Pebblebrook Hotel Trust
Form 10-Q
October 23, 2014

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 September 30, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission File Number 001-34571

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 October 20, 2014
Common shares of beneficial interest ($0.01 par value per share)	67,745,368

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.

Pebblebrook Hotel Trust
Consolidated Balance Sheets
(In thousands, except share data)

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Investment in hotel properties, net	$1,879,271	$1,717,611
Investment in joint venture	256,274	260,304
Ground lease asset, net	23,478	19,217
Cash and cash equivalents	119,307	55,136
Restricted cash	17,915	16,482
Hotel receivables (net of allowance for doubtful accounts of $215 and $270, respectively)	30,137	16,850
Deferred financing costs, net	3,726	4,736
Prepaid expenses and other assets	37,999	26,595
Total assets	$2,368,107	$2,116,931
LIABILITIES AND EQUITY		
Senior unsecured revolving credit facility	$—	$—
Term loan	100,000	100,000
Mortgage debt (including mortgage loan premium of $4,913 and $5,888, respectively)	497,235	454,247
Accounts payable and accrued expenses	88,792	61,428
Advance deposits	11,287	8,432
Accrued interest	2,054	1,945
Distribution payable	22,159	15,795
Total liabilities	721,527	641,847
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred shares of beneficial interest, $.01 par value (liquidation preference $350,000 at September 30, 2014 and $325,000 at December 31, 2013), 100,000,000 shares authorized; 14,000,000 and 13,000,000 shares issued and outstanding at September 30, 2014 and at December 31, 2013, respectively	140	130
Common shares of beneficial interest, $.01 par value, 500,000,000 shares authorized; 67,614,929 issued and outstanding at September 30, 2014 and 63,709,628 issued and outstanding at December 31, 2013	676	637
Additional paid-in capital	1,717,853	1,541,138
Accumulated other comprehensive income (loss)	954	1,086
Distributions in excess of retained earnings	(76,910)	(69,652)
Total shareholders' equity	1,642,713	1,473,339
Non-controlling interests	3,867	1,745
Total equity	1,646,580	1,475,084
Total liabilities and equity	$2,368,107	$2,116,931

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

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Room	$120,934	$90,093	$306,887	$240,632
Food and beverage	38,577	32,900	106,442	99,291
Other operating	10,165	8,241	29,513	22,526
Total revenues	169,676	131,234	442,842	362,449
Expenses:				
Hotel operating expenses:				
Room	27,807	22,063	75,561	61,768
Food and beverage	27,596	24,705	76,562	74,180
Other direct	3,687	3,619	10,812	10,344
Other indirect	40,192	32,629	110,951	92,893
Total hotel operating expenses	99,282	83,016	273,886	239,185
Depreciation and amortization	17,396	13,971	49,514	40,747
Real estate taxes, personal property taxes, property insurance, and ground rent	9,539	7,991	26,847	22,900
General and administrative	7,208	4,253	18,946	12,838
Hotel acquisition costs	475	268	996	1,429
Total operating expenses	133,900	109,499	370,189	317,099
Operating income (loss)	35,776	21,735	72,653	45,350
Interest income	645	670	1,880	1,964
Interest expense	(7,278)	(6,074)	(19,609)	(17,457)
Equity in earnings (loss) of joint venture	3,450	2,284	4,470	2,492
Income (loss) before income taxes	32,593	18,615	59,394	32,349
Income tax (expense) benefit	(2,154)	(1,088)	(1,941)	(137)
Net income (loss)	30,439	17,527	57,453	32,212
Net income (loss) attributable to non-controlling interests	274	112	537	211
Net income (loss) attributable to the Company	30,165	17,415	56,916	32,001
Distributions to preferred shareholders	(6,428)	(6,100)	(18,591)	(16,872)
Net income (loss) attributable to common shareholders	$23,737	$11,315	$38,325	$15,129
Net income (loss) per share attributable to common shareholders, basic and diluted	$0.36	$0.18	$0.59	$0.24
Weighted-average number of common shares, basic	64,859,494	61,179,524	64,133,134	61,086,834
Weighted-average number of common shares, diluted	65,346,188	61,347,863	64,613,449	61,279,252

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Comprehensive Income:				
Net income (loss)	$30,439	$17,527	$57,453	$32,212
Other comprehensive income (loss):				
Unrealized gain (loss) on derivative instruments	446	(589)	(132)	1,211
Comprehensive income (loss)	30,885	16,938	57,321	33,423
Comprehensive income (loss) attributable to non-controlling interests	278	108	536	218
Comprehensive income (loss) attributable to the Company	$30,607	$16,830	$56,785	$33,205

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

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Pebblebrook Hotel Trust
Consolidated Statements of Equity
(In thousands, except share data)
(Unaudited)

	Preferred Shares		Common Shares			Accumulated Other Comprehensive Income (Loss)	Distributions in Excess of Retained Earnings	Total Shareholders' Equity	Non-Controlling Interests	Total Equity
	Shares	Amount	Shares	Amount	Additional Paid-In Capital					
Balance at December 31, 2012	9,000,000	$90	60,955,090	$610	$1,362,349	$(300)	$(49,798)	$1,312,951	$141	$1,313,092
Issuance of shares, net of offering costs	4,000,000	40	171,893	2	101,200	—	—	101,242	—	101,242
Issuance of common shares for Board of Trustees compensation	—	—	9,097	—	207	—	—	207	—	207
Repurchase of common shares	—	—	(21,644)	—	(523)	—	—	(523)	—	(523)
Share-based compensation	—	—	65,192	—	2,672	—	—	2,672	1,185	3,857
Distributions on common shares/units	—	—	—	—	—	—	(29,522)	(29,522)	(183)	(29,705)
Distributions on preferred shares	—	—	—	—	—	—	(16,872)	(16,872)	(9)	(16,881)
Other comprehensive income (loss):										
Unrealized gain (loss) on derivative instruments	—	—	—	—	—	1,211	—	1,211	—	1,211
Net income (loss)	—	—	—	—	—	—	32,001	32,001	211	32,212
Balance at September 30, 2013	13,000,000	$130	61,179,628	$612	$1,465,905	$911	$(64,191)	$1,403,367	$1,345	$1,404,712
Balance at December 31, 2013	13,000,000	$130	63,709,628	$637	$1,541,138	$1,086	$(69,652)	$1,473,339	$1,745	$1,475,084
Issuance of shares, net of	1,000,000	10	3,850,000	39	170,701	—	—	170,750	—	170,750

offering costs										
Issuance of common shares for Board of Trustees compensation	—	—	13,793	—	421	—	—	421	—	421
Repurchase of common shares	—	—	(20,539)	—	(632)	—	—	(632)	—	(632)
Share-based compensation	—	—	62,047	—	6,225	—	—	6,225	2,012	8,237
Distributions on common shares/units	—	—	—	—	—	—	(45,583)	(45,583)	(420)	(46,003)
Distributions on preferred shares	—	—	—	—	—	—	(18,591)	(18,591)	(7)	(18,598)
Other comprehensive income (loss):										
Unrealized gain (loss) on derivative instruments	—	—	—	—	—	(132)	—	(132)	—	(132)
Net income (loss)	—	—	—	—	—	—	56,916	56,916	537	57,453
Balance at September 30, 2014	14,000,000	$140	67,614,929	$676	$1,717,853	$954	$(76,910)	$1,642,713	$3,867	$1,646,580

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

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

	For the nine months ended September 30,	
	2014	2013
Operating activities:		
Net income (loss)	$57,453	$32,212
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	49,514	40,747
Share-based compensation	8,237	3,857
Amortization of deferred financing costs and mortgage loan premiums	(455)	(147)
Non-cash ground rent	1,645	2,405
Equity in (earnings) loss from joint venture	(2,683)	(706)
Other	311	447
Changes in assets and liabilities:		
Restricted cash, net	(743)	(2,061)
Hotel receivables	(12,769)	(9,995)
Prepaid expenses and other assets	(2,590)	(4,413)
Distributions from joint venture	6,713	735
Accounts payable and accrued expenses	12,359	8,550
Advance deposits	1,945	3,433
Net cash provided by (used in) operating activities	118,937	75,064
Investing activities:		
Acquisition of hotel properties	(125,531)	(99,274)
Improvements and additions to hotel properties	(30,989)	(27,682)
Distribution from (investment in) joint venture, net	—	26,291
Acquisition of note receivable	(3,020)	—
Purchase of corporate office equipment, software, and furniture	(336)	(32)
Restricted cash, net	(690)	(1,835)
Property insurance proceeds	1,113	—
Net cash provided by (used in) investing activities	(159,453)	(102,532)
Financing activities:		
Gross proceeds from issuance of common shares	146,854	4,829
Gross proceeds from issuance of preferred shares	25,000	100,000
Payment of offering costs — common and preferred shares	(1,104)	(3,586)
Payment of deferred financing costs	(440)	(649)
Borrowings under senior credit facility	130,000	—
Repayments under senior credit facility	(130,000)	—
Repayments of mortgage debt	(6,761)	(5,881)
Repurchase of common shares	(632)	(523)
Distributions — common shares/units	(39,986)	(27,099)
Distributions — preferred shares	(18,244)	(15,481)
Net cash provided by (used in) financing activities	104,687	51,610
Net change in cash and cash equivalents	64,171	24,142
Cash and cash equivalents, beginning of year	55,136	85,900
Cash and cash equivalents, end of period	$119,307	$110,042

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 in October 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 September 30, 2014, the Company owned interests in 31 hotels, including 25 wholly owned hotels with a total of 6,046 guest rooms, and a 49% joint venture interest in six hotels with a total of 1,775 guest rooms. The hotels are located in the following markets: Atlanta (Buckhead), Georgia; Bethesda, Maryland; Boston, Massachusetts; Hollywood, California; Los Angeles, California; Miami, Florida; Minneapolis, Minnesota; New York, New York; Philadelphia, Pennsylvania; Portland, Oregon; San Diego, California; San Francisco, California; Santa Monica, California; Seattle, Washington; Stevenson, Washington; Washington, D.C.; West Hollywood, California; and Westwood, 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 September 30, 2014, the Company owned 99.1% of the common limited partnership units issued by the Operating Partnership ("common units"). The remaining 0.9% 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 of 1986, as amended (the "Code"), it cannot operate the hotels it owns. Therefore, the 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 comprehensive income 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 properties. 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, 2013.

The Company and its subsidiaries are separate legal entities and maintain records and books of account separate and apart from each other. The consolidated financial statements include all of the accounts of the Company and its subsidiaries and are presented in accordance with U.S. GAAP. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in entities in which 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.

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:

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

The Company's financial instruments include cash and cash equivalents, restricted cash, accounts payable and accrued expenses. Due to their short maturities, the carrying amounts of these assets and liabilities approximate fair value. See Note 6 for disclosures on the fair value of debt and derivative instruments.

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 arrangements in connection with the transaction, including 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 1 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 sell 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 generally classify the loss, together with the related operating results, as continuing operations on the statements of operations and classify the assets and related liabilities as held for sale on the balance sheet. See "Recent Accounting Standards" below.

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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. For retail operations, revenue is recognized on a straight-line basis over the lives of the retail leases. The Company collects sales, use, occupancy and similar taxes at its hotels which are presented on a net basis on the statement of operations.

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 is not 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. Share-based compensation awards that contain a performance condition are reviewed at least quarterly to assess the achievement of the performance condition. Compensation expense will be adjusted when a change in the assessment of achievement of the specific performance condition level is determined to be probable. The determination of fair value of these awards is subjective and involves significant estimates and assumptions including expected volatility of the Company's shares, expected dividend yield, expected term and assumptions of whether these awards will achieve parity with other operating partnership units or achieve performance thresholds.

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 dilutive securities, by the weighted-average number of common shares outstanding plus dilutive securities. Any anti-dilutive securities are excluded from the diluted per-share calculation.

Recent Accounting Standards

On April 10, 2014, the FASB issued ASU 2014-08 Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the criteria for determining which disposals are presented as discontinued operations and modifies related disclosure requirements. This standard is effective for fiscal years beginning after December 15, 2014 and for interim periods within those fiscal years with early adoption permitted. The Company has early adopted this standard effective January 1, 2014. Under this ASU, the Company anticipates that the majority of property sales will not be classified as discontinued operations.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give

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rise to substantial doubt about an entity's ability to continue as a going concern. This guidance is effective for the Company on January 1, 2017 and will not have an impact on the Company's financial position, results of operations or cash flows.

Note 3. Acquisition of Hotel Properties

On May 22, 2014, the Company acquired the 160-room Prescott Hotel located in San Francisco, California for $49.0 million. In addition, the Company paid certain costs of the seller of $1.3 million. The transaction included a fee simple acquisition of 96 guest rooms in one building and a leasehold interest acquisition of 64 guest rooms in an adjacent attached building. In connection with the acquisition of the leasehold interest, the Company assumed a long-term hotel lease with an unaffiliated third party that expires in 2059, with a one time extension option of 30 years. The Company is required to pay annual base rent of approximately $0.5 million, beginning in October 2017. The annual base rent is subject to a fixed increase every year during the remaining lease term. This transaction was funded with available cash and borrowings under the Company's senior unsecured revolving credit facility. The hotel will continue to be managed by Kimpton Hotel & Restaurant Group, LLC, the Hotel's current manager.

As noted above, the Prescott Hotel is subject to a long-term hotel lease of 64 rooms located in an adjacent attached building. The building portion of the long-term hotel lease assumed was determined to be a capital lease under the criteria in ASC 840 - Leases. At acquisition, the Company recorded a capital lease obligation of $10.8 million related to this leasehold interest, based on the estimated fair value of the payments for the remaining term, and is included in accounts payable and accrued expenses. The Company recorded a capital asset of $11.0 million based on an estimated fair value for the right to use the leased property, which is included in investment in hotel properties, net, in the accompanying consolidated balance sheets.

On July 17, 2014, the Company acquired the 331-room The Nines Hotel located in Portland, Oregon for $127.0 million. The acquisition was funded with $76.3 million of borrowings under the Company's senior unsecured revolving credit facility and assumption of three non-recourse mortgage loans totaling $50.7 million. The hotel will continue to be managed by Sage Hospitality, the Hotel's current manager.

In conjunction with the acquisition of The Nines Hotel, the Company is required to indemnify certain tax credit investors for certain income tax liabilities and related expenses such investors will incur if the Company were to repay the three mortgage loans before March 5, 2015 or engage in certain businesses prohibited under the New Markets Tax Credit program. Owning and operating a hotel is not one of those prohibited businesses. The potential indemnification obligation could range from zero to $28.3 million (plus interest, penalties and related expenses) and will expire on March 5, 2015, which is the end of the New Markets Tax Credit compliance period. Due to the nature of these requirements and because compliance with them is within the Company's control, the Company believes that the likelihood that the Company will be required to pay under this indemnity is remote.

The allocation of fair value to the acquired assets and liabilities is as follows (in thousands):

	2014 Acquisitions
Land	$31,055
Buildings and improvements	136,004
Furniture, fixtures and equipment	9,851
Below (Above) market rate contracts	10,731
Assumed debt	(50,725)
Capital lease obligation	(10,758)
Net working capital	(627)
Net assets acquired	$125,531

The following unaudited pro forma financial information presents the results of operations of the Company for the three and nine months ended September 30, 2014 and 2013 as if the hotels acquired in 2014 and 2013 were acquired

on January 1, 2013 and 2012, respectively. The following hotels' pro forma results are included in the pro forma table below: Embassy Suites San Diego Bay-Downtown, Redbury Hotel, Hotel Modera, Radisson Hotel Fisherman's Wharf, Prescott Hotel and The Nines Hotel. The pro forma results below exclude acquisition costs of $0.5 million and $0.3 million for the three months ended September 30, 2014 and 2013, respectively, and $1.0 million and $1.4 million for the nine months ended September 30, 2014 and 2013, respectively. The unaudited pro forma results have been prepared for comparative purposes only and do not purport

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to be indicative of either the results of operations that would have actually occurred had these transactions occurred or the future results of operations (in thousands, except per-share data).

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Total revenues	$171,501	$157,016	$468,070	$435,089
Operating income (loss)	36,136	29,605	76,695	61,910
Net income (loss) attributable to common shareholders	23,438	18,006	39,526	28,216
Net income (loss) per share available to common shareholders — basic	$0.36	$0.28	$0.61	$0.44
Net income (loss) per share available to common shareholders — diluted	$0.36	$0.27	$0.61	$0.43

For both the three and nine months ended September 30, 2014, the Company's consolidated statements of operations included $13.6 million and $15.1 million of revenues, respectively, and $7.9 million and $8.8 million of hotel operating expenses, respectively, related to the operations of the Prescott Hotel and The Nines Hotel acquired in 2014.

Note 4. Investment in Hotel Properties

Investment in hotel properties as of September 30, 2014 and December 31, 2013 consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Land	$303,715	$272,661
Buildings and improvements	1,590,813	1,437,593
Furniture, fixtures and equipment	158,813	135,547
Construction in progress	6,582	4,138
Investment in hotel properties	$2,059,923	$1,849,939
Less: Accumulated depreciation	(180,652)	(132,328)
Investment in hotel properties, net	$1,879,271	$1,717,611

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 transaction valued the six hotels at approximately $908.0 million (subject to working capital and similar adjustments). The Company accounts for this investment using the equity method.

On December 27, 2012, the Manhattan Collection joint venture refinanced its existing loans with a new, single $410.0 million loan, secured by five of the properties (excluding Affinia Dumont) owned by the joint venture. The new loan bears interest at an annual fixed rate of 3.67% and requires interest-only payments through maturity on January 5, 2018. In conjunction with the refinancing, the Company provided the joint venture a $50.0 million unsecured special loan which matures at the earlier of July 4, 2018, the closing of any refinancing of the secured loan or the closing date of a portfolio sale (as defined in the loan agreement). The unsecured special loan bears interest at an annual fixed rate of 9.75% and requires interest-only payments through maturity. The unsecured special loan is pre-payable by the joint venture at any time. The unsecured special loan to the joint venture is included in the investment in joint venture on the consolidated balance sheets. Interest income is recorded on the accrual basis and the Company's 49% pro-rata portion of the special loan and related interest income is eliminated.

As of September 30, 2014, the joint venture reported $472.9 million in total assets, which represents the basis of the hotels prior to the Company's investment. The joint venture's total liabilities and members' deficit include $460.0 million in existing first mortgage debt and a $50.0 million unsecured special loan. 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

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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 (loss) 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 and nine months ended September 30, 2014 and 2013 are presented below (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Revenues	$47,726	$43,299	$131,699	$121,868
Total expenses	41,771	39,881	126,107	119,273
Net income (loss)	$5,955	$3,418	$5,592	$2,595
Company's 49% interest of net income (loss)	2,918	1,675	2,740	1,272
Basis adjustment	(70)	7	(57)	(567)
Special loan interest income elimination	602	602	1,787	1,787
Equity in earnings (loss) in joint venture	$3,450	$2,284	$4,470	$2,492

The Company classifies the distributions from its joint venture in the statements of cash flows based upon an evaluation of the specific facts and circumstances of each distribution. For example, distributions from cash generated by property operations are classified as cash flows from operating activities. However, distributions received as a result of property sales are classified as cash flows from investing activities.

Note 6. Debt

Senior Unsecured Revolving Credit Facility

The Company's $300.0 million credit facility provides for a $200.0 million unsecured revolving credit facility and a $100.0 million unsecured term loan. The revolving credit facility matures in July 2016, and the Company has a one-year extension option. The Company has the ability to increase the aggregate borrowing capacity under the credit agreement up to $600.0 million, subject to lender approval. Borrowings on the revolving credit facility bear interest at LIBOR plus 1.75% to 2.50%, depending on the Company's leverage ratio. Additionally, the Company is required to pay an unused commitment fee at an annual rate of 0.25% or 0.35% of the unused portion of the revolving credit facility, depending on the amount of borrowings outstanding. The credit agreement contains certain financial covenants, including a maximum leverage ratio, a maximum debt service coverage ratio, a minimum fixed charge coverage ratio, and a minimum net worth. As of September 30, 2014 and December 31, 2013, the Company had no outstanding borrowings under the revolving credit facility. As of September 30, 2014, the Company was in compliance with the credit agreement debt covenants. For the three and nine months ended September 30, 2014, the Company incurred unused commitment fees of $0.1 million and $0.4 million, respectively. For the three and nine months ended September 30, 2013, the Company incurred unused commitment fees of $0.2 million and $0.5 million, respectively.

Term Loan

On August 13, 2012, the Company drew the entire $100.0 million unsecured term loan provided for under its amended senior credit agreement. The five-year term loan matures in July 2017 and bears interest at a variable rate, but was swapped to an effective fixed interest rate for the full five-year term (see "Derivative and Hedging Activities" below).

Derivative and Hedging Activities

The Company enters into interest rate swap agreements to hedge against interest rate fluctuations. Unrealized gains and losses on the effective portion of hedging instruments are reported in other comprehensive income (loss) and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. Ineffective portions of changes in the fair value of a cash flow hedge are recognized as interest expense. Effective August 13, 2012, the Company entered into three interest rate swap agreements with an aggregate notional amount of $100.0 million for the term loan's full five-year term, resulting in an effective fixed interest rate of 2.55% at the Company's current leverage ratio (as defined in the agreement). The Company has designated its pay-fixed, receive-floating interest rate swap derivatives as cash flow hedges.

The Company records all derivative instruments at fair value in the consolidated balance sheets. Fair values of interest rate swaps are determined using the standard market methodology of netting the discounted future fixed cash receipts/payments and the discounted expected variable cash payments/receipts. Variable interest rates used in the calculation of projected receipts

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and payments on the swaps are based on an expectation of future interest rates derived from observable market interest rate curves (Overnight Index Swap curves) and volatilities (level 2 inputs). Derivatives expose the Company to credit risk in the event of non-performance by the counterparties under the terms of the interest rate hedge agreements. The Company believes it minimizes the credit risk by transacting with major creditworthy financial institutions.

As of September 30, 2014, the Company's derivative instruments are in an asset position, with an aggregate fair value of $1.0 million, which is included in prepaid expenses and other assets in the accompanying consolidated balance sheets. For the three and nine months ended September 30, 2014, there was $0.4 million in unrealized gain and $0.1 million in unrealized loss, respectively, recorded in accumulated other comprehensive income. During the three and nine months ended September 30, 2014 the Company reclassified $0.1 million and $0.4 million, respectively, from accumulated other comprehensive income (loss) and to interest expense. During the three and nine months ended September 30, 2013, the Company reclassified $0.1 million and $0.4 million, respectively, from accumulated other comprehensive income to net income (loss) and to interest expense. The Company expects approximately $0.4 million will be reclassified from accumulated other comprehensive income to net income (loss) in the next 12 months.

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 customary carve-outs such as fraud or misapplication of funds.

In conjunction with the acquisition of The Nines Hotel, the Company assumed three non-recourse mortgage loans totaling $50.7 million secured by the property. The three loans are scheduled to mature on March 5, 2015, bear interest at a weighted-average rate of 7.39% and require monthly interest-only payments until maturity. As the weighted-average interest rate of the loans were above market for loans with comparable terms, the Company recorded a loan premium of $0.9 million, which is amortized as a reduction of interest expense over the remaining term.

Debt Summary

Debt as of September 30, 2014 and December 31, 2013 consisted of the following (dollars in thousands):

	Interest Rate	Maturity Date	Balance Outstanding as of September 30, 2014	December 31, 2013
Senior unsecured revolving credit facility	Floating	July 2016	$—	$—
Term loan	Floating[1]	July 2017	100,000	100,000
Mortgage loans				
The Nines Hotel [2]	7.39%	March 2015	50,725	—
InterContinental Buckhead	4.88%	January 2016	49,544	50,192
Skamania Lodge	5.44%	February 2016	29,465	29,811
DoubleTree by Hilton Bethesda-Washington DC	5.28%	February 2016	34,710	35,102
Embassy Suites San Diego Bay-Downtown	6.28%	June 2016	64,788	65,725
Hotel Modera	5.26%	July 2016	23,321	23,597
Monaco Washington DC	4.36%	February 2017	43,965	44,580
Argonaut Hotel	4.25%	March 2017	44,295	45,138
Sofitel Philadelphia	3.90%	June 2017	47,286	48,218
Hotel Palomar San Francisco	5.94%	September 2017	26,549	26,802
The Westin San Diego Gaslamp Quarter	3.69%	January 2020	77,674	79,194
Mortgage loans at stated value			492,322	448,359
Mortgage loan premiums [3]			4,913	5,888
Total mortgage loans			$497,235	$454,247
Total debt			$597,235	$554,247

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(1) The Company entered into interest rate swaps to effectively fix the interest rate at 2.55% for the full five-year term, based on its current leverage ratio.
(2) The interest rate of 7.39% represents a weighted-average interest rate of the three non-recourse mortgage loans assumed in conjunction with the acquisition of The Nines Hotel.
(3) Loan premiums on assumed mortgages recorded in purchase accounting for the Hotel Palomar San Francisco, Embassy Suites San Diego Bay - Downtown, Hotel Modera and The Nines Hotel.

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 mortgage debt as of September 30, 2014 and December 31, 2013 was $505.0 million and $460.9 million, respectively.

The Company was in compliance with all debt covenants as of September 30, 2014.

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.

During the nine months ended September 30, 2014, the Company issued 400,000 common shares at an average price of $38.09 per share under its $175.0 million "at the market" offering program (an "ATM program") and raised $15.0 million, net of commissions. On March 5, 2014, the Company filed a prospectus supplement with the SEC to sell up to $175.0 million in common shares under a new "at the market" offering program (an "ATM program"). At the same time, the Company terminated its prior $170.0 million ATM program. As of September 30, 2014, $159.8 million in common shares remained available for issuance under the $175.0 million ATM program.

On September 9, 2014, the Company issued 3,450,000 common shares at a price of $38.15 per share in an underwritten public offering and raised $131.6 million, net of the underwriting discount.

Common Dividends

The Company declared the following dividends on common shares/units for the nine months ended September 30, 2014:

Dividend per Share/Unit	For the quarter ended	Record Date	Payable Date
$0.23	March 31, 2014	March 31, 2014	April 15, 2014
$0.23	June 30, 2014	June 30, 2014	July 15, 2014
$0.23	September 30, 2014	September 30, 2014	October 15, 2014

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").

On September 30, 2014, the Company issued 1,000,000 of its 6.50% Series C Cumulative Redeemable Preferred Shares ("Series C Preferred Shares") at an offering price of $25.00 per share, for a total of $24.5 million of proceeds, net of the underwriting discount.

As of September 30, 2014, the Company had 5,600,000 of its 7.875% Series A Cumulative Redeemable Preferred Shares ("Series A Preferred Shares"), 3,400,000 of its 8.00% Series B Cumulative Redeemable Preferred Shares ("Series B Preferred Shares") and 5,000,000 of its Series C Preferred Shares outstanding. As of December 31, 2013, the Company had 5,600,000 Series A Preferred Shares, 3,400,000 Series B Preferred Shares and 4,000,000 Series C Preferred Shares outstanding.

The Series A Preferred Shares, Series B Preferred Shares and Series C 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, do not have any maturity date and are not subject to mandatory redemption. The Company may not redeem the Series A Preferred Shares, Series B Preferred Shares or

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Series C Preferred Shares prior to March 11, 2016, September 21, 2016, and March 18, 2018, 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 applicable 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 and the common securities of the acquiring or surviving entity are not listed on the New York Stock Exchange, the NYSE MKT or NASDAQ, or any successor exchanges, the Company may, at its option, redeem the Preferred Shares in whole or in part within 120 days following the change of control by paying $25.00 per share, plus any accrued and unpaid 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, each Series B Preferred Share is 3.4483 common shares, and each Series C Preferred Share is 2.0325 common shares.

Preferred Dividends

The Company declared the following dividends on preferred shares for the nine months ended September 30, 2014:

Security Type	Dividend per Share/Unit	For the quarter ended	Record Date	Payable Date
7.875% Series A	$0.49	March 31, 2014	March 31, 2014	April 15, 2014
7.875% Series A	$0.49	June 30, 2014	June 30, 2014	July 15, 2014
7.875% Series A	$0.49	September 30, 2014	September 30, 2014	October 15, 2014
8.00% Series B	$0.50	March 31, 2014	March 31, 2014	April 15, 2014
8.00% Series B	$0.50	June 30, 2014	June 30, 2014	July 15, 2014
8.00% Series B	$0.50	September 30, 2014	September 30, 2014	October 15, 2014
6.50% Series C	$0.41	March 31, 2014	March 31, 2014	April 15, 2014
6.50% Series C	$0.41	June 30, 2014	June 30, 2014	July 15, 2014
6.50% Series C	$0.41	September 30, 2014	September 30, 2014	October 15, 2014

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 the Operating Partnership's limited partners or the Company's shareholders.

As of September 30, 2014 and December 31, 2013, the Operating Partnership had 607,991 long-term incentive partnership units ("LTIP units") outstanding. Of the 607,991 LTIP units outstanding at September 30, 2014, 195,290 units have vested. Only vested LTIP units may be converted to common units of the Operating Partnership, which in turn can be tendered for redemption as described above.

Note 8. Share-Based Compensation Plan

The Company maintains the 2009 Equity Incentive Plan, as amended (the "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 the Plan vest over a period determined by the Board of Trustees, generally over three to five years, with certain awards vesting over periods of up to six years. The Company pays or accrues for dividends on share-based awards. 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 September 30, 2014, there were 940,721 common shares available for issuance under the Plan.

Service Condition Share Awards

From time to time, the Company awards restricted shares under the Plan to members of the Board of Trustees, officers and employees. These shares generally vest over three to five years based on continued service or employment.

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The following table provides a summary of service condition restricted share activity as of September 30, 2014:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at January 1, 2014	147,881	$ 24.59
Granted	44,322	$ 30.11
Vested	(62,047)	$ 23.12
Forfeited	(168)	$ 27.57
Unvested at September 30, 2014	129,988	$ 27.17

The fair value of each of these service condition restricted share awards is determined based on the closing price of the Company's common shares on the grant date and compensation expense is recognized on a straight-line basis over the vesting period. For the three and nine months ended September 30, 2014, the Company recognized approximately $0.4 million and $1.1 million, respectively, of share-based compensation expense related to these service condition restricted shares in the consolidated statements of operations. For the three and nine months ended September 30, 2013 the Company recognized approximately $0.4 million and $1.2 million, respectively, of share-based compensation expense related to these service condition restricted shares in the consolidated statements of operations. As of September 30, 2014, there was $2.5 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 2.8 years.

Performance-Based Equity Awards

On February 8, 2012, the Board of Trustees approved a target award of 72,056 performance-based equity awards to officers and employees of the Company. These awards vest on January 1, 2015. The actual number of common shares that ultimately vest will range from 0% to 200% of the target award (except for 12,048 target awards to non-executive management employees which have no maximum) and will be determined in 2015 based on three performance criteria as defined in the agreements for the period of performance from January 1, 2012 through December 31, 2014.

On January 30, 2013, the Board of Trustees approved a target award of 72,118 performance-based equity awards to officers and employees of the Company. These awards vest on January 1, 2016. The actual number of common shares that ultimately vest will range from 0% to 200% of the target award (except for 11,753 target awards to non-executive management employees which have no maximum) and will be determined in 2016 based on three performance criteria as defined in the agreements for the period of performance from January 1, 2013 through December 31, 2015.

On December 13, 2013, the Board of Trustees approved a target award of 252,088 performance-based equity awards to officers and employees of the Company. The awards vest ratably on January 1, 2016, 2017, 2018, 2019 and 2020. The actual number of common shares that ultimately vest will range from 0% to 200% of the target award and will be determined on each vesting date based upon the two performance criteria as defined in the agreements for the period of performance beginning on the grant date and ending on the applicable vesting date.

On February 4, 2014, the Board of Trustees approved a target award of 66,483 performance-based equity awards to officers and employees of the Company. These awards vest on January 1, 2017. The actual number of common shares that ultimately vest will range from 0% to 200% of the target award (except for 12,261 target awards to non-executive management employees which have no maximum) and will be determined in 2017 based on three performance criteria as defined in the agreements for the period of performance from January 1, 2014 through December 31, 2016.

The grant date fair value of the performance awards were determined using a Monte Carlo simulation method with the following assumptions:

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Performance Award Grant Date	Percentage of Total Award	Grant Date Fair Value by Component ($ in millions)	Volatility	Interest Rate	Dividend Yield
February 8, 2012					
Relative Total Shareholder Return[1]	30.00%	$0.7	33.00%	0.34%	2.20%
Absolute Total Shareholder Return [1]	30.00%	$0.6	33.00%	0.34%	2.20%
EBITDA Comparison [2]	40.00%	$0.7	33.00%	0.34%	2.20%
January 30, 2013					
Relative Total Shareholder Return [1]	30.00%	$0.7	31.00%	0.41%	2.20%
Absolute Total Shareholder Return [1]	30.00%	$0.5	31.00%	0.41%	2.20%
EBITDA Comparison [2]	40.00%	$0.7	31.00%	0.41%	2.20%
December 13, 2013					
Relative Total Shareholder Return [1]	50.00%	$4.7	29.00%	0.34% - 2.25%	2.40%
Absolute Total Shareholder Return [1]	50.00%	$2.9	29.00%	0.34% - 2.25%	2.40%
February 4, 2014					
Relative Total Shareholder Return [1]	30.00%	$0.7	29.00%	0.62%	2.40%
Absolute Total Shareholder Return [1]	30.00%	$0.5	29.00%	0.62%	2.40%
EBITDA Comparison [2]	40.00%	$0.8	29.00%	0.62%	2.40%

[1] The Relative Total Shareholder Return and Absolute Total Shareholder Return are market conditions as defined by ASC 718.
[2] The EBITDA Comparison component is a performance condition as defined by ASC 718, and therefore, compensation expense related to this 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.

Dividends on unvested performance-based equity awards accrue over the vesting period and will be paid on the actual number of shares that vest at the end of the applicable period. The Company recognizes compensation expense on a straight-line basis through the vesting date. As of September 30, 2014, there was approximately $10.5 million of unrecognized compensation expense related to these performance-based equity awards which will be recognized over the weighted-average remaining vesting period of 2.6 years. For the three and nine months ended September 30, 2014, the Company recognized $2.4 million and $5.2 million, respectively, in expense related to these awards. For the three and nine months ended September 30, 2013, the Company recognized $0.6 million and $1.5 million, respectively, in expense related to these awards.

Long-Term Incentive Partnership Units

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 Operating Partnership and 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. LTIP units are allocated their pro-rata share of the Company's net income (loss). Vested LTIP units may be converted by the holder, 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.

As of September 30, 2014, the Operating Partnership had two classes of LTIP units, LTIP Class A and LTIP Class B units, all of which are held by officers of the Company.

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LTIP Class A units were granted to executives of the Company concurrent with completion of the Company's initial public offering in December 2009. These LTIP units vest ratably on each of the first five anniversaries of their dates of grant and were valued at $8.50 per LTIP unit at the date of grant using a Monte Carlo simulation method model. On December 13, 2013, the Board of Trustees approved a grant of 226,882 LTIP Class B units to executive officers of the Company. The LTIP units are subject to time-based vesting in five equal installments beginning January 1, 2016 and ending on January 1, 2020. The fair value of each award was determined based on the closing price of the Company's common shares on the grant date of $29.19 per unit. The aggregate grant date fair value of the LTIP Class B units was $6.6 million.

As of September 30, 2014, the Company had 607,991 LTIP units outstanding. All LTIP units will vest upon a change in control. As of September 30, 2014, of the 607,991 units outstanding, 195,290 LTIP units have vested, all of which were LTIP Class A units.

For the three and nine months ended September 30, 2014, the Company recognized $0.7 million and $2.0 million, respectively, in expense related to these units. For the three and nine months ended September 30, 2013, the Company recognized $0.4 million and $1.2 million, respectively, in expense related to these units. As of September 30, 2014, there was $6.1 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 2.5 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's TRS, PHL, is subject to federal and state corporate income taxes at statutory tax rates. The Company has estimated PHL's income tax expense (benefit) for the nine months ended September 30, 2014 using an estimated combined federal and state statutory tax rate of 39.0%.

The Company files tax returns as prescribed by the tax laws of the jurisdictions in which it operates. In the normal course of business, the Company is subject to examination by federal, state, and local jurisdictions, where applicable. As of September 30, 2014 and December 31, 2013, the statute of limitations remains open for all major jurisdictions for tax years dating back to 2011 and 2010, respectively.

Note 10. Earnings Per 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 September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net income (loss) attributable to common shareholders	$23,737	$11,315	$38,325	$15,129
Less: dividends paid on unvested share-based compensation	(125)	(81)	(375)	(242)
Undistributed earnings attributable to share-based compensation	(63)	(11)	—	—
Net income (loss) available to common shareholders	$23,549	$11,223	$37,950	$14,887
Denominator:				
Weighted-average number of common shares — basic	64,859,494	61,179,524	64,133,134	61,086,834
Effect of dilutive share-based compensation	486,694	168,339	480,315	192,418
Weighted-average number of common shares — diluted	65,346,188	61,347,863	64,613,449	61,279,252
Net income (loss) per share available to common shareholders — basic	$0.36	$0.18	$0.59	$0.24

Net income (loss) per share available to common shareholders — diluted	$0.36	$0.18	$0.59	$0.24

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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 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 52 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 1% 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 $5.3 million and $13.7 million for the three and nine months ended September 30, 2014, respectively, and $4.2 million and $11.4 million for the three and nine months ended September 30, 2013, respectively. Base and incentive management fees are included in other indirect expenses in the Company's consolidated statements of operations and comprehensive income.

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 September 30, 2014 and December 31, 2013, the Company had $17.9 million and $16.5 million, respectively, in restricted 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 loan agreements. For purposes of the statement of cash flows, changes in restricted cash caused by changes in required reserves for real estate taxes or property insurance are shown as operating activities. Changes in restricted cash caused by changes in required reserves for furniture and fixtures replacement are shown as investing activities.

Ground and Hotel Leases

The Hotel 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 hotel structure due to its status as a national historic landmark.

The Argonaut Hotel 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 $1.3 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.

The Hotel Palomar San Francisco is subject to a long-term hotel lease for the right to use the ground floor lobby area and floors five through nine of the building and underlying land. The hotel lease expires in 2097. The hotel is required to pay

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annual base rent and a percentage rent, which is based on gross hotel and gross food and beverage revenues in excess of certain thresholds, as defined in the lease agreement.

The Radisson Hotel Fisherman's Wharf is subject to both a long-term primary ground lease and a secondary sublease. The primary ground lease requires the hotel to make annual base rental payments of $0.1 million and percentage rental payments based on 5% of hotel revenues and 7.5% of retail revenues attributed to guest rooms and retail space added to the hotel property in 1998. Beginning in 2017, the primary ground lease requires the hotel to pay percentage rent based on 6% of total hotel revenues and 7.5% of total retail and parking revenues. The primary ground lease expires in 2062. The secondary sublease requires the hotel to make rental payments based on hotel net income, as defined in the agreement, related to the rooms and retail space in existence prior to the 1998 renovation. The secondary sublease expires in April 2016 at which time the hotel will only be subject to the primary ground lease through its maturity in 2062.

The Prescott Hotel is subject to a long-term hotel lease for the right to use floors three through seven, the basement and the roof of an adjacent, attached building containing 64 of the 160 guest rooms at the property. The hotel lease expires in 2059, with a one time extension option of 30 years. The Company is required to pay annual base rent of approximately $0.5 million, beginning in October 2017. The annual base rent is subject to a fixed increase every year during the remaining lease term. The building portion of the long-term hotel lease assumed was determined to be a capital lease.

The ground leases and Hotel Palomar hotel lease are considered operating leases. The Company records expense on a straight-line basis for leases that provide for minimum rental payments that increase in pre-established amounts over the remaining terms of the leases. Ground rent expense was $2.5 million and $6.2 million for the three and nine months ended September 30, 2014, respectively, and $2.0 million and $5.7 million for the three and nine months ended September 30, 2013, respectively. Ground rent expense is included in real estate taxes, personal property taxes, property insurance and ground rent in the Company's consolidated statements of operations and comprehensive income.

Litigation

The nature of the operations of hotels exposes the Company's hotels, the Company and the Operating Partnership to the risk of claims and litigation in the normal course of their business. The Company has 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 nine months ended September 30,	
	2014	2013
	(in thousands)	
Interest paid, net of capitalized interest	$19,792	$17,242
Interest capitalized	$—	$206
Income taxes paid	$2,008	$1,420
Non-Cash Investing and Financing Activities:		
Distributions payable on common shares/units	$16,609	$10,068
Distributions payable on preferred shares	$5,550	$5,203
Issuance of common shares for Board of Trustees compensation	$421	$207
Mortgage loans assumed in connection with acquisition	$50,725	$90,448
Below (above) market rate contracts assumed in connection with acquisition	$1,826	$5,146
Capital lease obligation assumed in connection with acquisition	$10,758	$—
Deposit applied to purchase price of acquisition	$—	$4,000

Accrued additions and improvements to hotel properties	$2,086	$1,308

Note 13. Subsequent Events

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On October 7, 2014, the Company entered into an agreement to acquire an upscale, full-service hotel and adjacent commercial real estate and land parcel in the Boston, Massachusetts region for $261.0 million from an unaffiliated third party. The Company expects to fund the purchase price with available cash and borrowings on its unsecured credit facility. The closing is expected to occur before the end of 2014, however, because the acquisition is subject to customary closing requirements and conditions, the Company can give no assurance that the transaction will be consummated during that time period or at all.

On October 16, 2014, the Company amended and restated the credit agreement governing its unsecured revolving credit facility and unsecured term loan facility. As amended, the agreement provides for a $300.0 million unsecured revolving credit facility and a $300.0 million unsecured term loan facility. The unsecured revolving credit facility matures in January 2019 with options to extend the maturity date to January 2020 and the unsecured term loan facility matures in January 2020. In connection with entering into the amended and restated credit agreement, the prior notes evidencing the Company’s outstanding term loan were canceled and new notes evidencing the term loan were entered into, in effect extending the maturity date of the Company’s $100.0 million term loan to January 2020. The amended and restated credit agreement provides for a 180-day option to borrow an additional $200.0 million under the unsecured term loan facility. Borrowings under the revolving credit facility and the term loan facility will bear interest at LIBOR plus 1.55% to 2.3% and LIBOR plus 1.50% to 2.25%, respectively, depending on the Company's leverage ratio. Additionally, the Company is required to pay an unused commitment fee at an annual rate of 0.20% to 0.30% of the unused portion of the credit facility.

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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. (our "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.

Forward-Looking Statements

This report, together with other statements and information publicly disseminated by us, 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 (the "Exchange Act"). 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", "seek", "assume", "forecast", "believe", "expect", "intend", "anticipate", "estimate", "project" or similar expressions. Forward-looking statements in this report include, among others, statements about our business strategy, including acquisition and development strategies, industry trends, estimated revenues and expenses, our 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, performance or achievements. Factors that may cause actual results to differ materially from current expectations include, but are not limited to:

- risks associated with the hotel industry, including competition, increases in employment costs, energy costs and other operating costs, or decreases in demand caused by events beyond our control including, without limitation, actual or threatened terrorist attacks, cyber risk, any type or flu or disease-related pandemic, or downturns in general and local economic conditions;
- the availability and terms of financing and capital and the general volatility of securities markets;
- our dependence on third-party managers of our hotels, including our inability to implement strategic business decisions directly;
- risks associated with the real estate industry, including environmental contamination and costs of complying with the Americans with Disabilities Act and similar laws;
- interest rate increases;
- our possible failure to qualify as a REIT under the Code, as amended, and the risk of changes in laws affecting REITs;
- the timing and availability of potential hotel acquisitions and our ability to identify and complete hotel acquisitions in accordance with our business strategy;
- the possibility of uninsured losses;
- risks associated with redevelopment and repositioning projects, including delays and cost overruns; and
- the other factors discussed under the heading "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as may be updated elsewhere in this report.

Accordingly, there is no assurance that our expectations will be realized. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

Pebblebrook Hotel Trust is an internally managed hotel investment company, organized in October 2009, to opportunistically acquire and invest in hotel properties located primarily in major U.S. cities, with an emphasis on the major gateway coastal markets. As of September 30, 2014, the Company owned interests in 31 hotels, including 25 wholly owned hotels with a total of 6,046 guest rooms, and a 49% joint venture interest in six hotels with a total of 1,775 guest rooms.

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During the nine months ended September 30, 2014, we acquired two hotel properties, the 160-room Prescott Hotel, in San Francisco, California, for $49.0 million and the 331-room The Nines Hotel, in Portland, Oregon, for $127.0 million.

We continue to employ our asset management initiatives at our hotels. While we do not operate our hotel properties, both our asset management team and our executive management team monitor and work cooperatively with our hotel managers by advising and making recommendations in all aspects of our hotels' operations, including property positioning and repositioning, revenue management, operations analysis, physical design, renovation and capital improvements, guest experience and overall strategic direction. Through these efforts, we seek to improve property efficiencies, lower costs, maximize revenues, and enhance property operating margins which we expect will enhance returns to our shareholders. We expect to invest a total of approximately $15.0 million to $25.0 million for the remainder of 2014 on renovation and repositioning projects and other capital improvements.

The U.S. lodging industry has continued to exhibit strong underlying fundamentals through the first nine months of 2014 despite the relatively modest national economic recovery. While concerns continue about economic growth, global volatility and government fiscal deficits, U.S. employment levels, housing markets and consumer confidence have improved.

The strength in business transient, leisure and international inbound travel, specifically in the major urban markets at our west coast hotels, has continued to drive increases in occupancy and average daily rates. Nationally, group travel is improving and new hotel supply remains low in most markets, although the availability of financing for new hotel construction has also started to increase, albeit slowly. We continue to believe that we are in a long and healthy recovery in the lodging industry and believe our properties have opportunities to achieve significant growth in their operating cash flows and long-term economic values.

Key Indicators of Financial Condition and Operating Performance

We measure hotel results of operations and the operating performance of our business by evaluating financial and non-financial metrics such as room revenue per available room ("RevPAR"); average daily rate ("ADR"); occupancy rate ("occupancy"); funds from operations ("FFO"); and earnings before interest, income taxes, depreciation and amortization ("EBITDA"). We evaluate individual hotel and company-wide performance with comparisons to budgets, prior periods and competing properties. ADR, occupancy and RevPAR may be impacted by macroeconomic factors as well as regional and local economies and events. See "Non-GAAP Financial Matters" for further discussion of FFO and EBITDA.

Hotel Operating Statistics

The following table represents the key same-property hotel operating statistics for our wholly owned hotels for the three and nine months ended September 30, 2014 and 2013.

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Total Wholly Owned Portfolio				
Same-Property Occupancy	89.8 %	87.6 %	85.7 %	84.2 %
Same-Property ADR	$244.18	$223.62	$229.25	$210.88
Same-Property RevPAR	$219.36	$195.92	$196.58	$177.54

This schedule of hotel results for the three months ended September 30, 2014 and 2013 includes information from all of the hotels we owned as of September 30, 2014, except for our 49% ownership interest in the Manhattan Collection for both 2014 and 2013. The hotel results for the nine months ended September 30, 2014 and 2013 includes information from all of the hotels we owned as of September 30, 2014, except for the Prescott Hotel and The Nines Hotel, for Q1 and Q2 in both 2014 and 2013, and our 49% ownership interest in the Manhattan Collection for both 2014 and 2013. These hotel results for the respective periods include information reflecting operational performance for some hotels prior to our ownership of those hotels.

Results of Operations

At September 30, 2014 and 2013, we had 25 and 22 wholly owned properties and leasehold interests, respectively. All properties owned during these periods have been included in our results of operations during the respective periods since their

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dates of acquisition. Based on when a property was acquired, operating results for certain properties are not comparable for the three and nine months ended September 30, 2014 and 2013. The properties listed in the table below are hereinafter referred to as the non-comparable properties for the periods indicated and all other properties are considered and referred to as comparable properties:

Property	Location	Acquisition Date	Non-comparable property for the Three Months ended September 30, 2014 and 2013	Non-comparable property for the Nine Months ended September 30, 2014 and 2013
Embassy Suites San Diego Bay-Downtown	San Diego, CA	January 29, 2013		X
Redbury Hotel	Hollywood, CA	August 8, 2013	X	X
Hotel Modera	Portland, OR	August 28, 2013	X	X
Radisson Hotel Fisherman's Wharf	San Francisco, CA	December 9, 2013	X	X
Prescott Hotel	San Francisco, CA	May 22, 2014	X	X
The Nines Hotel	Portland, OR	July 17, 2014	X	X

Comparison of the three months ended September 30, 2014 to the three months ended September 30, 2013

Revenues — Total hotel revenues increased by $38.4 million, of which $11.9 million was from our comparable properties and $26.5 million was from the non-comparable properties. The increase from our comparable properties is primarily a result of increases in revenues at the Sir Francis Drake, Grand Hotel Minneapolis and Hotel Zetta as a result of increases in ADR at those hotels.

Hotel operating expenses — Total hotel operating expenses increased by $16.3 million. The comparable properties contributed $2.7 million of the increase, which is a result of cost increases resulting from increased revenues, partially offset by cost reduction initiatives. The remaining $13.6 million of the increase was from the non-comparable properties.

Depreciation and amortization — Depreciation and amortization expense increased by $3.4 million primarily due to the additional depreciation for the non-comparable properties.

Real estate taxes, personal property taxes, property insurance and ground rent — Real estate taxes, personal property taxes, insurance and ground rent increased by $1.5 million primarily due to the acquisitions of the Radisson Fisherman's Wharf and Prescott hotels, both of which are subject to ground leases.

Corporate general and administrative — Corporate general and administrative expenses increased by $3.0 million primarily as a result of increases in non-cash share-based employee compensation costs. Corporate general and administrative expenses consist of employee compensation costs, legal and professional fees, insurance, state franchise taxes and other expenses.

Hotel acquisition costs — Hotel acquisition costs remained consistent with the prior period. Typically, hotel property acquisition costs consist of legal fees, other professional fees, transfer taxes and other direct costs associated with our pursuit of hotel investments. As a result, these costs are generally higher when more properties are acquired or when we have significant ongoing acquisition activity.

Interest income — Interest income remained consistent with the prior period.

Interest expense — Interest expense increased by $1.2 million as a result of higher debt balances from mortgage assumptions in connection with non-comparable properties.

Equity in earnings (losses) of joint venture — Equity in earnings of joint venture increased $1.2 million due to increases in revenues as a result of increases in ADR at the joint venture hotels.

Income tax (expense) benefit — Income tax expense increased $1.1 million due to higher net income at our TRS compared to the prior year period.

Non-controlling interests — Non-controlling interests represent the allocation of income or loss of the Operating Partnership to the common units held by the LTIP unit holders. Non-controlling interests increased $0.2 million due to higher income allocation.

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Distributions to preferred shareholders — Distributions to preferred shareholders increased $0.3 million as a result of the issuance of Series C Preferred Shares in September 2014.

Comparison of the nine months ended September 30, 2014 to the nine months ended September 30, 2013

Revenues — Total hotel revenues increased by $80.4 million, of which $24.3 million was contributed by our comparable properties and $56.1 million was contributed by the non-comparable properties. The increase from our comparable properties is primarily a result of increases in revenues at our properties located on the west coast as a result of increases in ADR at those hotels.

Hotel operating expenses — Total hotel operating expenses increased by $34.7 million. The comparable properties contributed $4.6 million of the increase, which is a result of cost increases resulting from increased revenues, partially offset by cost reduction initiatives. The remaining $30.1 million of the increase was from the non-comparable properties.

Depreciation and amortization — Depreciation and amortization expense increased by $8.8 million primarily due to the additional depreciation for the non-comparable properties.

Real estate taxes, personal property taxes, property insurance and ground rent — Real estate taxes, personal property taxes, insurance and ground rent increased by $3.9 million primarily due to the non-comparable properties.

Corporate general and administrative — Corporate general and administrative expenses increased by $6.1 million primarily as a result of increases in non-cash share-based employee compensation costs. Corporate general and administrative expenses consist of employee compensation costs, legal and professional fees, insurance, state franchise taxes and other expenses.

Hotel acquisition costs — Hotel acquisition costs decreased by $0.4 million due to less acquisition activity during the current period compared to the prior period. Typically, hotel property acquisition costs consist of legal fees, other professional fees, transfer taxes and other direct costs associated with our pursuit of hotel investments. As a result, these costs are generally higher when more properties are acquired or when we have significant ongoing acquisition activity.

Interest income — Interest income remained consistent with the prior period.

Interest expense — Interest expense increased by $2.2 million a result of higher debt balances from mortgage assumptions in connection with non-comparable properties.

Equity in earnings (losses) of joint venture — Equity in earnings of joint venture increased $2.0 million due to increases in revenues as a result of increases in ADR at the Manhattan Collection joint venture hotels.

Income tax (expense) benefit — Income tax expense increased $1.8 million due to higher net income at our TRS compared to the prior period.

Non-controlling interests — Non-controlling interests represent the allocation of income or loss of our Operating Partnership to the common units held by the LTIP unit holders. Non-controlling interests increased $0.3 million due to higher income allocation.

Distributions to preferred shareholders — Distributions to preferred shareholders increased $1.7 million as a result of the issuances of the Series C Preferred Shares in 2013 and 2014.

Non-GAAP Financial Measures

Non-GAAP financial measures are measures of our historical or future financial performance that are different from measures calculated and presented in accordance with U.S. GAAP. We report FFO and EBITDA, which are non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance. We calculate FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (NAREIT), which defines FFO as net income (calculated in accordance with GAAP), excluding real estate related depreciation and amortization, gains (losses) from sales of real estate, impairments of real estate assets, the cumulative effect of changes in accounting principles and adjustments for unconsolidated partnerships and joint ventures. Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, most industry investors consider presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. By excluding the effect of real estate related depreciation and amortization including our share of the joint venture depreciation and amortization and gains (losses) from sales

of real estate, both of which are based on historical cost accounting and which may be of lesser

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significance in evaluating current performance, we believe that FFO provides investors a useful financial measure to evaluate our operating performance.

The following table reconciles net income (loss) to FFO and FFO available to common share and unit holders for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Net income (loss)	30,439	17,527	$57,453	$32,212
Adjustments:				
Depreciation and amortization	17,353	13,928	49,383	40,619
Depreciation and amortization from joint venture	2,269	2,022	6,720	6,776
FFO	$50,061	$33,477	$113,556	$79,607
Distribution to preferred shareholders	(6,428)	(6,100)	(18,591)	(16,872)
FFO available to common share and unit holders	$43,633	$27,377	$94,965	$62,735

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

The following table reconciles net income (loss) to EBITDA for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2014	2013	2014	2013
Net income (loss)	30,439	17,527	$57,453	$32,212
Adjustments:				
Interest expense	7,278	6,074	19,609	17,457
Interest expense from joint venture	2,302	2,306	6,836	6,601
Income tax expense (benefit)	2,154	1,088	1,941	137
Depreciation and amortization	17,396	13,971	49,514	40,747
Depreciation and amortization from joint venture	2,269	2,022	6,720	6,776
EBITDA	$61,838	$42,988	$142,073	$103,930

Neither FFO nor EBITDA represent cash generated from operating activities as determined by U.S. GAAP and neither should be considered as an alternative to U.S. GAAP net income (loss), as an indication of our financial performance, or to U.S. GAAP cash flow from operating activities, as a measure of liquidity. In addition, FFO and EBITDA are not indicative of funds available to fund cash needs, including the ability to make cash distributions.

Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances. All of our significant accounting policies, including certain critical accounting policies, are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Accounting Standards

See Note 2, “Summary of Significant Accounting Policies,” to our consolidated interim financial statements for additional information relating to recently issued accounting pronouncements.

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Liquidity and Capital Resources

We expect to meet our short-term liquidity requirements through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under our senior unsecured revolving credit facility. We expect our existing cash balances and cash provided by operations will be adequate to fund operating requirements, service debt and fund dividends in accordance with the REIT requirements of the federal income tax laws.

We expect to meet our long-term liquidity requirements, such as hotel property acquisitions, property redevelopment, investments in existing or new joint ventures, and debt principal payments and debt maturities, through the net proceeds from additional issuances of common shares, additional issuances of preferred shares, issuances of units of limited partnership interest in our operating partnership, secured and unsecured borrowings, and cash provided by operations. The success of our business strategy may depend in part on our ability to access additional capital through issuances of debt and equity securities, which is dependent on favorable market conditions.

We strive to maintain prudent debt leverage and intend to opportunistically enhance our capital position.

Senior Unsecured Credit Facility

We have a $300.0 million senior unsecured credit facility to fund acquisitions, property redevelopments, return on investment initiatives and general business needs. The senior unsecured credit facility consists of a $200.0 million revolver and a $100.0 million term loan. As of September 30, 2014, we had no outstanding borrowings under the revolver and we had $100.0 million outstanding under the term loan. We have the ability to increase the aggregate borrowing capacity under the credit agreement up to $600.0 million, subject to lender approval. We intend to repay indebtedness incurred under our senior unsecured revolving credit facility from time to time out of cash flows from operations and from the net proceeds of issuances of additional equity and debt securities, as market conditions permit.

Interest is paid on the periodic advances under the senior unsecured revolving credit facility at varying rates, based upon either LIBOR or the alternate base rate, plus an additional margin amount. The interest rate depends upon our leverage ratio pursuant to the provisions of the credit facility agreement. We entered into interest rate swaps to effectively fix the interest rate at 2.55% per annum for the term loan for the full five-year term at the Company's current leverage ratio (as defined in the credit agreement).

On October 16, 2014, we amended and restated the credit agreement governing our unsecured revolving credit facility and unsecured term loan facility. As amended, the agreement provides for a $300.0 million unsecured revolving credit facility and a $300.0 million unsecured term loan facility. The unsecured revolving credit facility matures in January 2019 with options to extend the maturity date to January 2020 and the unsecured term loan facility matures in January 2020. In connection with entering into the amended and restated credit agreement, the prior notes evidencing our outstanding term loan were canceled and new notes evidencing the term loan were entered into, in effect extending the maturity date of our $100.0 million term loan to January 2020. The amended and restated credit agreement provides for a 180-day option to borrow an additional $200.0 million under the unsecured term loan facility. Borrowings under the revolving credit facility and the term loan facility will bear interest at LIBOR plus 1.55% to 2.3% and LIBOR plus 1.50% to 2.25%, respectively, depending on the Company's leverage ratio. Additionally, we are required to pay an unused commitment fee at an annual rate of 0.20% to 0.30% of the unused portion of the credit facility.

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Debt Summary

Debt as of September 30, 2014 and December 31, 2013 consisted of the following (dollars in thousands):

	Interest Rate	Maturity Date	Balance Outstanding as of September 30, 2014	Balance Outstanding as of December 31, 2013
Senior unsecured revolving credit facility	Floating [1]	July 2016	$—	$—
Term loan	Floating[2]	July 2017	100,000	100,000
Mortgage loans				
The Nines Hotel [3]	7.39%	March 2015	50,725	—
InterContinental Buckhead	4.88%	January 2016	49,544	50,192
Skamania Lodge	5.44%	February 2016	29,465	29,811
DoubleTree by Hilton Bethesda-Washington DC	5.28%	February 2016	34,710	35,102
Embassy Suites San Diego Bay-Downtown	6.28%	June 2016	64,788	65,725
Hotel Modera	5.26%	July 2016	23,321	23,597
Monaco Washington DC	4.36%	February 2017	43,965	44,580
Argonaut Hotel	4.25%	March 2017	44,295	45,138
Sofitel Philadelphia	3.90%	June 2017	47,286	48,218
Hotel Palomar San Francisco	5.94%	September 2017	26,549	26,802
The Westin San Diego Gaslamp Quarter	3.69%	January 2020	77,674	79,194
Mortgage loans at stated value			492,322	448,359
Mortgage loan premiums [4]			4,913	5,888
Total mortgage loans			$497,235	$454,247
Total debt			$597,235	$554,247

[1] Borrowings bear interest at floating rates equal to, at our option, either (i) LIBOR plus an applicable margin or (ii) an Adjusted Base Rate (as defined in the senior unsecured credit agreement) plus an applicable margin. We have a one-year extension option.

[2] Borrowings bear interest at floating rates equal to, at our option, either (i) LIBOR plus an applicable margin or (ii) an Adjusted Base Rate plus an applicable margin. We entered into interest rate swaps to effectively fix the interest rate for the full five-year term at 2.55% per annum, based on our current leverage ratio.

[3] The interest rate of 7.39% represents a weighted-average interest rate of the three non-recourse mortgage loans assumed in conjunction with the acquisition of The Nines Hotel.

[4] Loan premiums on assumed mortgages recorded in purchase accounting for the Hotel Palomar San Francisco, Embassy Suites San Diego Bay - Downtown, Hotel Modera and The Nines Hotel as of September 30, 2014 and December 31, 2013.

Issuance of Shares of Beneficial Interest

On March 5, 2014, we entered into equity distribution agreements (collectively, the “Equity Distribution Agreements”) with each of Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Raymond James & Associates, Inc. (collectively, the “Sales Agents”), providing for our sale of our common shares having an aggregate offering price of up to $175.0 million from time to time, pursuant to a prospectus supplement we filed with the SEC, through any of the Sales Agents, acting as sales agent and/or principal (our “ATM program”). At the same time, we terminated our prior $170.0 million ATM program. For the nine months ended September 30, 2014, we issued and sold 400,000 common shares at an average price of $38.09 per share under our $175.0 million ATM program and raised $15.0 million, net of commissions. As of September 30, 2014, $159.8 million in common shares remained available for issuance under the $175.0 million ATM program.

On September 9, 2014, we issued and sold, in an underwritten public offering, 3,450,000 common shares at a price of $38.15 per share, raising proceeds of approximately $131.6 million, net of the underwriting discount.

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On September 30, 2014, we issued and sold, in an underwritten public offering, 1,000,000 Series C Preferred Shares at a price of $25.00 per share, raising proceeds of approximately $24.5 million, net of the underwriting discount.

We used or intend to use the net proceeds of these sales to repay debt outstanding on our senior unsecured revolving credit facility, to repay mortgage debt, to acquire hotel properties and for general corporate purposes.

Sources and Uses of Cash

Our principal sources of cash are cash from operations, borrowings under mortgage financings, draws on our credit facility and the proceeds from offerings of our equity securities. Our principal uses of cash are asset acquisitions, debt service, capital investments, operating costs, corporate expenses and dividends.

Cash provided by Operations. Our cash provided by operating activities was $118.9 million for the nine months ended September 30, 2014. Our cash from operations includes the operating activities of our 25 wholly owned hotels and cash distributions of $6.7 million from our Manhattan Collection joint venture. Our cash provided by operating activities for the nine months ended September 30, 2013 was $75.1 million and relates principally to the 22 wholly owned hotels and operating cash flow distributions received from our Manhattan Collection joint venture at September 30, 2013.

Cash used in Investing Activities. Our cash used in investing activities was $159.5 million for the nine months ended September 30, 2014. During the nine months ended September 30, 2014, we purchased two hotels using cash of $125.5 million, invested $31.0 million in improvements to our hotel properties, had an increase in restricted cash of $0.7 million, and received $1.1 million in property insurance proceeds. During the nine months ended September 30, 2013, we used $102.5 million of cash, of which we used $99.3 million to purchase three hotels, invested $27.7 million in improvements to our hotel properties, received a net distribution of $26.3 million from our joint venture and had an increase in restricted cash of $1.8 million.

Cash used in Financing Activities. Our cash provided by financing activities was $104.7 million for the nine months ended September 30, 2014. During the nine months ended September 30, 2014, we issued and sold 3.9 million common shares and 1.0 million Series C preferred shares for net proceeds totaling $170.8 million. We also borrowed $130.0 million from our revolving credit facility and repaid that amount in full, repaid $6.8 million of mortgage debt and paid $58.2 million in distributions. For the nine months ended September 30, 2013, cash flows provided by financing activities was $51.6 million, which consisted of net proceeds of $101.2 million from the issuance and sale of 4.0 million Series C Preferred Shares and 171,893 common shares, the repayment of $5.9 million of mortgage debt and the payment of $42.6 million in distributions.

Capital Investments

We maintain and intend to continue maintaining all of our hotels, including each hotel that we acquire in the future, in good repair and condition and in conformity with applicable laws and regulations and when applicable, in accordance with the franchisor’s standards and the agreed-upon requirements in our management agreements. Routine capital investments will be administered by the hotel management companies. However, we maintain approval rights over the capital investments as part of the annual budget process and as otherwise required from time to time.

From time to time, certain of our hotel properties may undergo renovations as a result of our decision to upgrade portions of the hotels, such as guestrooms, meeting space and restaurants, in order to better compete with other hotels in our markets. In addition, after we acquire a hotel property, we are often required by the franchisor or brand manager, if there is one, to complete a property improvement plan (“PIP”) in order to bring the hotel property up to the franchisor’s or brand’s standards. Generally, we expect to fund renovations and improvements with available cash, restricted cash, borrowings under our credit facility, or proceeds from new mortgage debt or equity offerings.

For the nine months ended September 30, 2014, we invested $31.0 million in capital investments to reposition and improve the properties we own. We expect to invest approximately $15.0 million to $25.0 million in capital investments for our wholly owned hotels through the remainder of 2014.

Contractual Obligations and Off-Balance Sheet Arrangements

The table below summarizes our contractual obligations as of September 30, 2014 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

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	Payments due by period				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Mortgage loans [1]	$544,927	$83,444	$384,350	$9,931	$67,202
Term loan [2]	107,324	2,585	104,739	—	—
Hotel and ground leases [3]	423,609	3,261	6,563	7,000	406,785
Capital lease obligation	36,542	—	—	600	35,942
Purchase commitments [4]	3,629	3,629	—	—	—
Corporate office lease	4,139	119	740	781	2,499
Total	$1,120,170	$93,038	$496,392	$18,312	$512,428

(1) Amounts include principal and interest.

(2) Amounts include principal and interest. Loan bears interest at a floating rate equal to LIBOR plus an applicable margin. We entered into separate interest rate swap agreements for the full five-year term, resulting in an effective fixed interest rate of 2.55% at our current leverage ratio (as defined in the credit agreement). It is assumed that the outstanding debt will be repaid upon maturity with fixed interest-only payments until then.

(3) The long-term ground leases on the Monaco Washington DC and Argonaut Hotel provide for the greater of base or percentage rent, adjusted for CPI increases. The long-term hotel lease on the Hotel Palomar San Francisco provides for base rent plus percentage rent, adjusted for CPI increases and contains a base rent floor and ceiling. The long-term leases on the Radisson Hotel Fisherman's Wharf provide for base plus percentage rent through 2016 and rent as a percentage of revenues and net income, as adjusted and defined in the agreements, in 2017 and thereafter. The long-term hotel lease on the Prescott Hotel was determined to be both an operating and capital lease. The lease contains a fixed base rental increase every year during the lease term. The table above reflects only minimum base rent for all periods presented and does not include assumptions for CPI adjustments.

(4) These represent purchase orders and contracts that have been executed for renovation projects at the properties. We are committed to these purchase orders and contracts and anticipate making similar arrangements in the future with the existing properties or any future properties that we may acquire.

Off-Balance Sheet Arrangements – Joint Venture Indebtedness

We have a 49% equity interest in the Manhattan Collection joint venture, which owns six properties in New York City that have mortgage debt secured by these properties. We exercise significant influence over, but do not control, the joint venture and therefore account for our investment in the joint venture using the equity method of accounting.

On December 27, 2012, the joint venture refinanced its existing loans with a new, single $410.0 million loan, secured by five of the properties (excluding Affinia Dumont) owned by the joint venture. The loan bears interest at an annual fixed rate of 3.67% and requires interest only payments through maturity on January 5, 2018. In conjunction with the re-financing, we provided the joint venture a $50.0 million unsecured special loan which matures at the earlier of July 4, 2018, the closing of any refinancing of the secured loan or the closing date of a portfolio sale (as defined in the loan agreement). The unsecured special loan bears interest at an annual fixed rate of 9.75% and requires interest-only payments through maturity. The unsecured special loan is pre-payable by the joint venture at any time.

On April 4, 2013, the joint venture obtained a $50.0 million first mortgage loan secured by the Affinia Dumont. The loan bears interest at an annual fixed interest rate of 3.14% and requires interest-only payments through maturity on May 1, 2018.

The joint venture was in compliance with all of its debt covenants as of September 30, 2014. We are not guarantors of the joint venture debt except for limited customary carve-outs related to fraud or misapplication of funds.

Inflation

We rely on the performance of the hotels to increase revenues to keep pace with inflation. Generally, our hotel operators possess the ability to adjust room rates daily, except for group or corporate rates contractually committed to in advance, although competitive pressures may limit the ability of our operators to raise rates faster than inflation or even at the same rate.

Seasonality

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Demand in the lodging industry is affected by recurring seasonal patterns which are greatly influenced by overall economic cycles, the geographic locations of the hotels and the customer mix at the hotels. Generally, our hotels will have lower revenue, operating income and cash flow in the first quarter and higher revenue, operating income and cash flow in the third quarter.

Derivative Instruments

In the normal course of business, we are exposed to the effects of interest rate changes. We may enter into derivative instruments including interest rate swaps, caps and collars to manage or hedge interest rate risk. Derivative instruments are subject to fair value reporting at each reporting date and the increase or decrease in fair value is recorded in net income (loss) or accumulated other comprehensive income (loss), based on the applicable hedge accounting guidance. Derivatives expose the Company to credit risk in the event of non-performance by the counterparties under the terms of the interest rate hedge agreements. The Company believes it minimizes the credit risk by transacting with major creditworthy financial institutions.

Effective August 13, 2012, we entered into three interest rate swap agreements with an aggregate notional amount of $100.0 million for the term loan's full five-year term, resulting in an effective fixed interest rate of 2.55% per annum at our current leverage ratio (as defined in the credit agreement). We have designated these pay-fixed, receive-floating interest rate swap derivatives as cash flow hedges. As of September 30, 2014, our derivative instruments are in an asset position, with an aggregate fair value of $1.0 million, which is included in prepaid expenses and other assets in the accompanying consolidated balance sheets. For the three and nine months ended September 30, 2014, there was $0.4 million in unrealized gain and $0.1 million, respectively, in unrealized loss recorded in accumulated other comprehensive income.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Interest Rate Sensitivity

We are exposed to market risk from changes in interest rates. We seek to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs by closely monitoring our variable rate debt and converting such debt to fixed rates when we deem such conversion advantageous. From time to time, we may enter into interest rate swap agreements or other interest rate hedging contracts. While these agreements are intended to lessen the impact of rising interest rates, they also expose us to the risks that the other parties to the agreements will not perform, we could incur significant costs associated with the settlement of the agreements and the agreements will be unenforceable.

As of September 30, 2014, we effectively have no debt outstanding that is subject to variable interest rates. The $100.0 million term loan was swapped to a fixed interest rate, therefore a change in the LIBOR rate on the term loan would have a corresponding offsetting change on the interest rate swap.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

There have been no changes to our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The nature of the operations of our hotels exposes the hotels and us to the risk of claims and litigation in the normal course of business. We are not presently subject to any material litigation nor, to our knowledge, is any litigation threatened against us, other than routine actions for negligence or other claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance and all of which collectively are not expected to have a material adverse effect on our liquidity, results of operations or our financial condition.

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Item 1A. Risk Factors.

There have been no material changes from the risk factors disclosed in the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Description of Exhibit
3.1†	Declaration of Trust, as amended and supplemented, of the Registrant.
3.2	Bylaws of the Registrant (incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-11 filed on July 13, 2010 (File No. 333-168078)).
3.3†	Second Amended and Restated Agreement of Limited Partnership of Pebblebrook Hotel, L.P., as amended.
31.1†	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2†	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1††	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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101.INS XBRL	Instance Document (1)
101.SCH XBRL	Taxonomy Extension Schema Document (1)
101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document (1)
101.LAB XBRL	Taxonomy Extension Label Linkbase Document (1)
101.DEF XBRL	Taxonomy Extension Definition Linkbase Document (1)
101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document (1)

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† Filed herewith.

†† Furnished herewith.

(1) Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations and Comprehensive Income; (iii) Consolidated Statements of Equity; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements.

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SIGNATURES

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

PEBBLEBROOK HOTEL TRUST

Date: October 23, 2014

/s/ JON E. BORTZ
Jon E. Bortz
Chairman, President and Chief Executive Officer

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