ASHFORD HOSPITALITY TRUST INC
Form 10-Q
August 11, 2014

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

FORM 10-Q

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

For the quarterly period ended June 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: 001-31775

ASHFORD HOSPITALITY TRUST, INC.

(Exact name of registrant as specified in its charter)

Maryland	86-1062192
(State or other jurisdiction of incorporation or organization)	(IRS employer identification number)

14185 Dallas Parkway, Suite 1100	
Dallas, Texas	75254
(Address of principal executive offices)	(Zip code)

(972) 490-9600
(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. þ 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). þ 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 (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨	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 þ No

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

Common Stock, $0.01 par value per share	89,290,897
(Class)	Outstanding at August 6, 2014

ASHFORD HOSPITALITY TRUST, INC
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2014

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PART I. FINANCIAL INFORMATION
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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except share and per share amounts)

	June 30, 2014	December 31, 2013
Assets		
Cash and cash equivalents	$212,292	$128,780
Marketable securities	34,935	29,601
Total cash, cash equivalents and marketable securities	247,227	158,381
Investments in hotel properties, net	2,079,506	2,164,389
Restricted cash	87,692	61,498
Accounts receivable, net of allowance of $197 and $242, respectively	32,234	21,791
Inventories	2,005	1,946
Note receivable, net of allowance of $7,732 and $7,937, respectively	3,466	3,384
Investment in unconsolidated entities	198,411	195,545
Deferred costs, net	8,473	10,155
Prepaid expenses	11,791	7,519
Derivative assets, net	55	19
Other assets	5,950	4,303
Due from Ashford Prime OP, net	4,616	13,042
Due from affiliates	4,536	1,302
Due from third-party hotel managers	14,091	33,728
Total assets	$2,700,053	$2,677,002
Liabilities and Equity		
Liabilities:		
Indebtedness	$1,776,761	$1,818,929
Capital leases payable	—	28
Accounts payable and accrued expenses	82,647	70,683
Dividends payable	21,903	20,735
Unfavorable management contract liabilities	6,318	7,306
Due to related party, net	753	270
Due to third-party hotel managers	1,607	958
Liabilities associated with marketable securities and other	6,699	3,764
Other liabilities	1,246	1,286
Total liabilities	1,897,934	1,923,959
Redeemable noncontrolling interests in operating partnership	202,541	134,206
Equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized:		
Series A Cumulative Preferred Stock, 1,657,206 shares issued and outstanding at June 30, 2014 and December 31, 2013	17	17
Series D Cumulative Preferred Stock, 9,468,706 shares issued and outstanding at June 30, 2014 and December 31, 2013	95	95
Series E Cumulative Preferred Stock, 4,630,000 shares issued and outstanding at June 30, 2014 and December 31, 2013	46	46

Common stock, $0.01 par value, 200,000,000 shares authorized, 124,896,765 shares issued, 89,290,897 and 80,565,563 shares outstanding at June 30, 2014 and December 31, 2013, respectively	1,249	1,249
Additional paid-in capital	1,722,032	1,652,743
Accumulated other comprehensive loss	(110)	(197)
Accumulated deficit	(998,583)	(896,110)
Treasury stock, at cost, 35,605,868 and 44,331,202 shares at June 30, 2014 and December 31, 2013, respectively	(125,938)	(140,054)
Total shareholders’ equity of the Company	598,808	617,789
Noncontrolling interests in consolidated entities	770	1,048
Total equity	599,578	618,837
Total liabilities and equity	$2,700,053	$2,677,002

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
REVENUE				
Rooms	$168,198	$205,740	$325,919	$389,209
Food and beverage	29,014	43,234	57,253	82,884
Other hotel revenue	6,656	9,429	13,033	18,145
Total hotel revenue	203,868	258,403	396,205	490,238
Advisory services	3,945	—	6,139	—
Other	1,076	136	2,141	243
Total Revenue	208,889	258,539	404,485	490,481
EXPENSES				
Hotel operating expenses:				
Rooms	36,172	45,075	71,093	87,231
Food and beverage	19,379	27,616	38,702	54,791
Other expenses	72,578	73,356	131,120	141,648
Management fees	8,116	10,686	15,896	20,579
Total hotel operating expenses	136,245	156,733	256,811	304,249
Property taxes, insurance, and other	8,981	11,663	18,601	23,911
Depreciation and amortization	26,612	32,842	52,841	65,322
Impairment charges	(104)	(99)	(205)	(195)
Transaction costs	83	1,170	83	1,170
Corporate, general, and administrative	19,451	14,699	32,186	29,215
Total Operating Expenses	191,268	217,008	360,317	423,672
OPERATING INCOME	17,621	41,531	44,168	66,809
Equity in earnings (loss) of unconsolidated entities	7,461	2,367	3,963	(4,521)
Interest income	12	13	18	49
Other income	2,000	310	3,277	6,132
Interest expense and amortization of loan costs	(27,922)	(36,026)	(56,447)	(71,406)
Write-off of loan costs and exit fees	(6)	—	(2,034)	(1,971)
Unrealized gain (loss) on marketable securities	(944)	(919)	(943)	1,782
Unrealized gain (loss) on derivatives	(263)	789	(610)	(6,360)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(2,041)	8,065	(8,608)	(9,486)
Income tax expense	(312)	(465)	(528)	(1,069)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(2,353)	7,600	(9,136)	(10,555)
Gain on sale of hotel property, net of tax	—	—	3,491	—
NET INCOME (LOSS)	(2,353)	7,600	(5,645)	(10,555)
(Income) loss from consolidated entities attributable to noncontrolling interests	(5)	8	22	715
Net (income) loss attributable to redeemable noncontrolling interests in operating partnership	772	(502)	1,649	2,260
NET INCOME (LOSS) ATTRIBUTABLE TO THE COMPANY	(1,586)	7,106	(3,974)	(7,580)
Preferred dividends	(8,491)	(8,491)	(16,981)	(16,981)
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$(10,077)	$(1,385)	$(20,955)	$(24,561)

LOSS PER SHARE - BASIC AND DILUTED:				
Basic:				
Net loss attributable to common shareholders	$(0.11)	$(0.02)	$(0.25)	$(0.36)
Weighted average common shares outstanding – basic	88,781	68,489	85,283	68,088
Diluted:				
Net loss attributable to common shareholders	$(0.11)	$(0.02)	$(0.25)	$(0.36)
Weighted average common shares outstanding – diluted	88,781	68,489	85,283	68,088
Dividends declared per common share	$0.12	$0.12	$0.24	$0.24
Amounts attributable to common shareholders:				
Net income (loss) attributable to the Company	$(1,586)	$7,106	$(3,974)	$(7,580)
Preferred dividends	(8,491)	(8,491)	(16,981)	(16,981)
Net loss attributable to common shareholders	$(10,077)	$(1,385)	$(20,955)	$(24,561)

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	$(2,353)	$7,600	$(5,645)	$(10,555)
Other comprehensive income (loss), net of tax:				
Change in unrealized loss on derivatives	—	—	—	(2)
Reclassification to interest expense	29	16	100	24
Total other comprehensive income	29	16	100	22
Comprehensive income (loss)	(2,324)	7,616	(5,545)	(10,533)
Less: Comprehensive (income) loss attributable to noncontrolling interests in consolidated entities	(5)	8	22	715
Less: Comprehensive (income) loss attributable to redeemable noncontrolling interests in operating partnership	768	(504)	1,636	2,257
Comprehensive income (loss) attributable to the Company	$(1,561)	$7,120	$(3,887)	$(7,561)

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(Unaudited, in thousands)

	Preferred Stock Series A		Series D		Series E		Common Stock		Additional Paid In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock		N In In C E
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				Shares	Amount	
Balance at January 1, 2014	1,657	$17	9,469	$95	4,630	$46	124,897	$1,249	$1,652,743	$(896,110)	$(197)	(44,331)	$(140,054)	$
Purchases of treasury shares	—	—	—	—	—	—	—	—	—	—	—	(41)	(458)	—
Equity-based compensation	—	—	—	—	—	—	—	—	1,647	—	—	—	—	—
Forfeitures of restricted shares	—	—	—	—	—	—	—	—	24	—	—	(7)	(16)	—
Issuance of restricted shares/units	—	—	—	—	—	—	—	—	(993)	—	—	423	993	—
Reissuance of treasury shares	—	—	—	—	—	—	—	—	72,243	—	—	8,350	13,597	—
Dividends declared- common shares	—	—	—	—	—	—	—	—	—	(20,427)	—	—	—	—
Dividends declared- preferred shares- Series A	—	—	—	—	—	—	—	—	—	(1,771)	—	—	—	—
Dividends declared- preferred shares- Series D	—	—	—	—	—	—	—	—	—	(10,001)	—	—	—	—
Dividends declared – preferred shares- Series E	—	—	—	—	—	—	—	—	—	(5,209)	—	—	—	—
Reclassification to interest expense	—	—	—	—	—	—	—	—	—	—	87	—	—	—
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	—	—	—	—	—	(2
Redemption value adjustment	—	—	—	—	—	—	—	—	—	(60,717)	—	—	—	—

Unvested operating partnership units reclassified to equity	—	—	—	—	—	—	—	—	(4,006)	—	—	—	—	—
Deferred compensation to be settled in shares	—	—	—	—	—	—	—	—	374	(374)	—	—	—	—
Net income (loss)	—	—	—	—	—	—	—	—	—	(3,974)	—	—	—	(2
Balance at June 30, 2014	1,657	$17	9,469	$95	4,630	$46	124,897	$1,249	$1,722,032	$(998,583)	$(110)	(35,606)	$(125,938)	$

See Notes to Consolidated Financial Statements.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Six Months Ended June 30,	
	2014	2013
Cash Flows from Operating Activities		
Net loss	$(5,645)	$(10,555)
Adjustments to reconcile net loss to net cash flow provided by operating activities:		
Depreciation and amortization	52,841	65,322
Impairment charges	(205)	(195)
Amortization of loan costs, write-off of loan costs, and exit fees	5,605	5,755
Equity in (earnings) loss of unconsolidated entities	(3,963)	4,521
Dividends from Ashford Prime OP	498	—
Income from financing derivatives	—	(6,215)
Gain on sale of hotel property	(3,604)	(76)
Realized and unrealized gains on marketable securities	(1,969)	(1,388)
Purchases of marketable securities	(44,223)	(14,255)
Sales of marketable securities	43,818	14,124
Net settlement of trading derivatives	(505)	229
Unrealized loss on derivatives	610	6,360
Equity-based compensation	12,230	12,893
Changes in operating assets and liabilities, exclusive of effect of disposition of hotel property:		
Restricted cash	(4,946)	6,832
Accounts receivable and inventories	(9,689)	(4,071)
Prepaid expenses and other assets	(4,855)	(5,528)
Accounts payable and accrued expenses	15,492	13,698
Due from affiliates	(3,234)	(1,201)
Due to/from related party	516	(2,943)
Due to/from third-party hotel managers	20,286	(5,908)
Due to/from Ashford Prime OP	(5,683)	—
Other liabilities	(997)	(2,548)
Net cash provided by operating activities	62,378	74,851
Cash Flows from Investing Activities		
Proceeds from payments of note receivable	123	122
Net proceeds from sales of hotel properties	22,726	307
Acquisition of hotel property, net of cash acquired	(1,765)	(88,204)
Restricted cash related to improvements and additions to hotel properties	(21,444)	—
Improvements and additions to hotel properties	(57,628)	(44,850)
Due from Ashford Prime	13,635	—
Proceeds from property insurance	356	—
Net cash used in investing activities	(43,997)	(132,625)
Cash Flows from Financing Activities		
Borrowings on indebtedness	206,900	199,875
Repayments of indebtedness and capital leases	(180,074)	(157,353)
Payments of loan costs and exit fees	(4,033)	(2,876)

Payments of dividends	(41,625)	(37,509)
Purchases of treasury shares	(458)	(391)
Payments for derivatives	(233)	(36)
Cash income from derivatives	—	7,878
Issuance of preferred stock	—	244
Issuances of treasury stock	85,840	125,891
Distributions to noncontrolling interests in consolidated entities	(1,236)	(13,489)
Other	50	69
Net cash provided by financing activities	65,131	122,303
Net increase in cash and cash equivalents	83,512	64,529
Cash and cash equivalents at beginning of period	128,780	185,935
Cash and cash equivalents at end of period	$212,292	$250,464
Supplemental Cash Flow Information		
Interest paid	$51,761	$65,701
Income taxes paid	1,009	936
Supplemental Disclosure of Non-Cash Investing and Financing Activity		
Deferred compensation to be settled in shares	$374	$—
Dividend receivable from Ashford Prime	249	—
Transfer of debt	69,000	—
Dividends declared but not paid	21,903	—

See Notes to Consolidated Financial Statements.

ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Description of Business

Ashford Hospitality Trust, Inc., together with its subsidiaries (“Ashford Trust”), is a self-advised real estate investment trust (“REIT”) focused on investing in the hospitality industry across all segments and in all methods including direct real estate, securities, equity, and debt. We own our lodging investments and conduct our business through Ashford Hospitality Limited Partnership (“AHLP”), our operating partnership. Ashford OP General Partner LLC, a wholly-owned subsidiary of Ashford Hospitality Trust, Inc., serves as the sole general partner of our operating partnership. In this report, terms such as the “Company,” “we,” “us,” or “our” refer to Ashford Hospitality Trust, Inc. and all entities included in its consolidated financial statements.

As of June 30, 2014, we owned interests in the following hotel properties (all located in the United States) and a note receivable:

- 86 consolidated hotel properties (“legacy hotel properties”), including 84 directly owned and two owned through a majority-owned investment in a consolidated entity, which represent 16,895 total rooms (or 16,868 net rooms excluding those attributable to our partners);
- 28 hotel properties owned through a 71.74% common equity interest and a 50.0% preferred equity interest in an unconsolidated entity (“PIM Highland JV”), which represent 8,083 total rooms (or 5,799 net rooms excluding those attributable to our partner);
- 10 hotel properties owned through a 14.6% interest in Ashford Hospitality Prime Limited Partnership (“Ashford Prime OP”);
- 89 hotel condominium units at WorldQuest Resort in Orlando, Florida; and
- a mezzanine loan with a carrying value of $3.5 million.

For federal income tax purposes, we have elected to be treated as a REIT, which imposes limitations related to operating hotels. As of June 30, 2014, our 86 legacy hotel properties were leased or owned by our wholly owned subsidiaries that are treated as taxable REIT subsidiaries for federal income tax purposes (collectively, these subsidiaries are referred to as “Ashford TRS”). Ashford TRS then engages third-party or affiliated hotel management companies to operate the hotels under management contracts. Hotel operating results related to these properties are included in the consolidated statements of operations. As of June 30, 2014, the 28 hotel properties owned by our unconsolidated joint venture, PIM Highland JV, are leased to its wholly owned subsidiary that is treated as a taxable REIT subsidiary for federal income tax purposes.

As of June 30, 2014, Remington Lodging & Hospitality, LLC, together with its affiliates (“Remington Lodging”), which is beneficially wholly owned by Mr. Monty J. Bennett, our Chairman and Chief Executive Officer, and Mr. Archie Bennett, Jr., our Chairman Emeritus, managed 53 of our 86 legacy hotel properties, 21 of the 28 PIM Highland JV hotel properties, one of the 10 Ashford Prime OP hotel properties and WorldQuest Resort. Third-party management companies managed the remaining hotel properties.

2. Significant Accounting Policies

Basis of Presentation – The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These consolidated financial statements include the accounts of Ashford Hospitality Trust, Inc., its majority-owned subsidiaries, and its majority-owned entities in which it has a controlling interest. All significant intercompany accounts and transactions between consolidated entities have been eliminated in these consolidated financial statements. These consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in our 2013 Annual Report to Shareholders on Form 10-K and Form 10-K/A filed with the Securities and Exchange Commission (“SEC”) on March 3, 2014 and March 31, 2014, respectively.

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ASHFORD HOSPITALITY TRUST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Unaudited)

The following items affect reporting comparability related to our consolidated financial statements:

- Historical seasonality patterns at some of our properties cause fluctuations in our overall operating results. Consequently, operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.
- On November 19, 2013, we completed the spin-off of Ashford Hospitality Prime, Inc. ("Ashford Prime") and on March 1, 2014 we completed the sale of the Pier House Resort to Ashford Prime. The results of the eight initial hotel properties that were spun-off on November 19, 2013 and are now owned by Ashford Prime, are included in our consolidated statements of operations for the three and six months ended June 30, 2013, in accordance with the applicable accounting guidance. The results of the Pier House Resort, which we acquired on May 14, 2013 and sold on March 1, 2014, are included in our results of operations for the six months ended June 30, 2014, until its date of sale. Because we acquired the Pier House Resort on May 14, 2013, its operating results are only included in our results of operations for the three and six months ended June 30, 2013 since May 14, 2013.

Use of Estimates – The preparation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Restricted Cash – Restricted cash includes reserves for debt service, real estate taxes, and insurance, as well as excess cash flow deposits and reserves for furniture, fixtures, and equipment replacements of approximately 4% to 6% of property revenue for certain hotels, as required by certain management or mortgage debt agreement restrictions and provisions. For purposes of the statements of cash flows, changes in restricted cash caused by using such funds for debt service, real estate taxes, and insurance are shown as operating activities. Changes in restricted cash caused by using such funds for furniture, fixtures, and equipment replacements are included in cash flows from investing activities.

Investments in Hotel Properties, net – Hotel properties are generally stated at cost. However, four hotel properties contributed upon Ashford Trust's formation in 2003 are stated at the predecessor's historical cost, net of impairment charges, if any, plus a partial step-up related to the acquisition of noncontrolling interests from third parties associated with certain of these properties. For hotel properties owned through our majority-owned entities, the carrying basis attributable to the partners' minority ownership is recorded at the predecessor's historical cost, net of any impairment charges, while the carrying basis attributable to our majority ownership is recorded based on the allocated purchase price of our ownership interests in the entities. All improvements and additions which extend the useful life of hotel properties are capitalized.

Impairment of Investments in Hotel Properties – Hotel properties are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Recoverability of the hotel is measured by comparison of the carrying amount of the hotel to the estimated future undiscounted cash flows, which take into account current market conditions and our intent with respect to holding or disposing of the hotel. If our analysis indicates that the carrying value of the hotel is not recoverable on an undiscounted cash flow basis, we recognize an impairment charge for the amount by which the property's net book value exceeds its estimated fair value, or fair value, less cost to sell. In evaluating impairment of hotel properties, we make many assumptions and estimates, including projected cash flows, expected holding period, and expected useful life. Fair value is determined through various valuation techniques, including internally developed discounted cash flow models, comparable market transactions and third-party appraisals, where considered necessary. No impairment charges were recorded for investments in hotel properties for the three and six months ended June 30, 2014 and 2013.

Note Receivable – Mezzanine loan financing, classified as note receivable, represents a loan held for investment and intended to be held to maturity. Note receivable is recorded at cost, net of unamortized loan origination costs and fees, loan purchase discounts, and allowance for losses when a loan is deemed to be impaired. Premiums, discounts, and net origination fees are amortized or accreted as an adjustment to interest income using the effective interest method over the life of the loan. We discontinue recording interest and amortizing discounts/premiums when the contractual payment of interest and/or principal is not received when contractually due. Payments received on impaired nonaccrual loans are recorded as adjustments to impairment charges. No interest income was recorded for the three and six months ended June 30, 2014 and 2013.

Variable interest entities ("VIEs"), as defined by authoritative accounting guidance, must be consolidated by their controlling interest beneficiaries if the VIEs do not effectively disperse risks among the parties involved. Our remaining mezzanine note receivable at June 30, 2014 is secured by a hotel property and is subordinate to the controlling interest in the secured hotel property. Although the note receivable is considered to be a variable interest in the entity that owns the related hotel, we are not considered to be the primary beneficiary of the hotel property as a result of holding the loan. Therefore, we do not consolidate the hotel property for which we have provided financing. We will evaluate interests in entities acquired or created in the future to determine whether such entities should be consolidated. In evaluating VIEs, our analysis involves considerable management judgment and assumptions.

Impairment of Note Receivable – We review notes receivable for impairment each reporting period. A loan is impaired when, based on current information and events, collection of all amounts recorded as assets on the balance sheet is no longer considered probable. We apply normal loan review and underwriting procedures (as may be implemented or modified from time to time) in making that judgment.

When a loan is impaired, we measure impairment based on the present value of expected cash flows discounted at the loan's effective interest rate against the value of the asset recorded on the balance sheet. We may also measure impairment based on a loan's observable market price or the fair value of collateral if the loan is collateral-dependent. Loan impairments are recorded as a valuation allowance and a charge to earnings. Our assessment of impairment is based on considerable management judgment and assumptions. No impairment charges were recorded during the three and six months ended June 30, 2014 and 2013. Valuation adjustments of $104,000 and $205,000 on previously impaired notes were credited to impairment charges during the three and six months ended June 30, 2014, respectively. Valuation adjustments of $99,000 and $195,000 on previously impaired notes were credited to impairment charges during the three and six months ended June 30, 2013, respectively.

Investments in Unconsolidated Entities – Investments in entities in which we have ownership interests ranging from 14.4% to 71.74% are accounted for under the equity method of accounting by recording the initial investment and our percentage of interest in the entities' net income (loss). We review the investments in our unconsolidated entities for impairment in each reporting period pursuant to the applicable authoritative accounting guidance. An investment is impaired when its estimated fair value is less than the carrying amount of our investment. Any impairment is recorded in equity earnings (loss) in unconsolidated entities. No such impairment was recorded in the three and six months ended June 30, 2014 and 2013.

Our investments in certain unconsolidated entities are considered to be variable interests in the underlying entities. Variable Interest Entities ("VIE"), as defined by authoritative accounting guidance, must be consolidated by a reporting entity if the reporting entity is the primary beneficiary because it has (i) the power to direct the VIE's activities that most significantly impact the VIE's economic performance, (ii) an implicit financial responsibility to ensure that a VIE operates as designed, and (iii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. Because we do not have the power and financial responsibility to direct the unconsolidated entities' activities and operations, we are not considered to be the primary beneficiary of these entities on an ongoing basis and therefore such entities should not be consolidated. In evaluating VIEs, our analysis involves considerable management judgment and assumptions.

We have a 71.74% ownership interest in PIM Highland JV. We adopted the equity accounting method for our investment in the PIM Highland JV because we exercise significant influence but do not control the joint venture. Although we have the majority ownership of 71.74% in the joint venture, all the major decisions related to the joint venture, including establishment of policies and operating procedures with respect to business affairs, incurring obligations and expenditures, are subject to the approval of an executive committee, which is comprised of four persons with us and our partner each designating two of those persons. Our investment in PIM Highland JV had a carrying value of $143.3 million and $139.3 million at June 30, 2014 and December 31, 2013, respectively.

In connection with the spin-off of Ashford Prime on November 19, 2013, we maintained an initial 20% ownership interest in Ashford Prime OP (subsequently reduced to a 14.6% ownership interest primarily as the result of an additional equity raise by Ashford Prime). We adopted the equity accounting method for our investment in Ashford Prime OP because we exercise significant influence but do not control the entity. All major decisions related to Ashford Prime OP that most significantly impact Ashford Prime OP's economic performance, including but not limited to operating procedures with respect to business affairs and any acquisitions, dispositions, financings, restructurings or other transactions with sellers, purchasers, lenders, brokers, agents and other applicable representatives, are subject to the approval of Ashford Prime OP General Partner LLC, its general partner. Our investment in Ashford Prime had a carrying value of $55.1 million and $56.2 million at June 30, 2014 and December 31, 2013, respectively.

Assets Held for Sale and Discontinued Operations – We classify assets as held for sale when management has obtained a firm commitment from a buyer and consummation of the sale is considered probable and expected within one year. In addition, we deconsolidate a property upon transfer of title. When deconsolidating a property/subsidiary, we recognize a gain or loss in net income measured as the difference between the fair value of any consideration received, the fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated, and the carrying amount of the former property/subsidiary. The related operations of assets held for sale are reported as discontinued if a) such operations and cash flows can be clearly distinguished, both operationally and financially, from our ongoing operations, b) such operations and cash flows will be eliminated from ongoing operations once the disposal occurs, and c) we will not have any significant continuing involvement subsequent to the disposal.

Marketable Securities – Marketable securities, including U.S. treasury bills, public equity securities and equity put and call options of certain publicly traded companies, are recorded at fair value. Equity put and call options are considered derivatives. The fair value of these investments is based on the closing price as of the balance sheet date and is reported as “Marketable securities” or “Liabilities associated with marketable securities and other” in the consolidated balance sheets. On the consolidated statements of operations, net investment income, including interest income (expense), dividends, realized gains or losses and related costs incurred, is reported as a component of “Other income” while unrealized gains and losses on these investments are reported as “Unrealized gain (loss) on marketable securities.”

Revenue Recognition – Hotel revenues, including room, food, beverage, and ancillary revenues such as long-distance telephone service, laundry, parking and space rentals, are recognized when services have been rendered. Taxes collected from customers and submitted to taxing authorities are not recorded in revenue. Advisory services are recognized when services have been rendered. The quarterly base fee is equal to 0.70% per annum of the total enterprise value of Ashford Prime, as defined in the advisory agreement, subject to certain minimums. The incentive fee is earned annually in each year that Ashford Prime’s total shareholder return exceeds the total shareholder return for Ashford Prime’s peer group, as defined in the advisory agreement. Reimbursements for overhead, travel expenses and internal audit services are recognized when services have been rendered. We also record advisory revenue for equity grants of Ashford Prime common stock and LTIP units awarded to our officers and employees in connection with providing advisory services equal to the fair value of the award that vested during the period, as well an offsetting expense in an equal amount included in “Corporate, general and administrative” expense. Interest income (including accretion of discounts on the mezzanine loan using the effective interest method) is recognized when earned. We discontinue recording interest and amortizing discounts/premiums when the contractual payment of interest and/or principal is not received when contractually due. We are reimbursed by PIM Highland JV for costs associated with managing its day-to-day operations and providing corporate administrative services such as accounting, insurance, marketing support, asset management and other services. Beginning with the three months ended March 31, 2014, we changed the presentation to report such reimbursements as “Other” revenue as opposed to credits within “Corporate, general and administrative” expense. This change had no impact on our financial condition or results of operations.

Derivatives and Hedges – We use interest rate derivatives to hedge our risks and to capitalize on the historical correlation between changes in LIBOR (London Interbank Offered Rate) and RevPAR (Revenue per Available Room). Interest rate derivatives could include swaps, caps, floors and flooridors. We assess the effectiveness of each hedging relationship by comparing changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. We also use credit default swaps to hedge financial and capital market risk. All of our derivatives are subject to master-netting settlement arrangements and the credit default swaps are subject to credit support annexes. For credit default swaps, cash collateral is posted by us as well as our counterparty. We offset the fair value of the derivative and the obligation/right to return/reclaim cash collateral.

All derivatives are recorded at fair value in accordance with the applicable authoritative accounting guidance. Interest rate derivatives and credit default swaps are reported as “Derivative assets, net” or “Liabilities associated with marketable securities and other” in the consolidated balance sheets. Accrued interest on non-hedge designated interest rate derivatives is included in “Accounts receivable, net” in the consolidated balance sheets. For interest rate derivatives designated as cash flow hedges:

a) the effective portion of changes in fair value is initially reported as a component of “Accumulated other comprehensive income (loss)” (“OCI”) in the equity section of the consolidated balance sheets and reclassified to interest expense in the consolidated statements of operations in the period during which the hedged transaction affects earnings, and

b) the ineffective portion of changes in fair value is recognized directly in earnings as “Unrealized gain (loss) on derivatives” in the consolidated statements of operations. For the three and six months ended June 30, 2014 and 2013 there was no ineffectiveness.

For non-hedge designated interest rate derivatives and credit default swaps, changes in fair value are recognized in earnings as “Unrealized gain (loss) on derivatives” in the consolidated statements of operations.

Income Taxes - As a REIT, we generally will not be subject to federal corporate income tax on the portion of our net income (loss) that does not relate to taxable REIT subsidiaries. However, Ashford TRS is treated as a taxable REIT subsidiary for federal income tax purposes. In accordance with authoritative accounting guidance, we account for income taxes related to Ashford TRS using the asset and liability method under which deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. In addition, the analysis utilized by us in determining our deferred tax asset valuation allowance involves considerable management judgment and assumptions.

Recently Issued Accounting Standards - In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08"). ASU 2014-08 revises the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results, removing the lack of continuing involvement criteria and requiring discontinued operations reporting for the disposal of an equity method investment that meets the definition of discontinued operations. The update also requires expanded disclosures for discontinued operations, including disclosure of pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting. ASU 2014-08 is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. Upon adoption of this standard, we will be required to evaluate whether a disposal meets the discontinued operations requirements under ASU 2014-08. We will make the additional disclosures upon adoption. We do not expect the adoption of this standard will have an impact on our financial position, results of operations or cash flows.

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 is a comprehensive new revenue recognition model, which requires a company to recognize revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration the company expects to receive in exchange for those goods or services. The update will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective in fiscal periods beginning after December 15, 2016. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method.

3. Investments in Hotel Properties, net

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

	June 30, 2014	December 31, 2013
Land	$353,248	$410,148
Buildings and improvements	2,064,037	2,071,811
Furniture, fixtures, and equipment	186,030	166,193
Construction in progress	13,662	11,956
Condominium properties	12,352	12,442
Total cost	2,629,329	2,672,550
Accumulated depreciation	(549,823)	(508,161)
Investments in hotel properties, net	$2,079,506	$2,164,389

4. Note Receivable

As of June 30, 2014 and December 31, 2013, we had one mezzanine loan receivable with a net carrying value of $3.5 million and $3.4 million, respectively, net of a valuation allowance of $7.7 million and $7.9 million, respectively. This note is secured by one hotel property, bears interest at a rate of 6.09%, and matures in 2017. All required payments on this loan are current. Ongoing payments are treated as reductions of carrying value with related valuation allowance adjustments recorded as credits to impairment charges.

5. Investment in Unconsolidated Entities

We hold a 71.74% common equity interest and a $25.0 million, or 50%, preferred equity interest earning an accrued but unpaid 15% annual return with priority over common equity distributions in PIM Highland JV, a 28-hotel portfolio venture. Although we have majority ownership in PIM Highland JV, all major decisions related to the joint venture, including establishment of policies and operating procedures with respect to business affairs and incurring obligations and expenditures, are subject to the approval of an executive committee, which is comprised of four persons with us and our partner each designating two of those

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persons. As a result, we utilize the equity accounting method with respect to PIM Highland JV, which had a carrying value of $143.3 million and $139.3 million at June 30, 2014 and December 31, 2013, respectively.

Mortgage and mezzanine loans securing PIM Highland JV are non-recourse to the borrowers, except for customary exceptions or carve-outs that trigger recourse liability to the borrowers in certain limited instances. Recourse obligations typically include only the payment of costs and liabilities suffered by the lenders as a result of the occurrence of certain bad acts on the part of the borrower. However, in certain cases, the carve-outs could trigger recourse obligations on the part of the borrower with respect to repayment of all or a portion of the outstanding principal amount of the loans. We have entered into customary guaranty agreements pursuant to which we guaranty payment of any recourse liabilities of the borrowers that result from non-recourse carve-outs (which include, but are not limited to, fraud, misrepresentation, willful conduct resulting in waste, misappropriations of rents following an event of default, voluntary bankruptcy filings, unpermitted transfers of collateral, and certain environmental liabilities). In the opinion of management, none of these guaranty agreements, either individually or in the aggregate, are likely to have a material adverse effect on our business, results of operations, or financial condition.

The following tables summarize the consolidated balance sheets as of June 30, 2014 and December 31, 2013 and the consolidated statements of operations for the three and six months ended June 30, 2014 and 2013 of the PIM Highland JV (in thousands):

PIM Highland JV

Condensed Consolidated Balance Sheets

	June 30, 2014	December 31, 2013
Total assets	$1,400,250	$1,390,782