolute TSR"); and (3) the change in the gap between the Company's hotel-level earnings before interest, taxes, depreciation and amortization ("Hotel EBITDA") margin compared to that of a peer company. Dividends accumulate over the vesting period and are paid to the grantee once the number of vested shares is determined.

The Relative TSR and Absolute TSR measurements each represent 30 percent of the award and the Hotel EBITDA margin measurement represents 40 percent of the award. The Relative and Absolute TSR measurements are market conditions and the Hotel EBITDA measurement is a performance condition as market and performance conditions are defined in ASC Topic 718.

On February 8, 2012, the Board of Trustees approved a grant of up to a maximum 120,016 performance-based equity awards to certain officers of the Company ("officer awards") and approved a target award of 12,102 performance-based equity awards to employees of the Company ("employee awards"). The fair values of the market conditions were determined using a Monte Carlo simulation method performed by a third-party valuation firm. The assumptions for determining the fair value of the Relative TSR and Absolute TSR components included: risk-free interest rate of 0.34%, dividend yield of 2.2%, and expected volatility of 33%. The simulations also considered the actual TSR performance of our shares and the share performance of the peer group. The grant date fair value of the performance condition was determined based on the closing share price on the date of grant times the target number of shares for this component of the award. Compensation expense on the Hotel EBITDA component will be reassessed at each reporting date to determine whether achievement of the target performance condition is probable, and the accrual of compensation expense will be adjusted as appropriate.

The Company recognizes compensation expense on a straight-line basis through December 31, 2014, the vesting date. The grant date fair value of the officer and employee awards, based upon the estimated number of shares (the target awards) that are expected to vest, was $1.9 million. As of March 31, 2012, there was approximately $1.8 million of unrecognized compensation expense related to these awards which will be recognized over 2.8 years. For the quarter ended March 31, 2012, the Company recognized $0.1 million in expense related to these awards.

Long-Term Incentive Partnership Units

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LTIP units, which are also referred to as profits interest units, may be issued to eligible participants for the performance of services to or for the benefit of the Operating Partnership. LTIP units are a class of partnership unit in the Company's Operating Partnership and will receive, whether vested or not, the same per-unit profit distributions as the other outstanding units in the Operating Partnership, which equal per-share distributions on common shares. Prior to reaching parity with common units, LTIP units have a capital account balance of zero, do not receive an allocation of net income (loss) and do not have full parity with the common Operating Partnership units with respect to liquidating distributions. If such parity is reached, vested LTIP units may be converted, at any time, into an equal number of common Operating Partnership units and thereafter will possess all of the rights and interests of a common Operating Partnership unit, including the right to redeem the common Operating Partnership unit for a common share in the Company or cash, at the option of the Operating Partnership.

Upon completion of the Company's equity offering of common shares on April 6, 2011, the Company determined that a revaluation event occurred, as defined in the Internal Revenue Code, and the LTIP units achieved full parity with the common Operating Partnership units with respect to liquidating distributions and all other purposes. These LTIP units are allocated their pro-rata share of the Company's net income (loss).

As of March 31, 2012, the Company had 929,099 LTIP units outstanding, all of which have reached parity with common units. All of the LTIP units were held by officers of the Company as of March 31, 2012. These LTIP units vest ratably on each of the first five anniversaries of their dates of grant. All LTIP units will vest upon a change in control. The LTIP units were valued using a Monte Carlo simulation method model. The LTIP unit grants were valued at $8.50 per LTIP unit. As of March 31, 2012, 371,640 LTIP units have vested.

The Company recognized $0.4 million in share-based compensation expense related to the LTIP units for the three months ended March 31, 2012 and 2011. As of March 31, 2012, there was $4.3 million of total unrecognized share-based compensation expense related to LTIP units. This unrecognized share-based compensation expense is expected to be recognized over the weighted-average remaining vesting period of 2.8 years. The aggregate expense related to the LTIP unit grants is presented as non-controlling interest in the Company's consolidated balance sheets.

Note 9. Income Taxes

The Company has estimated PHL's income tax benefit for the three months ended March 31, 2012 using an estimated combined federal and state statutory tax rate of 40.2%. As of March 31, 2012, the Company had deferred tax assets of $2.7 million primarily due to current period tax net operating losses. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

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Note 10. Earnings per Common Share

The following is a reconciliation of basic and diluted earnings per common share (in thousands, except share and per-share data):

	For the three months ended March 31,	
	2012	2011
Numerator:		
Net income (loss) attributable to common shareholders	$(7,247)	$(3,591)
Less: dividends paid on unvested share-based compensation	(83)	(15)
Undistributed earnings attributable to share-based compensation	—	—
Net income (loss) available to common shareholders	$(7,330)	$(3,606)
Denominator:		
Weighted-average number of common shares — basic	51,009,904	39,827,551
Effect of dilutive share-based compensation	—	—
Weighted-average number of common shares — diluted	51,009,904	39,827,551
Net income (loss) per share attributable to common shareholders — basic	$(0.14)	$(0.09)
Net income (loss) per share attributable to common shareholders — diluted	$(0.14)	$(0.09)

For the three months ended March 31, 2012, 204,995 of unvested restricted shares and performance-based equity awards were excluded from diluted weighted-average common shares, as their effect would have been anti-dilutive. For the three months ended March 31, 2011, 124,564 unvested restricted shares were excluded from diluted weighted-average common shares, as their effect would have been anti-dilutive. The LTIP units held by the non-controlling interest holders have been excluded from the denominator of the diluted earnings per share as there would be no effect on the amounts since the limited partners' share of income (loss) would also be added or subtracted to derive at net income (loss) available to common shareholders.

Note 11. Commitments and Contingencies

Management Agreements

The Company’s hotel properties are operated pursuant to management agreements with various management companies. The initial terms of these management agreements range from five years to 20 years, not including renewals, and five years to 40 years, including renewals. Many of the Company’s management agreements are terminable at will by the Company upon paying a termination fee and some are terminable by the Company upon sale of the property, with in some cases, the payment of termination fees. Most of the agreements also provide the Company the ability to terminate based on failure to achieve defined operating performance thresholds. Termination fees range from zero to up to six times the annual base management and incentive management fees, depending on the agreement and the reason for termination. Certain of the Company’s management agreements are non-terminable except upon the manager’s breach of a material representation or the manager’s failure to meet performance thresholds as defined in the management agreement.

The management agreements require the payment of a base management fee generally between 2% and 4% of hotel revenues. Under certain management agreements, the management companies are also eligible to receive an incentive management fee if hotel operating income, cash flows or other performance measures, as defined in the agreements, exceed certain performance thresholds. The incentive management fee is generally calculated as a percentage of hotel operating income after the Company has received a priority return on its investment in the hotel. Combined base and incentive management fees were $2.1 million and $1.2 million for the three months ended March 31, 2012 and 2011, respectively.

Reserve Funds

Certain of the Company’s agreements with its hotel managers, franchisors and lenders have provisions for the Company to provide funds, typically 4.0% of hotel revenues, sufficient to cover the cost of (a) certain non-routine repairs and maintenance to the hotels and (b) replacements and renewals to the hotels’ furniture, fixtures and equipment.

Restricted Cash

At March 31, 2012 and December 31, 2011, the Company had $8.8 million and $9.5 million, respectively, in restricted

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cash, which consisted of reserves for replacement of furniture and fixtures or reserves to pay for real estate taxes or property insurance under certain hotel management agreements or lender requirements.

Ground Lease

The Monaco Washington DC is subject to a long-term ground lease agreement on the land underlying the hotel. The ground lease expires in 2059. The hotel is required to pay the greater of an annual base rent of $0.2 million or a percentage of gross hotel revenues and gross food and beverage revenues in excess of certain thresholds, as defined in the agreement. The lease contains certain restrictions on modifications that can be made to the structure due to its status as a national historic landmark.

The Company assumed a long-term ground lease agreement in connection with its acquisition of the Argonaut Hotel. The ground lease expires in 2059. The hotel is required to pay the greater of an annual base rent of $1.2 million or a percentage of rooms revenues, food and beverage revenues and other department revenues in excess of certain thresholds, as defined in the agreement. The lease contains certain restrictions on modifications that can be made to the structure due to its status as a national historic landmark.

Litigation

The nature of the operations of the hotels exposes the hotels, the Company and the Operating Partnership to the risk of claims and litigation in the normal course of their business. The Company may obtain insurance to cover certain potential material losses. The Company is not presently subject to any material litigation nor, to the Company’s knowledge, is any material litigation threatened against the Company.

Note 12. Supplemental Information to Statements of Cash Flows

	For the three months ended March 31,	
	2012	2011
	(in thousands)	
Interest paid	$2,906	$1,936
Income taxes paid	$232	$62
Non-Cash Investing and Financing Activities:		
Distributions payable on common shares/units	$6,393	$4,898
Distributions payable on preferred shares	$3,813	$547
Issuance of common shares for board of trustees compensation	$199	$183
Mortgage loan assumed in connection with acquisition	$—	$42,000
Accrued additions and improvements to hotel properties	$2,493	$—

Note 13. Subsequent Events

On April 4, 2012, the Company acquired the 108-room Hotel Milano located in San Francisco, California for $29.8 million. The acquisition was funded with available cash. The Company retained Viceroy Hotel Group to manage the property. The Company plans to invest between $8.0 million and $10.0 million over the next 12 months in a complete renovation and repositioning of the hotel, including all guestrooms, public areas and the restaurant.

In April 2012, the Company terminated the management agreement at the DoubleTree by Hilton Bethesda-Washington DC Hotel. The Company will incur approximately $1.1 million in termination and transition expenses. The Company will retain Davidson Hotel Group to manage the property.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. Pebblebrook Hotel Trust is a Maryland real estate investment trust that conducts its operations so as to qualify as a REIT under the Code. Substantially all of the operations are conducted through Pebblebrook Hotel, L.P. (the “Operating Partnership”), a Delaware limited partnership of which Pebblebrook Hotel Trust is the sole general partner. In this report, we use the terms “the Company,” “we” or “our” to refer to Pebblebrook Hotel Trust and its subsidiaries, unless the context indicates otherwise.

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Forward-Looking Statements

This report, together with other statements and information publicly disseminated by the Company, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend 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 include this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words “may,” “will,” “should,” “potential,” “could,” “predict,” “continue,” “assume,” “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” “forecast” or similar expressions. Forward-looking statements in this report include, among others, statements about our business strategy, including our acquisition and development strategies, industry trends, estimated revenues and expenses, ability to realize deferred tax assets and expected liquidity needs and sources (including capital expenditures and our ability to obtain financing or raise capital). You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and which could materially affect actual results, performances or achievements. Factors that may cause actual results to differ materially from current expectations include, but are not limited to: