

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____ to _____

SOTHERLY HOTELS INC.

(Exact name of registrant as specified in its charter)

MARYLAND
(State or Other Jurisdiction of
Incorporation or Organization)

001-32379
(Commission File Number)

20-1531029
(I.R.S. Employer
Identification No.)

SOTHERLY HOTELS LP

(Exact name of registrant as specified in its charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

001-36091
(Commission File Number)

20-1965427
(I.R.S. Employer
Identification No.)

410 West Francis Street

Williamsburg, Virginia 23185

(Address of Principal Executive Officers) (Zip Code)

757-229-5648

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Registrant</u>	<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Sotherly Hotels Inc.	Common Stock, \$0.01 par value	The NASDAQ Stock Market LLC
Sotherly Hotels Inc.	8.0% Series B Cumulative Redeemable Perpetual Preferred Stock, \$0.01 par value	The NASDAQ Stock Market LLC
Sotherly Hotels Inc.	7.875% Series C Cumulative Redeemable Perpetual Preferred Stock, \$0.01 par value	The NASDAQ Stock Market LLC
Sotherly Hotels LP	7.25% Senior Unsecured Notes due 2021	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

(Title of Class)

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Sotherly Hotels Inc. Yes No **Sotherly Hotels LP** Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Sotherly Hotels Inc. Yes No **Sotherly Hotels LP** Yes No

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.

Sotherly Hotels Inc. Yes No **Sotherly Hotels LP** Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Sotherly Hotels Inc. Yes No **Sotherly Hotels LP** Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. (See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Securities Exchange Act of 1934).

Sotherly Hotels Inc.

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company Emerging growth company

Sotherly Hotels LP

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Sotherly Hotels Inc. Yes No **Sotherly Hotels LP** Yes No

The aggregate market value of common stock held by non-affiliates of Sotherly Hotels Inc. as of June 30, 2018, the last business day of Sotherly Hotels Inc.'s most recently completed second fiscal quarter, was approximately \$84,739,106 based on the closing price quoted on the NASDAQ @ Stock Market.

As of March 14, 2019, there were 14,222,378 shares of Sotherly Hotels Inc.'s common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain portions of Sotherly Hotels Inc.'s proxy statement for its 2019 annual meeting of stockholders to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year covered by this report.

**SOTHERLY HOTELS INC.
SOTHERLY HOTELS LP**

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EXPLANATORY NOTE

We refer to Sotherly Hotels Inc. as the “Company,” Sotherly Hotels LP as the “Operating Partnership,” the Company’s common stock as “common stock,” the Company’s preferred stock as “preferred stock,” the Operating Partnership’s common partnership interest as “partnership units,” and the Operating Partnership’s preferred interest as the “preferred units.” References to “we” and “our” mean the Company, its Operating Partnership and its subsidiaries and predecessors, collectively, unless the context otherwise requires or where otherwise indicated.

The Company conducts virtually all of its activities through the Operating Partnership and is its sole general partner. The partnership agreement provides that the Operating Partnership will assume and pay when due, or reimburse the Company for payment of, all costs and expenses relating to the ownership and operations of, or for the benefit of, the Operating Partnership. The partnership agreement further provides that all expenses of the Company are deemed to be incurred for the benefit of the Operating Partnership.

This report combines the Annual Reports on Form 10-K for the period ended December 31, 2018 of the Company and the Operating Partnership. We believe combining the annual reports into this single report results in the following benefits:

- combined reports better reflect how management and investors view the business as a single operating unit;
- combined reports enhance investors’ understanding of the Company and the Operating Partnership by enabling them to view the business as a whole and in the same manner as management;
- combined reports are more efficient for the Company and the Operating Partnership and result in savings of time, effort and expense; and
- combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

To help investors understand the significant differences between the Company and the Operating Partnership, this report presents the following separate sections for each of the Company and the Operating Partnership:

- Item 5 – Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities – selected portions;
- Item 6 – Selected Financial Data;
- Item 9A – Controls and Procedures;
- Consolidated Financial Statements;
- the following Notes to Consolidated Financial Statements:
 - Note 7 – Preferred Stock and Units;
 - Note 8 – Common Stock and Units;
 - Note 14 – Income (Loss) Per Share and Unit; and
- Certifications of CEO and CFO Pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Information included and incorporated by reference in this Form 10-K may contain 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, and as such may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements, which are based on certain assumptions and describe our current strategies, expectations and future plans, are generally identified by our use of words, such as “intend,” “plan,” “may,” “should,” “will,” “project,” “estimate,” “anticipate,” “believe,” “expect,” “continue,” “potential,” “opportunity,” and similar expressions, whether in the negative or affirmative, but the absence of these words does not necessarily mean that a statement is not forward looking. All statements regarding our expected financial position, business and financing plans are forward-looking statements. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to:

- national and local economic and business conditions that affect occupancy rates and revenues at our hotels and the demand for hotel products and services;
- risks associated with the hotel industry, including competition and new supply of hotel rooms, increases in wages, energy costs and other operating costs;
- risks associated with adverse weather conditions, including hurricanes;
- the availability and terms of financing and capital and the general volatility of the securities markets;
- our intent to repurchase shares from time to time;
- risks associated with the level of our indebtedness and our ability to meet covenants in our debt agreements and, if necessary, to refinance or seek an extension of the maturity of such indebtedness or modify such debt agreements;
- management and performance of our hotels;
- risks associated with maintaining our system of internal controls;
- risks associated with the conflicts of interest of the Company’s officers and directors;
- risks associated with redevelopment and repositioning projects, including delays and cost overruns;
- supply and demand for hotel rooms in our current and proposed market areas;
- risks associated with our ability to maintain our franchise agreements with our third party franchisors;
- our ability to acquire additional properties and the risk that potential acquisitions may not perform in accordance with expectations;
- our ability to successfully expand into new markets;
- legislative/regulatory changes, including changes to laws governing taxation of real estate investment trusts (“REITs”);
- the Company’s ability to maintain its qualification as a REIT; and
- our ability to maintain adequate insurance coverage.

Additional factors that could cause actual results to vary from our forward-looking statements are set forth under the Section titled “Risk Factors” in Item 1A of this report.

These risks and uncertainties should be considered in evaluating any forward-looking statement contained in this report or incorporated by reference herein. All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are qualified by the cautionary statements in this section. We undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report, except as required by law. In addition, our past results are not necessarily indicative of our future results.

PART I

Item 1. *Business*

Organization

Sotherly Hotels Inc. (the “Company”) is a self-managed and self-administered lodging real estate investment trust, or REIT, that was formed in August 2004 to own, acquire, renovate and reposition full-service, primarily upscale and upper-upscale hotel properties located in primary markets in the mid-Atlantic and southern United States. On December 21, 2004, the Company successfully completed its initial public offering and elected to be treated as a self-advised REIT for federal income tax purposes. The Company conducts its business through Sotherly Hotels LP, its operating partnership (the “Operating Partnership”), of which the Company is the general partner. The Company owns approximately 88.9% of the partnership units in the Operating Partnership. Limited partners (including certain of the Company’s officers and directors) own the remaining Operating Partnership units.

As of December 31, 2018, our portfolio consisted of twelve full-service, primarily upscale and upper-upscale hotels located in eight states with an aggregate total of 3,156 rooms and the hotel commercial condominium unit of the Hyde Resort & Residences condominium hotel, with approximately 157,000 square feet of total meeting space. All of our hotels are wholly-owned by subsidiaries of the Operating Partnership, and all are managed on a day to day basis by either MHI Hotels Services, LLC, which does business as Chesapeake Hospitality (“Chesapeake Hospitality”), or Highgate Hotels, L.P. (“Highgate Hotels”).

In order for the Company to qualify as a REIT, it cannot directly manage or operate our wholly-owned hotels. Therefore, we lease our wholly-owned hotel properties to entities that we refer to as our TRS Lessees, which in turn have engaged Chesapeake Hospitality and Highgate Hotels, each of which is an eligible independent management company, to manage our hotels. Our TRS Lessees are wholly-owned subsidiaries of MHI Hospitality TRS Holding, Inc. (“MHI Holding”, and collectively, “MHI TRS”). MHI TRS is a taxable REIT subsidiary for federal income tax purposes.

Our corporate office is located at 410 West Francis Street, Williamsburg, Virginia 23185. Our telephone number is (757) 229-5648.

Our Properties

As of December 31, 2018, our hotels were located in Florida, Georgia, Indiana, Maryland, Virginia, North Carolina, Pennsylvania and Texas. Nine of these hotels operate under franchise agreements with major hotel brands, and three are independent hotels. We also own the hotel commercial condominium unit of the Hyde Resort & Residences condominium hotel. Developments at our properties for the five years ended December 31, 2018 included the following:

- In 2014, we acquired the Georgian Terrace located in Atlanta, Georgia at an aggregate cost of approximately \$61.1 million, including certain closing costs. We also, after extensive renovations, re-branded and renamed the Hilton Philadelphia Airport to the DoubleTree by Hilton Philadelphia Airport.
- In 2015, we acquired the remaining 75.0% interest in (i) the entity that owns the DoubleTree Resort by Hilton Hollywood Beach (formerly known as the Crowne Plaza Hollywood Beach Resort), and (ii) the entity that leases the DoubleTree Resort by Hilton Hollywood Beach. As a result, the Operating Partnership now has a 100% indirect ownership interest in the entities that own the DoubleTree Resort by Hilton Hollywood Beach. We also, after extensive renovations, re-branded and renamed the Crowne Plaza Jacksonville Riverfront to the DoubleTree by Hilton Jacksonville Riverfront, and re-branded and renamed the Holiday Inn Laurel West to the DoubleTree by Hilton Laurel.
- In 2016, after extensive renovations, we re-branded and renamed the Crowne Plaza Houston Downtown in Houston, Texas to The Whitehall.
- In 2017, we acquired the Hyde Resort & Residences hotel commercial condominium unit at an aggregate cost of approximately \$4.8 million, including inventory, other assets and certain closing costs and initiated a rental program for residential condominium unit owners. We sold the Crowne Plaza Hampton Marina property for approximately \$5.6 million. We also re-branded and renamed the Hilton Savannah DeSoto to The DeSoto, after extensive renovations, and re-branded and renamed the Crowne Plaza Hollywood Beach to the DoubleTree Resort by Hilton Hollywood Beach. We entered into contracts to purchase a commercial unit in the Hyde Beach House Resort & Residences condominium hotel under development in Hollywood Beach, Florida, and to acquire the Hyatt Centric Arlington hotel in Arlington, Virginia.
- In 2018, we acquired the Hyatt Centric Arlington hotel in Arlington, Virginia at an aggregate cost of approximately \$79.7 million, including certain closing costs.

See Items 2 and 7 of this Form 10-K for additional detail on our properties.

Our Strategy and Investment Criteria

Our strategy is to grow through acquisitions of full-service, upscale and upper-upscale hotel properties located in the primary markets of the southern United States. We intend to grow our portfolio through disciplined acquisitions of hotel properties and believe that we will be able to source significant external growth opportunities through our management team's extensive network of industry, corporate and institutional relationships.

Our investment criteria are further detailed below:

- *Geographic Growth Markets:* We are focusing our growth strategy on the major markets in the Southern region of the United States. Our management team remains confident in the long-term growth potential associated with this part of the United States. We believe these markets have, during the Company's and our predecessors' existence, been characterized by population growth, economic expansion, growth in new businesses and growth in the resort, recreation and leisure segments. We will continue to focus on these markets, including coastal locations, and will investigate other markets for acquisitions only if we believe these new markets will provide similar long-term growth prospects.
- *Full-Service Hotels:* We focus our acquisition strategy on the full-service hotel segment. Our full-service hotels fall primarily under the upscale to upper-upscale categories and include such brands as Hilton, Doubletree by Hilton, Sheraton, Hyatt and Crowne Plaza, as well as independent hotels affiliated with Preferred Hotels & Resorts. We may also acquire commercial unit(s) within upscale to upper-upscale condominium hotel projects, allowing us to establish and operate unit rental programs. We do not own economy hotels. We believe that full-service hotels, in the upscale to upper-upscale categories, will outperform the broader U.S. hotel industry, and thus offer the highest returns on invested capital.
- *Significant Barriers to Entry:* We intend to execute a strategy that entails the acquisition of hotels in prime locations with significant barriers to entry.
- *Proximity to Demand Generators:* We seek to acquire hotel properties located in central business districts for both leisure and business travelers within the respective markets, including large state universities, airports, convention centers, corporate headquarters, sports venues and office buildings. We seek to be in walking locations that are proximate to the markets' major demand generators.

We generally have a bias toward acquiring underperforming hotels, which we typically define as those that are poorly managed, suffer from significant deferred maintenance and capital investment and that are not properly positioned in their respective markets. In pursuing these opportunities, we hope to improve revenue and cash flow and increase the long-term value of the underperforming hotels we acquire. Our ultimate goal is to achieve a total investment that is substantially less than replacement cost of a hotel or the acquisition cost of a market performing hotel. In analyzing a potential investment in an underperforming hotel property, we typically characterize the investment opportunity as one of the following:

- *Branding Opportunity:* The acquisition of properties that includes a repositioning of the property through a change in brand affiliation, which may include positioning the property as an independent hotel. Branding opportunities typically include physical upgrades and enhanced efficiencies brought about by changes in operations.
- *Shallow-Turn Opportunity:* The acquisition of an underperforming but structurally sound hotel that requires moderate renovation to re-establish the hotel in its market.
- *Deep-Turn Opportunity:* The acquisition of a hotel that is closed or functionally obsolete and requires a restructuring of both the business components of the operations as well as the physical plant of the hotel, including extensive renovation of the building, furniture, fixtures and equipment.

Typically, in our experience, a deep turn opportunity takes a total of approximately four years from the initial acquisition of a property to achieving full post-renovation stabilization. Therefore, when evaluating future opportunities in underperforming hotels, we intend to focus on up-branding and shallow-turn opportunities, and to pursue deep-turn opportunities on a more limited basis and in joint venture partnerships, if possible.

Investment Vehicles. In pursuit of our investment strategy, we may employ various traditional and non-traditional investment vehicles:

- *Direct Purchase Opportunity:* Our traditional investment strategy is to acquire direct ownership interests via our Operating Partnership in properties that meet our investment criteria, including opportunities that involve full-service, upscale and upper-upscale properties in identified geographic growth markets that have significant barriers to entry for new product delivery. Such properties, or portfolio of properties, may or may not be acquired subject to a mortgage, or other financing or lending instruments, by the seller or third-party.

- *Joint Venture/Mezzanine Lending Opportunities:* We may, from time to time, undertake a significant renovation and rehabilitation project that we characterize as a deep-turn opportunity. In such cases, we may acquire a functionally obsolete hotel whose renovation may be very lengthy and require significant capital. In these projects, we may choose to structure such acquisitions as a joint venture, or mezzanine lending program, in order to avoid severe short-term dilution and loss of current income commonly referred to as the “negative carry” associated with such extensive renovation programs. We will not pursue joint venture or mezzanine programs in which we would become a “de facto” lender to the real estate community.

Portfolio and Asset Management Strategy

We intend to ensure that the management of our hotel properties maximizes market share, as evidenced by revenue per available room (“RevPAR”) penetration indices, and that our market share yields the optimum level of revenues for our hotels in their respective markets. Our strategy is designed to actively monitor our hotels’ operating expenses in an effort to maximize hotel earnings before interest, taxes, depreciation and amortization (“Hotel EBITDA”).

Over our long history in the lodging industry we have refined many portfolio and asset management techniques that we believe provide for exceptional cash returns at our hotels. We undertake extensive budgeting due diligence wherein we examine market trends, one-time or exceptional revenue opportunities, and/or changes in the regulatory climate that may impact costs. We review daily revenue results and revenue management strategies at the hotels, and we focus on our managers’ ability to produce high quality revenues that translate to higher profit margins. We look for ancillary forms of revenues, such as leasing roof-top space for cellular towers and other communication devices and also look to lease space to third parties in our hotels, which may include, but are not limited to, gift shops or restaurants. We have and will continue to engage parking management companies to maximize parking revenue. Our efforts further include periodic review of property insurance costs and coverage, and the cost of real and personal property taxes. We generally appeal tax increases in an effort to secure lower tax payments and routinely pursue strategies that allow for lower overall insurance costs, such as purchasing re-insurance.

We also require detailed and refined reporting data from our hotel managers, which includes detailed accounts of revenues, revenue segments, expenses and forecasts based on current and historic booking patterns. We also believe we optimize and successfully manage capital costs at our hotels while ensuring that adequate product standards are maintained to provide a positive guest experience.

None of our hotels are managed by a major national or global hotel franchise company. Through our long history in the lodging industry, we have found that management of our hotels by management companies other than franchisors is preferable to and more profitable than management services provided by the major franchise companies, specifically with respect to optimization of operating expenses and the delivery of guest service.

Our portfolio management strategy includes efforts to optimize labor costs. Our third-party hotel managers are responsible for hiring and maintaining the labor force at each of our hotels. Although we do not directly employ or manage employees at our hotels, we monitor our hotel managers and make recommendations regarding the operation of our hotels. The labor force in our hotels is predominately non-unionized, with only one property, the DoubleTree by Hilton Jacksonville Riverfront, having approximately 22 employees electing to participate under a collective bargaining arrangement. Further, the labor force at our hotels that are managed by Chesapeake Hospitality is eligible to receive health and other insurance coverage through Chesapeake Hospitality, which self-insures. Self-insuring has, in our opinion and experience, provided significant savings over traditional insurance company sponsored plans.

Asset Disposition Strategy. When a property no longer fits with our investment objectives, we will pursue a direct sale of the property for cash so that our investment capital can be redeployed according to the investment strategies outlined above. Where possible, we will seek to subsequently purchase a hotel in connection with the requirements of a tax-free exchange. Such a strategy may be deployed in order to mitigate the tax consequence that a direct sale may cause.

Our Principal Agreements

Management Agreements

Chesapeake Hospitality is the management company for eleven of our twelve wholly-owned hotels, as well as the Hyde Resort & Residences. Andrew M. Sims, our chairman and chief executive officer owns an equity interest in Chesapeake Hospitality.

On December 15, 2014, we entered into a master agreement (the “Master Agreement”) and a series of individual hotel management agreements (each a “Hotel Management Agreement” and, together, the “Hotel Management Agreements”) between the Company, the Operating Partnership, and MHI Hospitality TRS, LLC (and other TRS Lessees) on the one hand and Chesapeake

Hospitality on the other hand. The Master Agreement and Hotel Management Agreements provide for ongoing management of the Company's hotels other than the Hyatt Centric Arlington, which is managed by Highgate Hotels.

The Master Agreement:

- expires on December 31, 2019, or earlier if all of the Hotel Management Agreements expire or are terminated prior to that date. The Master Agreement will be extended beyond 2019 for such additional periods as a Hotel Management Agreement remains in effect;
- caused the Hotel Management Agreements to come into effect on December 31, 2014;
- requires Chesapeake Hospitality to provide dedicated executive level support for our managed hotels pursuant to certain criteria;
- provides a mechanism and established conditions on which the Company will offer Chesapeake Hospitality the opportunity to manage hotels acquired by the Company in the future, pursuant to a negotiated form of single facility management agreement, with the caveat that the Company is not required to offer the management of future hotels to Chesapeake Hospitality; and
- sets an incentive management fee for each of the hotels to be managed by Chesapeake Hospitality equal to 10% of the amount by which gross operating profit, as defined in the Hotel Management Agreement, for a given year exceeds the budgeted gross operating profit for such year; provided, however, that the incentive management fee payable in respect of any such year shall not exceed 0.25% of the gross revenues of the hotel included in such calculation.

Each of the Hotel Management Agreements has a term of five years commencing January 1, 2015, with the exception of the Hotel Management Agreement for the management of the DoubleTree Resort by Hilton Hollywood Beach, which has a term of five years commencing July 31, 2015. Each of the Hotel Management Agreements may be extended for up to two additional periods of five years subject to the approval of both parties with respect to any such extension. The agreements provide that Chesapeake Hospitality will be the sole and exclusive manager of the hotels as the agent of the respective TRS Lessee and at the sole cost and expense of the TRS Lessee and subject to certain operating standards. Each agreement may be terminated in connection with a sale of the related hotel. In connection with a termination upon the sale of the hotel, Chesapeake Hospitality will be entitled to receive a termination fee equal to the lesser of the management fee paid with respect to the prior twelve months or the management fees paid for that number of months prior to the closing date of the hotel sale equal to the number of months remaining on the current term of the Hotel Management Agreement. No sale termination fee will be payable in the event the Company elects to provide Chesapeake Hospitality with the opportunity to manage another comparable hotel and Chesapeake Hospitality is not precluded from accepting such opportunity. Chesapeake Hospitality is required to qualify as an eligible independent contractor in order to permit the Company to continue to operate as a real estate investment trust.

On February 3, 2017, we entered into a Condominium Hotel Management Agreement (the "Hyde Management Agreement") with Chesapeake Hospitality for the management of the Hyde Resort & Residences condominium hotel. In accordance with the Master Agreement, the Hyde Management Agreement has an initial term of five years commencing January 30, 2017 and mirrors the material terms of the other Hotel Management Agreements. The terms of the Hyde Management Agreement provide for a base management fee equal to a percentage of gross revenues of the rental of condominium units participating in our rental program in the amount of 2.00% through January 2018, 2.25% through January 2019, and 2.50% thereafter. Pursuant to the Hyde Management Agreement, Chesapeake Hospitality will manage for us the rental of individually owned condominium units pursuant to rental agreements entered into with individual condominium unit owners. We also entered into an Association Sub Management and Assignment Agreement with Chesapeake Hospitality for the management and operation of the condominium association responsible for the operation of the Hyde Resort & Residences, and a Rental Management Agreement pursuant to which Chesapeake Hospitality agreed to manage the marketing and negotiation of rental agreements with individual condominium unit owners.

We have also entered into a 20-year Association Management Agreement with the condominium association, whereby we have been engaged to manage the condominium association and to operate the Hyde Resort & Residences as a condominium hotel. Individual condominium unit owners may elect for their condominium units to be rented to condominium hotel guests pursuant to a rental management program managed for us by Chesapeake Hospitality pursuant to the Hyde Management Agreement, described above. As part of the rental management program, we have entered into individual rental agreements with condominium unit owners who have chosen to participate in our rental program, and may enter into rental agreements with unit owners in the future. We expect the number of individual condominium unit owners who elect to participate in our rental program to vary, and the number of units available for rental to condominium hotel guests at any given time will fluctuate pursuant to that participation and due to owner occupation of the condominium hotel units.

Amounts Payable under the Management Agreements. Each of our management companies receives a base management fee, and, if a hotel exceeds certain financial thresholds, an additional incentive management fee for the management of our hotels.

Currently, the base management fee for each of our hotels and for the Hyde Resort & Residences is 2.5% of the gross revenues of each respective hotel and is due monthly. The historical base management fees (as a percentage of gross revenues) for each of our wholly-owned hotels and the Hyde Resort & Residences are shown below:

	Commencement Date	Expiration Date	Year 1	Year 2	Year 3	Year 4-5 Renewals
Crowne Plaza Tampa Westshore	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
The DeSoto	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
DoubleTree by Hilton Jacksonville Riverfront	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
DoubleTree by Hilton Laurel	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
DoubleTree by Hilton Philadelphia Airport	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
DoubleTree by Hilton Raleigh Brownstone – University	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
DoubleTree Resort by Hilton Hollywood Beach	July 31, 2015	July 31, 2020	2.00%	2.25%	2.50%	2.50%
Georgian Terrace	January 1, 2015	January 1, 2020	2.00%	2.25%	2.50%	2.50%
Hotel Ballast Wilmington, Tapestry Collection by Hilton	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
Hyatt Centric Arlington ⁽¹⁾	March 1, 2018	March 1, 2021	2.50%	2.50%	2.50%	2.50%
Sheraton Louisville Riverside	January 1, 2015	January 1, 2020	2.65%	2.65%	2.65%	2.50%
The Whitehall	January 1, 2015	January 1, 2020	2.00%	2.25%	2.50%	2.50%
Hyde Resort & Residences	January 30, 2017	January 30, 2022	2.00%	2.25%	2.50%	2.50%

- (1) On March 1, 2018, we acquired the Hyatt Centric Arlington hotel and entered into a three-year management agreement with the incumbent manager, Highgate Hotels that provides for a base management fee equal to 2.5% of gross revenue.

With respect to future hotel management agreements with Chesapeake Hospitality, the base management fee for a hotel acquired in the future which is first leased by our TRS Lessees, other than on the first day of a fiscal year, will be 2.0% for the partial year such hotel is first leased and for the first full year such hotel is managed. There is no fee cap on the base management fee.

Subsequently Acquired Hotel Properties Managed by Chesapeake Hospitality

First year	2.00%
Second year	2.25%
Third year and thereafter	2.50%

Franchise Agreements

As of December 31, 2018, all but three of our wholly-owned hotels operate under franchise licenses from national hotel companies. On March 27, 2014, we purchased an independent full-service hotel in Atlanta, Georgia, which does not operate under a franchise license. On April 12, 2016, we allowed the Crowne Plaza Houston Downtown's franchise agreement to expire and rebranded it as The Whitehall, an independent full-service hotel. On July 31, 2017, we allowed the Hilton Savannah DeSoto's franchise agreement to expire and rebranded it as The DeSoto. As our franchise agreements expire, we will continue to evaluate each hotel on a case-by-case basis and decide whether to renew or terminate the agreement. We also periodically review our independent hotels to determine whether they would be better served by operating under a franchise license.

Our TRS Lessees hold the franchise licenses for our wholly-owned hotels. Our hotel managers must operate each of our hotels they manage in accordance with and pursuant to the terms of the franchise agreement for the hotel.

The franchise licenses generally specify certain management, operational, record keeping, accounting, reporting and marketing standards and procedures with which the franchisee must comply. Under the franchise licenses, the franchisee must comply with the franchisors' standards and requirements with respect to:

- training of operational personnel;
- safety;
- maintaining specified insurance;
- the types of services and products ancillary to guest room services that may be provided;
- display of signage;
- marketing standards including print media, billboards, and promotions standards; and
- the type, quality and age of furniture, fixtures and equipment included in guest rooms, lobbies and other common areas.

As the franchisee, our TRS Lessees are required to pay franchise/royalty fees, as well as certain other fees for marketing and reservations services in amounts that range from approximately 3.0% to 4.0% of gross revenues. The following table sets forth certain information for the franchise licenses of our wholly-owned hotel properties as of December 31, 2018:

	Franchise/Royalty Fee (1)	Expiration Date
Crowne Plaza Tampa Westshore	5.0%	March 2019 September 2025
DoubleTree by Hilton Jacksonville Riverfront	5.0%	October 2030
DoubleTree by Hilton Laurel	5.0%	October 2024 November 2021
DoubleTree by Hilton Philadelphia – Airport	5.0%	October 2027
DoubleTree by Hilton Raleigh Brownstone – University	5.0%	April 2028
DoubleTree Resort by Hilton Hollywood Beach	5.0%	March 2038
Hotel Ballast Wilmington, Tapestry Collection by Hilton ⁽²⁾	3.0%	April 2023
Hyatt Centric Arlington	5.0%	
Sheraton Louisville Riverside	5.0%	

(1) Percentage of room revenues payable to the franchisor.

(2) The Franchise/Royalty Fee is 3.0% for operating year 1, 4.0% for operating year 2, and 5.0% thereafter.

Lease Agreements

TRS Leases

In order for the Company to maintain qualification as a REIT, neither the Company nor the Operating Partnership or its subsidiaries can operate our hotels directly. Our wholly-owned hotels are leased to our TRS Lessees, which have engaged a third-party management company to manage the hotels. Each lease has a non-cancelable term of four to thirty years, subject to earlier termination upon the occurrence of certain contingencies described in the lease.

During the term of each lease, our TRS Lessees are obligated to pay a fixed annual base rent plus a percentage rent and certain other additional charges. Base rent accrues and is paid monthly. Percentage rent is calculated by multiplying fixed percentages by gross room revenues, in excess of certain threshold amounts and is paid monthly or quarterly, according to the terms of the agreement.

Other Leases

We have entered into several agreements related to the Hyde Resort & Residences, which is zoned and operated as a condominium hotel with individual condominium units owned by third parties. In addition to our ownership of the commercial condominium unit, consisting of the designated lobby and front desk areas, we entered into a 20-year lease agreement with the condominium association responsible for the operation of the condominium, whereby we lease other common areas, including meeting rooms, office spaces, and 400 parking spaces, and also manage the parking garage.

We lease the land underlying the Hyatt Centric Arlington hotel pursuant to a ground lease. The ground lease requires us to make rental payments of \$50,000 per year in base rent and percentage rent equal to 3.5% of gross room revenue in excess of certain

thresholds, as defined in the ground lease agreement. The initial term of the ground lease expires in 2025 and may be extended by us for five additional renewal periods of 10 years each. Rent expense for the twelve months ended December 31, 2018 was \$524,490. The ground lease requires us to obtain the consent of the third-party lessor in order to sell the Hyatt Centric Arlington hotel or to assign our leasehold interest in the ground lease.

Tax Status

The Company elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the “Code”), commencing with its taxable year ended December 31, 2004. In order to maintain its qualification as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute, as “qualifying distributions,” at least 90.0% of its taxable income (determined without regard to the deduction for dividends paid and by excluding its net capital gains and reduced by certain non-cash items) to its stockholders. The Company has adhered to these requirements each taxable year since its formation in 2004 and intends to continue to adhere to these requirements and maintain its qualification for taxation as a REIT. As a REIT, the Company generally will not be subject to federal corporate income tax on that portion of its taxable income (including its net capital gain) that is distributed to its stockholders. If the Company fails to qualify for taxation as a REIT in any taxable year, and no relief provision applies, it will be subject to federal income taxes at regular corporate rates and it would be disqualified from re-electing treatment as a REIT until the fifth taxable year after the year in which it failed to qualify as a REIT. Even if the Company qualifies for taxation as a REIT, it may be 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, taxable income from non-REIT activities managed through taxable REIT subsidiaries is subject to federal, state and local income taxes.

While the Operating Partnership is generally not subject to federal and state income taxes, the unit holders of the Operating Partnership, including the Company, are subject to tax on their respective allocable shares of the Operating Partnership’s taxable income.

The Company has one taxable REIT subsidiary, MHI Holding, in which it owns an interest through the Operating Partnership. MHI Holding is subject to federal, state and local income taxes. MHI Holding has operated at a cumulative taxable loss, through December 31, 2018, of approximately \$17.1 million and deferred timing differences of approximately \$2.8 million attributable to accrued, but not deductible, vacation and sick pay amounts and other depreciation and amortizable timing differences. The Company has not incurred federal income taxes since its formation. The cumulative taxable loss and combined timing differences result in a net deferred tax asset of approximately \$5.1 million for these cumulative deferred tax loss carryforwards.

Environmental Matters

In connection with the ownership and operation of the hotels, we are subject to various federal, state and local laws, ordinances and regulations relating to environmental protection. Under these laws, a current or previous owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on, under, or in such property. Such laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence of hazardous or toxic substances. In addition, the presence of contamination from hazardous or toxic substances, or the failure to remediate such contaminated property properly, may adversely affect the owner’s ability to borrow using such property as collateral. Furthermore, a person who arranges for the disposal or treatment of a hazardous or toxic substance at a property owned by another, or who transports such substance to or from such property, may be liable for the costs of removal or remediation of such substance released into the environment at the disposal or treatment facility. The costs of remediation or removal of such substances may be substantial, and the presence of such substances may adversely affect the owner’s ability to sell such real estate or to borrow using such real estate as collateral. In connection with the ownership and operation of the hotels, we may be potentially liable for such costs.

We believe that our hotels are in compliance, in all material respects, with all federal, state and local environmental ordinances and regulations regarding hazardous or toxic substances and other environmental matters, the violation of which would have a material adverse effect on us. We have not received written notice from any governmental authority of any material noncompliance, liability or claim relating to hazardous or toxic substances or other environmental matters in connection with any of our present hotel properties.

Employees

As of December 31, 2018, we employed thirteen full-time persons, all of whom work at our corporate office in Williamsburg, Virginia. All persons employed in the day-to-day operations of each of our hotels are employees of our third-party hotel managers engaged by our TRS Lessees to operate such hotels.

Other Commitments

On June 1, 2017, we entered into an agreement to purchase the commercial unit of the planned Hyde Beach House Resort & Residences, a condominium hotel under development in Hollywood, Florida, for a price of \$5.1 million from 4000 South Ocean Property Owner, LLLP. In connection with the agreement, we also entered into a pre-opening services agreement whereby the seller has agreed to pay the Company approximately \$0.8 million in connection with certain pre-opening activities to be undertaken prior to the closing. The Company has agreed to purchase inventories at closing consistent with the management and operation of the planned hotel and the related condominium association for an additional amount and has further agreed to enter into a lease agreement for the parking garage and poolside cabanas associated with the planned hotel; and to enter into a management agreement relating to the operation and management of the planned hotel's condominium association. The Company anticipates that the closing of the transaction and the execution of related agreements will take place by the end of 2019, once construction of the planned hotel has been substantially completed. The closing of the transaction is subject to various closing conditions as described in the purchase agreement.

Available Information

We maintain an Internet site, <http://www.sotherlyhotels.com>, which contains additional information concerning Sotherly Hotels Inc. We make available free of charge through our Internet site all our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, definitive proxy statements and other reports filed with the Securities and Exchange Commission as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. We have also posted on this website the Company's Code of Business Conduct and the charters of the Company's Nominating, Corporate Governance and Compensation ("NCGC") and Audit Committees of the Company's board of directors. We intend to disclose on our website any changes to, or waivers from, the Company's Code of Business Conduct. Information on the Company's Internet site is neither part of nor incorporated into this Form 10-K.

Item 1A. Risk Factors

The following are the material risks that may affect us. Any of the risks discussed herein can materially adversely affect our business, liquidity, operations, industry or financial position or our future financial performance.

Risks Related to Our Business and Properties

If the economy falls into a recessionary period or fails to maintain positive growth, our operating performance and financial results may be harmed by declines in occupancy, average daily room rates and/or other operating revenues.

The performance of the lodging industry and the general economy historically have been closely linked. In an economic downturn, business and leisure travelers may seek to reduce costs by limiting travel and/or reducing costs on their trips. Our hotels, which are all full-service hotels, may be more susceptible to a decrease in revenue, as compared to hotels in other categories that have lower room rates. A decrease in demand for hotel stays and hotel services will negatively affect our operating revenues, which will lower our cash flow and may affect our ability to make distributions to stockholders and to maintain compliance with our loan obligations. We had net loss attributable to the common stockholders of approximately \$(5.7) million for the 2018 fiscal year. An economic downturn may increase our losses or reduce our income in the future. A weakening of the economy may adversely and materially affect our industry, business and results of operations and we cannot predict the likelihood, severity or duration of any such downturn. Moreover, reduced revenues as a result of a weakening economy may also reduce our working capital and impact our long-term business strategy.

We own a limited number of hotels and significant adverse changes at one hotel could have a material adverse effect on our financial performance and may limit our ability to make distributions to stockholders.

As of December 31, 2018, our portfolio consisted of twelve wholly-owned hotels with a total of 3,156 rooms and the hotel commercial condominium unit of the Hyde Resort & Residences condominium hotel. Significant adverse changes in the operations of any one hotel could have a material adverse effect on our financial performance and, accordingly, on our ability to make distributions to stockholders.

We are subject to risks of increased hotel operating expenses and decreased hotel revenues.

Our leases with our TRS Lessees provide for the payment of rent based in part on gross revenues from our hotels. Our TRS Lessees are subject to hotel operating risks including decreased hotel revenues and increased hotel operating expenses, including but not limited to the following:

- wage and benefit costs;
- repair and maintenance expenses;
- energy costs;
- property taxes;
- insurance costs; and
- other operating expenses.

Any increases in these operating expenses can have a significant adverse impact on our TRS Lessees' ability to pay rent and other operating expenses and, consequently, our earnings and cash flow.

In keeping with our investment strategy, we may acquire, renovate and/or re-brand hotels in new or existing geographic markets as part of our repositioning strategy. Unanticipated expenses and insufficient demand for newly repositioned hotels could adversely affect our financial performance and our ability to comply with covenants in the indenture to the 7.25% Notes and to make distributions to the Company's stockholders.

We have in the past, and may in the future, develop or acquire hotels in geographic areas in which our management may have little or no operating experience. Additionally, those properties may also be renovated and re-branded as part of a repositioning strategy. Potential customers may not be familiar with our newly renovated hotel or be aware of the brand change. As a result, we may have to incur costs relating to the opening, operation and promotion of those new hotel properties that are substantially greater than those incurred in other geographic areas. These hotels may attract fewer customers than expected and we may choose to increase spending on advertising and marketing to promote the hotel and increase customer demand. Unanticipated expenses and insufficient demand at new hotel properties, therefore, could adversely affect our financial performance and our ability to comply with covenants in the indenture and to make distributions to the Company's stockholders.

We do not have the authority to require any hotel to be operated in a particular manner or to govern any particular aspect of the daily operations of any hotel and as a result, our returns are dependent on the management of our hotels by our hotel management companies.

Since federal income tax laws restrict REITs and their subsidiaries from operating or managing hotels, we do not operate or manage our hotels. Instead, we lease all of our hotels to our TRS Lessees, and our TRS Lessees retain managers to operate our hotels pursuant to management agreements.

Under the terms of our management agreements with our hotel managers and the REIT qualification rules, our ability to participate in operating decisions regarding the hotels is limited. We will depend on our hotel managers to operate our hotels as provided in the management agreements. We do not have the authority to require any hotel to be operated in a particular manner or to govern any particular aspect of the daily operations of any hotel. Thus, even if we believe our hotels are being operated inefficiently or in a manner that does not result in satisfactory occupancy rates, RevPAR, and average daily rates (“ADR”), we may not be able to force a hotel management company to change its method of operating our hotels. Additionally, in the event that we need to replace a hotel management company in the future, we may be required by the terms of the applicable management agreement to pay substantial termination fees and may experience significant disruptions at the affected hotels.

Our ability to make distributions to the Company’s stockholders is subject to fluctuations in our financial performance, operating results and capital improvement requirements.

As a REIT, the Company is required to distribute, as “qualifying distributions,” at least 90.0% of its REIT taxable income (determined without regard to the dividends-paid deduction and by excluding its net capital gains, and reduced by certain non-cash items), each year to the Company’s stockholders. However, several factors may make us unable to declare or pay distributions to the Company’s stockholders, including poor operating results and financial performance or unanticipated capital improvements to our hotels, including capital improvements that may be required by our franchisors.

We lease all of our hotels to our TRS Lessees. Our TRS Lessees are subject to hotel operating risks, including risks of sustaining operating losses after payment of hotel operating expenses, including management fees. Among the factors which could cause our TRS Lessees to fail to make required rent payments are reduced net operating profits or operating losses, increased debt service requirements and capital expenditures at our hotels, including capital expenditures required by the franchisors of our hotels. Among the factors that could reduce the net operating profits of our TRS Lessees are decreases in hotel revenues and increases in hotel operating expenses. Hotel revenue can decrease for a number of reasons, including increased competition from a new supply of hotel rooms and decreased demand for hotel rooms. These factors can reduce both occupancy and room rates at our hotels.

The amount of any dividend distributions to holders of the Company’s common stock is in the sole discretion of the Company’s board of directors, which will consider, among other factors, our financial performance, debt service obligations, debt covenants and capital expenditure requirements. We cannot assure you that we will continue to generate sufficient cash to fund distributions.

Geographic concentration of our hotels makes our business vulnerable to economic downturns in the mid-Atlantic and southern United States.

Our hotels are located in the mid-Atlantic and southern United States. As a result, economic conditions in the mid-Atlantic and southern United States significantly affect our revenues and the value of our hotels to a greater extent than if we had a more geographically diversified portfolio. Business layoffs or downsizing, industry slowdowns, changing demographics and other similar factors that may adversely affect the economic climate in these areas could have a significant adverse impact on our business. Any resulting oversupply or reduced demand for hotels in the mid-Atlantic and southern United States and in our markets in particular would therefore have a disproportionate negative impact on our revenues and limit our ability to make distributions to stockholders.

A substantial number of our hotels operate under brands owned by Hilton Worldwide (Hilton); therefore, we are subject to risks associated with concentrating our portfolio in one brand. We also own hotels operated under brands owned by InterContinental Hotels Group (IHG), Marriott International, Inc. (Marriott) and Hyatt Hotels Corporation (Hyatt).

In our portfolio, the majority of the hotels that we owned as of December 31, 2018 utilize brands owned by Hilton. As a result, our success is dependent in part on the continued success of Hilton and their respective brands. If market recognition or the positive perception of Hilton is reduced or compromised, the goodwill associated with the Hilton branded hotels in our portfolio may be adversely affected, which may have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders. As of March 1, 2019, we owned one property each under the IHG, Marriott, and Hyatt brands. Our success is also dependent in part on the continued success, market recognition, and positive perception of these brands.

Our ground lease for the Hyatt Centric Arlington may constrain us from acting in the best interest of shareholders or require us to make certain payments.

The Hyatt Centric Arlington is subject to a ground lease with a third-party lessor which requires us to obtain the consent of the relevant third party lessor in order to sell the Hyatt Centric Arlington hotel or to assign our leasehold interest in the ground lease. Accordingly, we may be prevented from completing such a transaction if we are unable to obtain the required consent from the lessor, even if we determine that the sale of this hotel or the assignment of our leasehold interest in the ground lease is in the best interest of the Company or our shareholders. In addition, at any given time, potential purchasers may be less interested in buying a hotel subject to a ground lease and may demand a lower price for the hotel than for a comparable property without such a restriction, or they may not purchase the hotel at any price. For these reasons, we may have a difficult time selling the hotel or may receive lower proceeds from any such sale. The ground lease is subject to five renewal periods of 10 years each, with the first renewal period beginning in 2025. At the beginning of each renewal period, certain provisions of the lease may be adjusted by the lessor, which could impact payments we are required to make to the lessor. In addition, if we are not able to come to reasonable terms with the lessor at the end of the term or if we are found to have breached certain obligations under the ground lease, we may be required to dispose of the hotel at a substantial loss.

Hedging against interest rate exposure may adversely affect us and our hedges may fail to protect us from the losses that the hedges were designed to offset.

Subject to maintaining the Company's qualification as a REIT, we may elect to manage our exposure to interest rate volatility by using interest rate hedging arrangements, such as cap agreements and swap agreements. These agreements involve the risks that these arrangements may fail to protect or adversely affect us because, among other things:

- interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates;
- available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought;
- the financial instruments we select may not have the effect of reducing our interest rate risk;
- the duration of the hedge may not match the duration of the related liability;
- the credit quality of the hedging counterparty owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and
- the hedging counterparty owing money in the hedging transaction may default on its obligation to pay.

As a result of any of the foregoing, our hedging transactions, which are intended to limit losses, may fail to protect us from the losses that the hedges were designed to offset and could have a material adverse effect on us.

Our investment opportunities and growth prospects may be affected by competition for acquisitions.

We compete for investment opportunities with other entities, some of which have substantially greater financial resources than we do. This competition may generally limit the number of suitable investment opportunities offered to us, which may limit our ability to grow. This competition may also increase the bargaining power of property owners seeking to sell to us, making it more difficult for us to acquire new properties on attractive terms, or at all.

If we fail to maintain an effective system of internal controls, we may not be able to accurately determine our financial results or prevent fraud. As a result, the Company's stockholders could lose confidence in our financial results, which could harm our business and the value of the Company's shares.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate and report on our internal controls over financial reporting. Our internal controls and financial reporting are subject to attestation by our independent registered public accounting firm pursuant to the Sarbanes-Oxley Act of 2002 for issuers that are "large accelerated filers" or "accelerated filers" under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. While we have undertaken substantial work to maintain effective internal controls, we cannot be certain that we will be successful in maintaining adequate internal controls over our financial reporting and financial processes in the future. We may in the future discover areas of our internal controls that need improvement. Furthermore, as we grow our business, our internal controls will become more complex, and we will require significantly more resources to ensure our internal controls remain effective. If we or our independent auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market value of the Company's shares. Additionally, the existence of any material weakness or significant deficiency would require management to devote significant time and incur significant expense to remediate any such material

weaknesses or significant deficiencies and management may not be able to remediate any such material weaknesses or significant deficiencies in a timely manner.

We and our hotel managers rely on information technology in our operations, and any material failure, inadequacy, interruption or security failure of that technology could harm our business.

We and our hotel managers rely on information technology networks and systems, including the Internet, to process, transmit and store electronic information, and to manage or support a variety of business processes, including financial transactions and records, personal identifying information, reservations, billing and operating data. We and our hotel managers purchase some of our information technology from vendors, on whom our systems depend. We and our hotel managers rely on commercially available systems, software, tools and monitoring to provide security for processing, transmission and storage of confidential operator and other customer information, such as individually identifiable information, including information relating to financial accounts. Although we and our hotel managers have taken steps we believe are necessary to protect the security of our information systems and the data maintained in those systems, it is possible that the safety and security measures taken will not be able to prevent the systems' improper functioning or damage, or the improper access or disclosure of personally identifiable information such as in the event of cyber-attacks. Security breaches, including physical or electronic break-ins, computer viruses, attacks by hackers and similar breaches, can create system disruptions, shutdowns or unauthorized disclosure of confidential information. Any failure to maintain proper functionality, security and availability of our information systems could interrupt our operations, damage our reputation, subject us to liability claims or regulatory penalties and could have a material adverse effect on our business, financial condition and results of operations.

We face possible risks associated with natural disasters and the physical effects of climate change.

We are subject to the risks associated with natural disasters and the physical effects of climate change, which can include more frequent or severe storms, droughts, hurricanes and flooding, any of which could have a material adverse effect on our hotels, operations and business. Over time, our coastal markets are expected to experience increases in storm intensity and rising sea-levels causing damage to our properties. As a result, we could become subject to significant losses and/or repair costs that may or may not be fully covered by insurance. Other markets may experience prolonged variations in temperature or precipitation that may limit access to the water needed to operate our hotels or significantly increase energy costs, which may subject those hotels to additional regulatory burdens, such as limitations on water usage or stricter energy efficiency standards. Climate change also may affect our business by increasing the cost of (or making unavailable) property insurance on terms we find acceptable in areas most vulnerable to such events, increasing operating costs at our hotels, such as the cost of water or energy, and requiring us to expend funds as we seek to repair and protect our hotels against such risks. There can be no assurance that climate change will not have a material adverse effect on our hotels, operations or business.

Risks Related to the Lodging Industry

Our ability to comply with the terms of the indenture for the 7.25% Notes, our ability to make distributions to the Company's stockholders and the value of our hotels in general, may be adversely affected by factors in the lodging industry.

Operating Risks

Our hotel properties are subject to various operating risks common to the lodging industry, many of which are beyond our control, including the following:

- competition from other hotel properties in our markets;
- over-building of hotels in our markets, which adversely affects occupancy and revenues at our hotels;
- dependence on business and commercial travelers and tourism;
- increases in energy costs and other expenses affecting travel, which may affect travel patterns and reduce the number of business and commercial travelers and tourists;
- increases in operating costs due to inflation and other factors, including increases in labor costs, that may not be offset by increased room rates;
- changes in interest rates and in the availability, cost and terms of debt financing;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- adverse effects of international, national, regional and local economic and market conditions;

- adverse effects of a downturn in the lodging industry; and
- risks generally associated with the ownership of hotel properties and real estate, as we discuss in detail below.

These factors could reduce the net income of our TRS Lessees, which in turn could adversely affect the value of our hotels and our ability to comply with the terms of the indenture and to make distributions to the Company's stockholders.

Seasonality of the Hotel Business

The lodging industry is seasonal in nature, which can be expected to cause quarterly fluctuations in our revenues. Our quarterly earnings may be adversely affected by factors outside our control, including weather conditions and poor economic factors. As a result, we may have to enter into short-term borrowings in certain quarters in order to offset these fluctuations in revenues and to make distributions to the Company's stockholders.

Investment Concentration in Particular Segments of a Single Industry

Our entire business is lodging-related. Therefore, a downturn in the lodging industry, in general, and the full-service, upscale and upper-upscale segments in which we operate, in particular, will have a material adverse effect on the value of our hotels, our financial condition and the extent to which cash may be available for distribution to the Company's stockholders.

Capital Expenditures

Our hotel properties have an ongoing need for renovations and other capital improvements, including replacements, from time to time, of furniture, fixtures and equipment. The franchisors of our hotels also require us to make periodic capital improvements as a condition of keeping the franchise licenses. In addition, several of our mortgage lenders require that we set aside amounts for capital improvements to the secured properties on a monthly basis. For the years ended December 31, 2018 and 2017, we spent approximately \$22.1 million and approximately \$23.2 million, respectively, on capital improvements to our hotels. Capital improvements and renovation projects may give rise to the following risks:

- possible environmental problems;
- construction cost overruns and delays;
- a possible shortage of available cash to fund capital improvements and the related possibility that financing for these capital improvements may not be available to us on affordable terms; and
- uncertainties as to market demand or a loss of market demand after capital improvements have begun.

The costs of all these capital improvements as well as future capital improvements could adversely affect our financial condition and amounts available for distribution to the Company's stockholders.

Operating our hotels under franchise agreements could increase our operating costs and lower our net income.

Most of our hotels operate under franchise agreements which subject us to risks in the event of negative publicity related to one of our franchisors.

The maintenance of the franchise licenses for our hotels is subject to our franchisors' operating standards and other terms and conditions. Our franchisors periodically inspect our hotels to ensure that we, our TRS Lessees, and the management companies follow their standards. Failure by us, our TRS Lessees or a management company to maintain these standards or other terms and conditions could result in a franchise license being canceled. If a franchise license terminates due to our failure to make required improvements or to otherwise comply with its terms, we may also be liable to the franchisor for a termination payment, which varies by franchisor and by hotel. As a condition of continuing a franchise license, a franchisor may require us to make capital expenditures, even if we do not believe the capital improvements are necessary or desirable or will result in an acceptable return on our investment. Nonetheless, we may risk losing a franchise license if we do not make franchisor-required capital expenditures.

If a franchisor terminates the franchise license, we may try either to obtain a suitable replacement franchise license or to operate the hotel without a franchise license. The loss of a franchise license could significantly decrease the revenues at the hotel and reduce the underlying value of the hotel because of the loss of associated name recognition, marketing support and centralized reservation systems provided by the franchisor. A loss of a franchise license for one or more hotels could materially and adversely affect our revenues. This loss of revenues could, therefore, also adversely affect our financial condition and results of operations, our ability to comply with the terms of the indenture for the 7.25% Notes and reduce our cash available for distribution to stockholders.

Restrictive covenants in certain of our franchise agreements contain provisions that may operate to limit our ability to sell or refinance our hotels, which could have a material adverse effect on us.

Franchise agreements typically contain covenants that may affect our ability to sell or refinance a hotel, including requirements to obtain the consent of the franchisor in the event of such a sale or refinancing transaction. In the event that a franchisor's consent is not forthcoming, the terms of a sale or refinancing may be less favorable to us than would otherwise be the case. Some of our franchise agreements provide the franchisor with a right of first offer in the event of certain sales or transfers of a hotel and provide that the franchisor has the right to approve any change in the hotel management company engaged to manage the hotel. Generally, we may be limited in our ability to sell, lease or otherwise transfer hotels unless the transferee is not a competitor of the franchisor and the transferee agrees to assume the related franchise agreements. If the franchisor does not consent to the sale or financing of our hotels, we may be unable to consummate transactions that are in our best interests or the terms of those transactions may be less favorable to us, which could have a material adverse effect on our financial condition and the execution of our strategies.

Hotel re-development is subject to timing, budgeting and other risks that would increase our operating costs and limit our ability to make distributions to stockholders.

We intend to acquire hotel properties from time to time as suitable opportunities arise, taking into consideration general economic conditions, and seek to re-develop or reposition these hotels. Redevelopment of hotel properties involves a number of risks, including risks associated with:

- construction delays or cost overruns that may increase project costs;
- receipt of zoning, occupancy and other required governmental permits and authorizations;
- development costs incurred for projects that are not pursued to completion;
- acts of God such as earthquakes, hurricanes, floods or fires that could adversely impact a project;
- financing; and
- governmental restrictions on the nature or size of a project.

We cannot assure you that any re-development project will be completed on time or within budget. Our inability to complete a project on time or within budget would increase our operating costs and reduce our net income.

The hotel business is capital intensive and our inability to obtain financing could limit our growth.

Our hotel properties will require periodic capital expenditures and renovation to remain competitive. Acquisitions or development of additional hotel properties will require significant capital expenditures. In addition, several of our mortgage lenders require that we set aside annual amounts for capital improvements to the secured property. We may not be able to fund capital improvements or acquisitions solely from cash provided from our operating activities because we must distribute at least 90.0% of our REIT taxable income, excluding net capital gains, each year to maintain our REIT tax status. As a result, our ability to fund significant capital expenditures, acquisitions or hotel development through retained earnings is very limited. Consequently, we rely upon the availability of debt or equity capital to fund any significant investments or capital improvements. Our ability to grow through acquisitions or development of hotels will be limited if we cannot obtain satisfactory debt or equity financing which will depend on market conditions. Neither our charter nor our bylaws limit the amount of debt that we can incur. However, we cannot assure you that we will be able to obtain additional equity or debt financing or that we will be able to obtain such financing on favorable terms.

Uninsured and underinsured losses could adversely affect our operating results and our ability to make distributions to the Company's stockholders.

We maintain comprehensive insurance on each of our hotel properties, including liability, fire and extended coverage, of the type and amount we believe are customarily obtained for or by hotel owners. There are no assurances that current coverage will continue to be available at reasonable rates. Various types of catastrophic losses, like hurricanes, earthquakes and floods, such as Hurricanes Harvey and Irma in August and September 2017, respectively, Hurricane Matthew in October 2016 and Hurricane Sandy in October 2012, losses from foreign terrorist activities, such as those on September 11, 2001, losses from power outages or losses from domestic terrorist activities, such as the Oklahoma City bombing on April 19, 1995, may not be insurable or may not be economically insurable. Currently, our insurers provide terrorism coverage in conjunction with the Terrorism Risk Insurance Program sponsored by the federal government through which insurers are able to receive compensation for insured losses resulting from acts of terrorism.

In the event of a substantial loss, our insurance coverage may not be sufficient to cover the full current market value or replacement cost of our lost investment. Should an uninsured loss or a loss in excess of insured limits occur, we could lose all or a portion of the capital we have invested in a hotel, as well as the anticipated future revenue from the hotel. In that event, we might nevertheless remain obligated for any mortgage debt or other financial obligations related to the property. Inflation, changes in building codes and ordinances, environmental considerations and other factors might also keep us from using insurance proceeds to replace or renovate a hotel after it has been damaged or destroyed. Under those circumstances, the insurance proceeds we receive might be inadequate to restore our economic position on the damaged or destroyed property.

Noncompliance with governmental regulations could adversely affect our operating results.

Environmental Matters

Our hotels may be subject to environmental liabilities. An owner of real property can face liability for environmental contamination created by the presence or discharge of hazardous substances on the property. We may face liability regardless of:

- our knowledge of the contamination;
- the timing of the contamination;
- the cause of the contamination; or
- the party responsible for the contamination of the property.

There may be unknown environmental problems associated with our properties. If environmental contamination exists on our properties, we could become subject to strict, joint and several liability for the contamination by virtue of our ownership interest.

The presence of hazardous substances on a property may adversely affect our ability to sell the property and we may incur substantial remediation costs. The discovery of environmental liabilities attached to our properties could have a material adverse effect on our results of operations and financial condition and our ability to comply with our covenants and to pay distributions to stockholders.

Americans with Disabilities Act and Other Changes in Governmental Rules and Regulations

Under the Americans with Disabilities Act of 1990, or the ADA, all public accommodations must meet various federal requirements related to access and use by disabled persons. Compliance with the ADA's requirements could require removal of access barriers, and non-compliance could result in the U.S. government imposing fines or in private litigants winning damages. If we are required to make substantial modifications to our hotels, whether to comply with the ADA or other changes in governmental rules and regulations, our financial condition, results of operations and ability to comply with the terms of the indenture for the 7.25% Notes and to make distributions to the Company's stockholders could be adversely affected.

Our hotels may be subject to unknown or contingent liabilities which could cause us to incur substantial costs.

The hotel properties that we acquire may be subject to unknown or contingent liabilities for which we may have no recourse, or only limited recourse, against the sellers. Contingent or unknown liabilities with respect to entities or properties acquired might include:

- liabilities for environmental conditions;
- losses in excess of our insured coverage;
- accrued but unpaid liabilities incurred in the ordinary course of business;
- tax, legal and regulatory liabilities;
- claims of customers, vendors or other persons dealing with the Company's predecessors prior to our acquisition transactions that had not been asserted or were unknown prior to the Company's acquisition transactions; and
- claims for indemnification by the general partners, officers and directors and others indemnified by the former owners of our properties.

In general, the representations and warranties provided under the transaction agreements related to the sales of the hotel properties may not survive the closing of the transactions. While we will likely seek to require the sellers to indemnify us with respect to breaches of representations and warranties that survive, such indemnification may be limited and subject to various materiality

thresholds, a significant deductible or an aggregate cap on losses. As a result, there is no guarantee that we will recover any amounts with respect to losses due to breaches by the sellers of their representations and warranties. In addition, the total amount of costs and expenses that may be incurred with respect to liabilities associated with these hotels may exceed our expectations, and we may experience other unanticipated adverse effects, all of which may adversely affect our financial condition, results of operations and our ability to make distributions to the Company's stockholders.

Future terrorist activities may adversely affect, and create uncertainty in, our business.

Terrorism in the United States or elsewhere could have an adverse effect on our business, although the degree of impact will depend on a number of factors, including the U.S. and global economies and global financial markets. Previous terrorist attacks in the United States and subsequent terrorism alerts have adversely affected the travel and hospitality industries in the past. Such attacks, or the threat of such attacks, could have a material adverse effect on our business, our ability to finance our business, our ability to insure our properties and/or our results of operations and financial condition, as a whole.

We face risks related to pandemic diseases, which could materially and adversely affect travel and result in reduced demand for our hotels.

Our business could be materially and adversely affected by the effect of a pandemic disease on the travel industry. For example, the outbreaks of SARS and avian flu in 2003 had a severe impact on the travel industry, the outbreaks of H1N1 flu in 2009 threatened to have a similar impact, and the perceived threat of a Zika virus outbreak in 2016 had an impact on the south Florida market. A prolonged recurrence of SARS, avian flu, H1N1 flu, Ebola virus, Zika virus or another pandemic disease also may result in health or other government authorities imposing restrictions on travel. Any of these events could result in a significant drop in demand for our hotels and adversely affect our financial conditions and results of operations.

General Risks Related to the Real Estate Industry

Illiquidity of real estate investments could significantly impede our ability to respond to adverse changes in the performance of our properties and harm our financial condition.

Because real estate investments are relatively illiquid, our ability to promptly sell one or more hotel properties in our portfolio in response to changing economic, financial and investment conditions is limited.

The real estate market is affected by many factors that are beyond our control, including:

- adverse changes in international, national, regional and local economic and market conditions;
- changes in interest rates and in the cost and terms of debt financing;
- absence of liquidity in credit markets which limits the availability and amount of debt financing;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the ongoing need for capital improvements, particularly in older structures;
- changes in operating expenses; and
- civil unrest, acts of war or terrorism and the consequences of terrorist acts, acts of God, including earthquakes, hurricanes, floods and other natural disasters, which may result in uninsured losses.

We may decide to sell our hotels in the future. We cannot predict whether we will be able to sell any hotel property for the price or on the terms set by us, or whether any price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a hotel property.

We may be required to expend funds to correct defects or to make improvements before a hotel property can be sold. We cannot assure you that we will have funds available to correct those defects or to make those improvements. In acquiring a hotel property, we may agree to lock-out provisions that materially restrict us from selling that property for a period of time or impose other restrictions, such as a limitation on the amount of debt that can be placed or repaid on that property. These factors and any others that would impede our ability to respond to adverse changes in the performance of our properties could have a material adverse effect on our operating results and financial condition, as well as our ability to comply with the terms of the indenture and to pay distributions to stockholders.

Future acquisitions may not yield the returns expected, may result in disruptions to our business, may strain management resources and may result in stockholder dilution.

Our business strategy may not ultimately be successful and may not provide positive returns on our investments. Acquisitions may cause disruptions in our operations and divert management's attention away from day-to-day operations. The issuance of equity securities in connection with any acquisition could be substantially dilutive to the Company's stockholders.

Our hotels may contain or develop harmful mold, which could lead to liability for adverse health effects and costs of remediating the problem.

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Concern about indoor exposure to mold has been increasing, as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold at any of our properties could require us to undertake a costly remediation program to contain or remove the mold from the affected property, which would reduce our cash available for distribution. In addition, the presence of significant mold could expose us to liability from our guests, employees or the management company and others if property damage or health concerns arise and could harm our reputation.

Increases in property taxes would increase our operating costs, reduce our income and adversely affect our ability to make distributions to the Company's stockholders.

Each of our hotel properties is subject to real and personal property taxes. These taxes may increase as tax rates change and as the properties are assessed or reassessed by taxing authorities. If property taxes increase, our financial condition, results of operations and our ability to make distributions to the Company's stockholders could be materially and adversely affected and the market price of the Company's shares could decline.

Risks Related to Our Organization and Structure

Our ability to effect a merger or other business combination transaction may be restricted by our Operating Partnership agreement.

In the event of a change of control of the Company, the limited partners of our Operating Partnership will have the right, for a period of 30 days following the change of control event, to cause the Operating Partnership to redeem all of the units held by the limited partners for a cash amount equal to the cash redemption amount otherwise payable upon redemption pursuant to the partnership agreement. This cash redemption right may make it more unlikely or difficult for a third party to propose or consummate a change of control transaction, even if such transaction were in the best interests of the Company's stockholders.

Provisions of the Company's charter may limit the ability of a third party to acquire control of the Company.

Aggregate Share and Common Share Ownership Limits

The Company's charter provides that no person may directly or indirectly own more than 9.9% of the value of the Company's outstanding shares of capital stock or more than 9.9% of the number of the Company's outstanding shares of common stock. These ownership limitations may prevent an acquisition of control of the Company by a third party without the Company's board of directors' approval, even if the Company's stockholders believe the change of control is in their best interest. The Company's board of directors has discretion to waive that ownership limit if, including other considerations, the board receives evidence that ownership in excess of the limit will not jeopardize the Company's REIT status.

Authority to Issue Stock

The Company's amended and restated charter authorizes our board of directors to issue up to 49,000,000 shares of common stock and up to 11,000,000 shares of preferred stock, to classify or reclassify any unissued shares of common stock or preferred stock and to set the preferences, rights and other terms of the classified or reclassified shares. Issuances of additional shares of stock may have the effect of delaying or preventing a change in control of the Company, including transactions at a premium over the market price of the Company's stock, even if stockholders believe that a change of control is in their best interest. The Company will be able to issue additional shares of common or preferred stock without stockholder approval, unless stockholder approval is required by applicable law or the rules of any stock exchange or automated quotation system on which the Company's securities may be listed or traded.

Provisions of Maryland law may limit the ability of a third party to acquire control of the Company.

Certain provisions of the Maryland General Corporation Law, or the MGCL, may have the effect of inhibiting a third party from making a proposal to acquire us or of impeding a change of control under circumstances that otherwise could provide the holders of shares of the Company's common stock with the opportunity to realize a premium over the then-prevailing market price of such shares, including:

- “business combination” provisions that, subject to limitations, prohibit certain business combinations between us and an “interested stockholder” (defined generally as any person who beneficially owns 10.0% or more of the voting power of our shares or an affiliate thereof) for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter imposes special appraisal rights and special stockholder voting requirements on these combinations; and
- “control share” provisions that provide that “control shares” of the Company (defined as shares which, when aggregated with other shares controlled by the stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of “control shares”) have no voting rights except to the extent approved by the Company's stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

The Company has opted out of these provisions of the MGCL, in the case of the business combination provisions of the MGCL by resolution of the Company's board of directors, and in the case of the control share provisions of the MGCL pursuant to a provision in the Company's bylaws. However, the Company's board of directors may by resolution elect to opt in to the business combination provisions of the MGCL and the Company may, by amendment to its bylaws, opt in to the control share provisions of the MGCL in the future. The Company's board of directors has the exclusive power to amend the Company's bylaws.

Additionally, Title 8, Subtitle 3 of the MGCL permits the Company's board of directors, without stockholder approval and regardless of what is currently provided in the Company's charter or bylaws, to implement takeover defenses, some of which (for example, a classified board) the Company does not currently have. These provisions may have the effect of inhibiting a third party from making an acquisition proposal for the Company or of delaying, deferring or preventing a change in control of the Company under the circumstances that otherwise could provide the holders of the Company's common stock with the opportunity to realize a premium over the then current market price.

Provisions in the Company's executive officers' employment agreements may make a change of control of the Company more costly or difficult.

The Company's employment agreements with Andrew M. Sims, its chief executive officer, David R. Folsom, its president and chief operating officer, and Anthony E. Domalski, its secretary and chief financial officer, contain provisions providing for substantial payments to these officers in the event of a change of control of the Company. Specifically, if the Company terminates these executive's employment without cause or the executive resigns with good reason, which includes a failure to nominate Andrew M. Sims to the Company's board of directors or his involuntary removal from the Company's board of directors, unless for cause or by vote of the stockholders, or if there is a change of control, each of these executives is entitled to the following:

- any accrued but unpaid salary and bonuses;
- vesting of any previously issued stock options and restricted stock;
- payment of the executive's life, health and disability insurance coverage for a period of five years following termination;
- any unreimbursed expenses; and
- a severance payment equal to three times for Andrew M. Sims', David R. Folsom's and Anthony E. Domalski's respective combined salary and actual bonus compensation for the preceding fiscal year.

In addition, these executives will receive additional payments to compensate them for the additional taxes, if any, imposed on them under Section 4999 of the Code by reason of receipt of excess parachute payments. We will not be able to deduct any of the above amounts paid to the executives for tax purposes.

These provisions may make a change of control of the Company, even if it is in the best interests of the Company's stockholders, more costly and difficult and may reduce the amounts the Company's stockholders would receive in a change of control transaction.

Our ownership limitations may restrict or prevent you from engaging in certain transfers of the Company's common stock or preferred stock.

In order to maintain the Company's REIT qualification, it cannot be closely held (i.e., more than 50.0% in value of our outstanding stock cannot be owned, directly or indirectly, by five or fewer individuals during the last half of any taxable year). To preserve the Company's REIT qualification, the Company's charter contains a 9.9% aggregate share ownership limit and a 9.9% common share ownership limit. Generally, any shares of the Company's stock owned by affiliated persons will be added together for purposes of the aggregate share ownership limit, and any shares of common stock owned by affiliated owners will be added together for purposes of the common share ownership limit.

If anyone transfers shares in a way that would violate the aggregate share ownership limit or the common share ownership limit, or prevent the Company from continuing to qualify as a REIT under the federal income tax laws, those shares instead will be transferred to a trust for the benefit of a charitable beneficiary and will be either redeemed by us or sold to a person whose ownership of the shares will not violate the aggregate share ownership limit or the common share ownership limit. If this transfer to a trust fails to prevent such a violation or fails to preserve the Company's continued qualification as a REIT, then the Company will consider the initial intended transfer to be null and void from the outset. The intended transferee of those shares will be deemed never to have owned the shares. Anyone who acquires shares in violation of the aggregate share ownership limit, the common share ownership limit or the other restrictions on transfer in the Company's charter bears the risk of suffering a financial loss when the shares are redeemed or sold if the market price of the Company's stock falls between the date of purchase and the date of redemption or sale.

The Company's articles supplementary establishing and fixing the rights and preferences of each of our 8.0% Series B Cumulative Redeemable Perpetual Preferred Stock (the "Series B Preferred Stock") and 7.875% Series C Cumulative Redeemable Perpetual Preferred Stock (the "Series C Preferred Stock") provide that no person may directly or indirectly own more than 9.9% of the aggregate number of outstanding shares of Series B Preferred Stock or Series C Preferred Stock, respectively, excluding any outstanding shares of Series B Preferred Stock or Series C Preferred Stock not treated as outstanding for federal income tax purposes. The Company's board of directors has discretion to waive that ownership limit if, including other considerations, the board receives evidence that ownership in excess of the limit will not jeopardize the Company's REIT status.

Holders of our outstanding preferred shares have dividend, liquidation and other rights that are senior to the rights of the holders of our common shares.

Our board of directors has the authority to designate and issue preferred shares with liquidation, dividend and other rights that are senior to those of our common shares. As of December 31, 2018, 1,610,000 shares of our Series B Preferred Stock were issued and outstanding, and 1,352,141 shares of our Series C Preferred Stock were issued and outstanding. The aggregate liquidation preference with respect to the outstanding shares of Series B Preferred Stock is approximately \$40.3 million, and annual dividends on our outstanding shares of Series B Preferred Stock are approximately \$3.2 million. The aggregate liquidation preference with respect to the outstanding shares of Series C Preferred Stock is approximately \$33.8 million, and annual dividends on our outstanding shares of Series C Preferred Stock are approximately \$2.7 million. Holders of both our Series B and Series C Preferred Stock are entitled to cumulative dividends before any dividends may be declared or set aside on our common shares. Upon our voluntary or involuntary liquidation, dissolution or winding up, before any payment is made to holders of our common shares, holders of these preferred shares are entitled to receive a liquidation preference of \$25.00 per share plus any accrued and unpaid distributions. This will reduce the remaining amount of our assets, if any, available to distribute to holders of our common shares. In addition, holders of the Series B Preferred Stock and Series C Preferred Stock voting together as a separate class have the right to elect two additional directors to our board of directors whenever dividends on the preferred shares are in arrears in an aggregate amount equivalent to six or more quarterly dividends (whether or not consecutive). Because our decision to issue securities will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future preferred offerings. Thus, our stockholders bear the risk of our future securities issuances reducing the market price of our common shares and diluting their interest.

The change of control conversion and redemption features of the Series B and Series C Preferred Stock may make it more difficult for a party to take over our Company or discourage a party from taking over our Company.

Upon a change of control (as defined in our charter), holders of both our Series B and Series C Preferred Stock will have the right (unless, as provided in our charter, we have provided or provide notice of our election to exercise our special optional redemption right before the relevant date) to convert some or all of their shares of preferred stock into shares of our common stock (or equivalent value of alternative consideration). Upon such a conversion, holders will be limited to a maximum number of shares equal to the share cap, subject to adjustments. If the common stock price is less than \$3.015, subject to adjustment, holders will receive a maximum of 8.29187 shares of our common stock per share of Series B Preferred Stock, which may result in a holder receiving value that is less than the liquidation preference of the Series B Preferred Stock. If the common stock price is less than \$2.94, subject to adjustment, holders will receive a maximum of 8.50340 shares of our common stock per share of Series C Preferred Stock, which may

result in a holder receiving value that is less than the liquidation preference of the Series C Preferred Stock. In addition, those features of our Series B and Series C Preferred Stock may have the effect of inhibiting or discouraging a third party from making an acquisition proposal for our Company or of delaying, deferring or preventing a change in control of our Company under circumstances that otherwise could provide the holders of shares of our common stock and shares of our Series B and Series C Preferred Stock with the opportunity to realize a premium over the then current market price or that stockholders may otherwise believe is in their best interests.

Our organizational documents have no limitation on the amount of indebtedness we may incur. As a result, we may become highly leveraged in the future, which could materially and adversely affect us.

Our business strategy contemplates the use of both secured and unsecured debt to finance long-term growth. In addition, our organizational documents contain no limitations on the amount of debt that we may incur, and the Company's board of directors may change our financing policy at any time. As a result, we may be able to incur substantial additional debt, including secured debt, in the future. Incurring debt could subject us to many risks, including the risks that:

- our cash flows from operations may be insufficient to make required payments of principal and interest;
- our debt may increase our vulnerability to adverse economic and industry conditions;
- we may be required to dedicate a substantial portion of our cash flows from operations to payments on our debt, thereby reducing cash available for funds available for operations and capital expenditures, future business opportunities or other purposes; and
- the terms of any refinancing may not be in the same amount or on terms as favorable as the terms of the existing debt being refinanced.

The board of directors' revocation of the Company's REIT status without stockholder approval may decrease the Company's stockholders' total return.

The Company's charter provides that the Company's board of directors may revoke or otherwise terminate the Company's REIT election, without the approval of the Company's stockholders, if the Company's board of directors determines that it is no longer in the Company's best interest to continue to qualify as a REIT. If the Company ceases to be a REIT, it would become subject to federal income tax on its taxable income and would no longer be required to distribute most of its taxable income to the Company's stockholders, which may have adverse consequences on our total return to the Company's stockholders.

The ability of the Company's board of directors to change the Company's major corporate policies may not be in your best interest.

The Company's board of directors determines the Company's major corporate policies, including its acquisition, financing, growth, operations and distribution policies. The Company's board of directors may amend or revise these and other policies from time to time without the vote or consent of the Company's stockholders.

Our success depends on key personnel whose continued service is not guaranteed.

We depend on the efforts and expertise of our chairman and chief executive officer, Andrew M. Sims; our president and chief operating officer, David R. Folsom; and our chief financial officer, Anthony E. Domalski, to manage our day-to-day operations and strategic business direction. The loss of any of their services could have an adverse effect on our operations.

Risks Related to Our Debt

We have substantial financial leverage.

As of December 31, 2018, the principal balance of our secured debt was approximately \$367.6 million, not accounting for reductions of unamortized premiums or deferred financing costs as shown on our balance sheet. Historically, we have incurred debt for acquisitions and to fund our renovation, redevelopment and rebranding programs. Limitations upon our access to additional debt could adversely affect our ability to fund these programs or acquire hotels in the future.

Our financial leverage could negatively affect our business and financial results, including the following:

- require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing funds available for operations, working capital, capital expenditures, future business opportunities, paying dividends or other purposes;

- limit our ability to obtain additional financing for working capital, renovation, redevelopment and rebranding plans, acquisitions, debt service requirements and other purposes;
- adversely affect our ability to satisfy our financial obligations, including those related to the 7.25% Notes;
- limit our ability to refinance existing debt;
- require us to agree to additional restrictions and limitations on our business operations and capital structure to obtain financing;
- force us to dispose of one or more of our properties, possibly on unfavorable terms;
- increase our vulnerability to adverse economic and industry conditions, and to interest rate fluctuations;
- force us to issue additional equity, possibly on terms unfavorable to existing shareholders;
- limit our flexibility to make, or react to, changes in our business and our industry; and
- place us at a competitive disadvantage, compared to our competitors that have less debt.

We must comply with financial covenants in our mortgage loan agreements and in the indenture for the 7.25% Notes.

Our mortgage loan agreements and indenture for the 7.25% Notes contain various financial covenants. Failure to comply with these financial covenants could result from, among other things, changes in the local competitive environment, general economic conditions and disruption caused by renovation activity or major weather disturbances.

If we violate the financial covenants contained in our mortgage loan agreements, we may attempt to negotiate waivers of the violations or amend the terms of the applicable mortgage loan agreement with the lender; however, we can make no assurance that we would be successful in any such negotiation or that, if successful in obtaining waivers or amendments, such waivers or amendments would be on attractive terms. Some mortgage loan agreements provide alternate cure provisions which may allow us to otherwise comply with the financial covenants by obtaining an appraisal of the hotel, prepaying a portion of the outstanding indebtedness or by providing cash collateral until such time as the financial covenants are met by the collateralized property without consideration of the cash collateral. Alternate cure provisions which include prepaying a portion of the outstanding indebtedness or providing cash collateral may have a material impact on our liquidity.

If we violate the financial covenants in the indenture for the 7.25% Notes, we may attempt to cure that violation by engaging in one or more transactions pursuant to the cure provision in that indenture.

If we are unable to negotiate a waiver or amendment or satisfy alternate cure provisions, if any, or unable to meet any alternate cure requirements and a default were to occur, we would possibly have to refinance the debt through debt financing, private or public offerings of debt securities, additional equity financing, or by disposing of an asset. We are uncertain whether we will be able to refinance these obligations or if refinancing terms will be favorable.

We have one mortgage debt obligation maturing in 2019, and if we are not successful in extending the terms of this indebtedness or in refinancing this debt on acceptable economic terms or at all, our overall financial condition could be materially and adversely affected.

We will be required to seek additional capital in the near future to refinance or replace existing long-term mortgage debt that is maturing. The ability to refinance or replace mortgage debt is subject to market conditions, and could become limited in the future. There can be no assurance that we will be able to obtain future financings on acceptable terms, if at all. In June of 2019, the mortgage on our Crowne Plaza Tampa Westshore matures. We also have additional significant obligations maturing in subsequent years. The total aggregate amount of our debt obligation scheduled to mature in 2019, inclusive of monthly principal amortization of all our indebtedness, is approximately \$24.3 million, which represents approximately 6.19% of our total debt obligation outstanding as of December 31, 2018.

We will need to, and plan to, renew, replace or extend our long-term indebtedness prior to the respective maturity date. If we are unable to extend this loan, we may be required to repay the outstanding principal amount at maturity or a portion of such indebtedness upon refinance. If we do not have sufficient funds to repay any portion of the indebtedness, it may be necessary to raise capital through debt financing, private or public offerings of debt securities or equity financings. We are uncertain whether we will be able to refinance this obligation or if refinancing terms will be favorable. If, at the time of any refinancing, prevailing interest rates or other factors result in higher interest rates on refinancing, increases in interest expense would lower our cash flow, and, consequently, cash available to meet our financial obligations. If we are unable to obtain alternative or additional financing arrangements in the future, or if we cannot obtain financing on acceptable terms, we may not be able to execute our business strategies or we may be forced to

dispose of hotel properties on disadvantageous terms, potentially resulting in losses and potentially reducing cash flow from operating activities if the sale proceeds in excess of the amount required to satisfy the indebtedness could not be reinvested in equally profitable real property investments. Moreover, the terms of any additional financing may restrict our financial flexibility, including the debt we may incur in the future, or may restrict our ability to manage our business as we had intended. To the extent we cannot repay our outstanding debt, we risk losing some or all of our hotel properties to foreclosure and we could be required to invoke insolvency proceedings including, but not limited to, commencing a voluntary case under the U.S. Bankruptcy Code.

For tax purposes, a foreclosure of any of our hotels would be treated as a sale of the hotel for a purchase price equal to the outstanding balance of the debt secured by the mortgage. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the hotel, we would recognize taxable income on foreclosure, but we would not receive any cash proceeds, which could hinder Sotherly's ability to meet the REIT distribution requirements imposed by the Internal Revenue Code of 1986, as amended (the "Code"). In addition, we may give full or partial guarantees to lenders of mortgage debt on behalf of the entities that own our hotels. When we give a guarantee on behalf of an entity that owns one of our hotels, we will be responsible to the lender for satisfaction of the debt if it is not paid by such entity.

Our borrowing costs are sensitive to fluctuations in interest rates.

Higher interest rates could increase our debt service requirements and interest expense. Currently, our floating rate debt is limited to the mortgages on the DoubleTree by Hilton Raleigh Brownstone-University, the DoubleTree by Hilton Philadelphia Airport, the Crowne Plaza Tampa Westshore and The Whitehall. Each of these mortgages bears interest at rates tied to the 1-month London Interbank Offered Rate ("LIBOR") and provide for minimum rates of interest. To the extent that increases in the LIBOR rate of interest cause the interest on the mortgages to exceed the minimum rates of interest, we are exposed to rising interest rates.

Should we obtain new debt financing or refinance existing indebtedness, we may increase the amount of floating rate debt that currently exists. In addition, adverse economic conditions could also cause the terms on which we borrow to be unfavorable.

Changes in the method of determining LIBOR rates and potential phasing out of LIBOR after 2021 may affect our financial results.

The chief executive of the United Kingdom Financial Conduct Authority ("FCA"), which regulates LIBOR, has recently announced that the FCA intends to stop compelling banks to submit rates for the calculation of LIBOR after 2021. It is not possible to predict the effect of these changes, other reforms or the establishment of alternative reference rates in the United Kingdom or elsewhere. Furthermore, in the United States, efforts to identify a set of alternative U.S. dollar reference interest rates are underway. Any alternative methods may result in interest rates that are higher than if LIBOR were available in its current form, which could have a material adverse effect on results.

Any changes announced by the FCA, including the FCA Announcement, other regulators or any other successor governance or oversight body, or future changes adopted by such body, in the method pursuant to which the LIBOR rates are determined may result in a sudden or prolonged increase or decrease in the reported LIBOR rates. If that were to occur, the level of interest payments we incur may change. In addition, although certain of our LIBOR based obligations provide for alternative methods of calculating the interest rate payable on those obligations if LIBOR is not reported, uncertainty as to the extent and manner of future changes may result in interest rates and/or payments that are higher than, lower than or that do not otherwise correlate over time with the interest rates and/or payments that would have been made on our obligations if LIBOR rate was available in its current form.

Risks Related to Conflicts of Interest of Our Officers and Directors

Conflicts of interest could result in our executive officers and certain of our directors acting in a manner other than in the Company's stockholders' best interest.

Conflicts of interest relating to Chesapeake Hospitality, the entity that manages all but one of our hotels, and the terms of its management agreements with Chesapeake Hospitality may lead to management decisions that are not in the stockholders' best interest.

Conflicts of interest relating to Chesapeake Hospitality may lead to management decisions that are not in the stockholders' best interest. Andrew M. Sims, our chairman and chief executive officer, along with two of his immediate family members, together own a substantial interest in Chesapeake Hospitality which manages all but one of our hotels.

Our management agreements with Chesapeake Hospitality establish the terms of Chesapeake Hospitality's management of our hotels covered by those agreements. The Master Agreement provides that in the event the agreement is terminated in connection with the sale of a hotel, and Chesapeake Hospitality accepts an offer to manage another hotel which is reasonably comparable to the hotel that was sold, we will not be liable for any termination fee. If we do not offer Chesapeake Hospitality such opportunity or Chesapeake Hospitality declines such opportunity, then a termination fee equivalent to the lesser of the management fees paid for the prior twelve-

month period or the management fees for the period prior to the sale that is equal to the number of months remaining under the term of the agreement will be due. If we terminate the agreement at the end of any renewable five-year term, Chesapeake Hospitality is due a termination fee equivalent to one month's management fees, as determined under the agreement.

As a significant owner of Chesapeake Hospitality, which would receive any management and management termination fees payable by us under the management agreement, Andrew M. Sims may influence our decisions to sell a hotel or acquire or develop a hotel when it is not in the best interests of the Company's stockholders to do so. In addition, Andrew M. Sims will have conflicts of interest with respect to decisions to enforce provisions of the management agreement, including any termination thereof.

There can be no assurance that provisions in our bylaws will always be successful in mitigating conflicts of interest.

Under our bylaws, a committee consisting of only independent directors must approve any transaction between us and Chesapeake Hospitality or its affiliates or any interested director. However, there can be no assurance that these policies always will be successful in mitigating such conflicts, and decisions could be made that might not fully reflect the interests of all of the Company's stockholders.

Certain of our officers and directors control trusts that hold units in our Operating Partnership and may seek to avoid adverse tax consequences, which could result from transactions that would otherwise benefit the Company's stockholders.

Holders of units in our Operating Partnership, including trusts controlled in whole or part by members of our management team, may suffer adverse tax consequences upon our sale or refinancing of certain properties. Therefore, holders of units, including a trust controlled by Andrew M. Sims, a trust controlled by Andrew M. Sims and his immediate family members, and a charitable trust controlled by Edward S. Stein, may have different objectives than holders of the Company's stock regarding the appropriate pricing and timing of a property's sale, or the timing and amount of a property's refinancing. As of December 31, 2018, these trusts owned approximately 1.0% of the outstanding units in our Operating Partnership. Although the individuals controlling the trusts do not have any beneficial interest in the trusts, they may influence us not to sell or refinance certain properties, even if such sale or refinancing might be financially advantageous to the Company's stockholders, or may influence us to enter into tax-deferred exchanges with the proceeds of such sales when such a reinvestment might not otherwise be in our best interest.

Our agreements with Chesapeake Hospitality and its affiliates, including the contribution agreements and the partnership agreement of our Operating Partnership, were not negotiated on an arms' length basis and may be less favorable to us than we could have obtained from third parties.

In connection with the Company's initial public offering, we entered into various agreements with Chesapeake Hospitality and its affiliates, including contribution agreements and the partnership agreement of our Operating Partnership. In addition, we entered into the Master Agreement executed in December 2014 and new individual hotel agreements with Chesapeake Hospitality. The terms of all of these agreements were determined by our management team, who had conflicts of interest as described above and ownership interests in Chesapeake Hospitality and its affiliates. The terms of all of these agreements may be less favorable to us than we could have obtained from third parties.

Federal Income Tax Risks Related to the Company's Status as a REIT

The federal income tax laws governing REITs are complex.

The Company intends to operate in a manner that will maintain its qualification as a REIT under the federal income tax laws. The REIT qualification requirements are extremely complex, however, and interpretations of the federal income tax laws governing qualification as a REIT are limited. The Company has not requested or obtained a ruling from the Internal Revenue Service, or the IRS, that it qualifies as a REIT. Accordingly, we cannot be certain that the Company will be successful in operating in a manner that will permit it to qualify as a REIT. At any time, new laws, interpretations or court decisions may change the federal tax laws or the federal income tax consequences of the Company's qualification as a REIT. We cannot predict when or if any new federal income tax law, regulation or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation or interpretation may take effect retroactively. The Company and its stockholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation. We are not aware, however, of any pending tax legislation that would adversely affect the Company's ability to qualify as a REIT.

Failure to make distributions could subject the Company to tax.

In order to maintain its qualification as a REIT, each year the Company must pay out to its stockholders in distributions, as “qualifying distributions,” at least 90.0% of its REIT taxable income, computed without regard to the deductions for dividends paid and excluding net capital gains and reduced by certain non-cash items. To the extent that the Company satisfies this distribution requirement, but distributes less than 100.0% of its taxable income (including its net capital gain), it will be subject to federal corporate income tax on its undistributed taxable income. In addition, the Company will be subject to a 4.0% nondeductible excise tax if the actual amount that it pays out to its stockholders as a “qualifying distribution” for a calendar year is less than the sum of: (A) 85.0% of our ordinary income for such calendar year, plus (B) 95.0% of our capital gain net income for such calendar year. The Company’s only recurring source of funds to make these distributions comes from rent received from its TRS Lessees whose only recurring source of funds with which to make these payments and distributions is the net cash flow (after payment of operating and other costs and expenses and management fees) from hotel operations, and any dividend and other distributions that we may receive from MHI Holding. Accordingly, the Company may be required to borrow money or sell assets to make distributions sufficient to enable it to pay out enough of its taxable income to satisfy the distribution requirement and to avoid corporate income tax and the 4.0% nondeductible excise tax in a particular year.

Failure to qualify as a REIT would subject the Company to federal income tax.

If the Company fails to qualify as a REIT in any taxable year, it will be required to pay federal income tax on its taxable income at regular corporate rates. The resulting tax liability might cause the Company to borrow funds, liquidate some of its investments or take other steps that could negatively affect its operating results in order to pay any such tax. Unless it is entitled to relief under certain statutory provisions, the Company would be disqualified from treatment as a REIT for the four taxable years following the year in which it lost its qualification. If the Company lost its REIT status, its net earnings available for investment or distribution to stockholders would be significantly reduced for each of the years involved. In addition, the Company would no longer be required to make distributions to its stockholders, and it would not be able to deduct any stockholder distributions in computing its taxable income. This would substantially reduce the Company’s earnings, cash available to pay distributions, and the value of common stock.

Failure to qualify as a REIT may cause the Company to reduce or eliminate distributions to its stockholders, and the Company may face increased difficulty in raising capital or obtaining financing.

If the Company fails to remain qualified as a REIT, it may have to reduce or eliminate any distributions to its stockholders in order to satisfy its income tax liabilities. Any distributions that the Company does make to its stockholders would be treated as taxable dividends to the extent of its current and accumulated earnings and profits. This may result in negative investor and market perception regarding the market value of the Company’s stock, and the value of its stock may be reduced. In addition, the Company and the Operating Partnership may face increased difficulty in raising capital or obtaining financing if the Company fails to qualify or remain qualified as a REIT because of the resulting tax liability and potential reduction of its market valuation.

If MHI Holding exceeds certain value thresholds, this could cause the Company to fail to qualify as a REIT.

For taxable years of the Company ending after December 31, 2017, at the end of each quarter of each taxable year of the Company, no more than 20.0% of the value of the Company’s total assets may consist of securities of one or more taxable REIT subsidiaries (“TRSs”). MHI Holding is a TRS and the Company may form other TRSs in the future. The Company plans to monitor the value of its shares of MHI Holding and of any other TRS the Company may form. However, there can be no assurance that the Internal Revenue Service will not attempt to attribute additional value to the shares of MHI Holding or to the shares of any other TRS that the Company may form. If the Company is treated as owning securities of one or more TRSs with an aggregate value that is in excess of the thresholds outlined above, the Company could lose its status as a REIT or become subject to penalties.

Even if the Company remains qualified as a REIT, it may face other tax liabilities that reduce its cash flow.

Even if the Company remains qualified for taxation as a REIT, it may be subject to certain federal, state and local taxes on its income and assets. For example:

- it will be required to pay tax on undistributed REIT taxable income (including net capital gain);
- if it has net income from the disposition of foreclosure property held primarily for sale to customers in the ordinary course of business or other non-qualifying income from foreclosure property, it must pay tax on that income at the highest corporate rate;
- if it (or the Operating Partnership or any subsidiary of the Operating Partnership other than MHI Holding) sells a property in a “prohibited transaction,” its gain, or its share of such gain, from the sale would be subject to a 100.0% penalty tax. A

“prohibited transaction” would be a sale of property, other than a foreclosure property, held primarily for sale to customers in the ordinary course of business;

- MHI Holding is a fully taxable corporation and is required to pay federal and state taxes on its taxable income; and
- it may experience increases in its state and/or local income tax burdens as states and localities continue to look to modify their tax laws in order to raise revenues, including by (among other things) changing from a net taxable income-based regime to a gross receipts-based regime, suspending and/or limiting the use of net operating losses, increasing tax rates and fees, imposing surcharges and subjecting partnerships to an entity-level tax, and limiting or disallowing certain U.S. federal deductions such as the dividends-paid deduction.

Complying with REIT requirements may cause the Company to forgo attractive opportunities that could otherwise generate strong risk-adjusted returns and instead pursue less attractive opportunities, or none at all.

To qualify as a REIT for federal income tax purposes, the Company must continually satisfy tests concerning, among other things, the sources of its income, the nature and diversification of its assets, the amounts it distributes to its stockholders and the ownership of its stock.

In general, when applying these tests, the Company is treated as owning its proportionate share of the Operating Partnership’s assets (which share is determined in accordance with the Company’s capital interest in the Operating Partnership) and as being entitled to the Operating Partnership’s income attributable to such share. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of generating strong risk-adjusted returns on invested capital for our stockholders.

Complying with REIT requirements may force the Company to liquidate otherwise attractive investments, which could result in an overall loss on its investments.

To maintain qualification as a REIT, the Company must ensure that at the end of each calendar quarter at least 75.0% of the value of its assets consists of cash, cash items, government securities and qualified REIT real estate assets. The remainder of the Company’s assets (other than securities of one or more taxable REIT subsidiaries) generally cannot include more than 10.0% of the outstanding voting securities of any one issuer or more than 10.0% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5.0% of the value of the Company’s assets (other than government securities, qualified real estate assets and securities of one or more taxable REIT subsidiaries) can consist of the securities of any one issuer, and no more than 20.0% of the value of the Company’s total assets can be represented by securities of one or more taxable REIT subsidiaries.

When applying these asset tests, the Company is treated as owning its proportionate share of the Operating Partnership’s assets (which is determined in accordance with the Company’s capital interest in the Operating Partnership). If the Company fails to comply with these requirements at the end of any calendar quarter, it must correct such failure within 30 days after the end of the calendar quarter to avoid losing its REIT status and suffering adverse tax consequences. If the Company fails to comply with these requirements at the end of any calendar quarter, and the failure exceeds a de-minimis threshold, the Company may be able to preserve its REIT status if the failure was due to reasonable cause and not to willful neglect. In this case, we will be required to dispose of the assets causing the failure within six months after the last day of the quarter in which the failure occurred, and we will be required to pay an additional tax of the greater of \$50,000 or the product of the highest applicable tax rate multiplied by the net income generated on those assets.

As a result, we may be required to liquidate otherwise attractive investments.

If the Operating Partnership fails to qualify as a partnership for federal income tax purposes, the Company could cease to qualify as a REIT and suffer other adverse consequences.

We believe that the Operating Partnership will continue to qualify to be treated as a partnership for U.S. federal income tax purposes. As a partnership, the Operating Partnership is not subject to federal income tax on its income. Instead, each of its partners, including the Company, will be required to pay tax on its allocable share of the Operating Partnership’s income. We cannot assure you, however, that the IRS will not challenge the Operating Partnership’s status as a partnership for U.S. federal income tax purposes, or that a court would not sustain such a challenge. If the IRS were successful in treating the Operating Partnership as a corporation for federal income tax purposes, the Company could fail to meet the gross income tests and certain of the asset tests applicable to REITs and, accordingly, cease to qualify as a REIT. Also, the failure of the Operating Partnership to qualify as a partnership would cause the Operating Partnership to become subject to federal and state corporate income tax, which would reduce significantly the amount of cash available for debt service and for distribution to its partners, including the Company.

The Company's failure to qualify as a REIT would have serious adverse consequences to its stockholders.

The Company elected to be taxed as a REIT under Sections 856 through 860 of the Code, commencing with its taxable year ended December 31, 2004. The Company believes it has operated so as to qualify as a REIT under the Code and believes that its current organization and method of operation comply with the rules and regulations promulgated under the Code to enable the Company to continue to qualify as a REIT. However, it is possible that the Company has been organized or has operated in a manner that would not allow it to qualify as a REIT, or that its future operations could cause it to fail to qualify. Qualification as a REIT requires the Company to satisfy numerous requirements (some on an annual and others on a quarterly basis) established under highly technical and complex sections of the Code for which there are only limited judicial and administrative interpretations, and involves the determination of various factual matters and circumstances not entirely within its control. For example, in order to qualify as a REIT, the Company must satisfy a 75.0% gross income test pursuant to Code Section 856(c)(3) and a 95.0% gross income test pursuant to Code Section 856(c)(2) each taxable year. In addition, the Company must pay dividends, as "qualifying distributions," to its stockholders aggregating annually at least 90.0% of its REIT taxable income (determined without regard to the dividends-paid deduction and by excluding capital gains, and reduced by certain non-cash items) and must satisfy specified asset tests on a quarterly basis. While historically the Company has satisfied the distribution requirement discussed above by making cash distributions to its stockholders, the Company may choose to satisfy this requirement by making distributions of cash or other property, including, in limited circumstances, its stock. The provisions of the Code and applicable Treasury regulations regarding qualification as a REIT are more complicated in the Company's case because it holds its assets through the Operating Partnership.

If MHI Holding does not qualify as a taxable REIT subsidiary, or if the Company's hotel manager does not qualify as an "eligible independent contractor," the Company would fail to qualify as a REIT and would be subject to higher taxes and have less cash available for distribution to its shareholders.

Rent paid by a lessee that is a "related party tenant" of ours will not be qualifying income for purposes of the two gross income tests applicable to REITs. The Company currently leases substantially all of its hotels to the TRS Lessees, which are disregarded entities for U.S. federal income tax purposes and are wholly-owned by MHI Holding, a taxable REIT subsidiary, and expects to continue to do so. So long as MHI Holding qualifies as a taxable REIT subsidiary, it will not be treated as a "related party tenant" with respect to the Company's properties that are managed by an independent hotel management company that qualifies as an "eligible independent contractor." The Company believes that MHI Holding will continue to qualify to be treated as a taxable REIT subsidiary for federal income tax purposes, but there can be no assurance that the IRS will not challenge this status or that a court would not sustain such a challenge. If the IRS were successful in such challenge, it is possible that the Company would fail to meet the asset tests applicable to REITs and substantially all of its income would fail to be qualifying income for purposes of the two gross income tests. If the Company failed to meet any of the asset or gross income tests, it would likely lose its REIT qualification for federal income tax purposes.

Additionally, if the Company's hotel manager does not qualify as an "eligible independent contractor," the Company would fail to qualify as a REIT. Each hotel manager that enters into a management contract with the TRS Lessees must qualify as an "eligible independent contractor" under the REIT rules in order for the rent paid by the TRS Lessees to be qualifying income for purposes of the REIT gross income tests. Among other requirements, in order to qualify as an eligible independent contractor, a hotel manager must not own, directly or through its shareholders, more than 35.0% of the Company's outstanding shares, taking into account certain ownership attribution rules. The ownership attribution rules that apply for purposes of these 35.0% thresholds are complex. Although the Company intends to monitor ownership of its shares by its hotel manager and its owners, there can be no assurance that these ownership levels will not be exceeded.

Foreign investors may be subject to U.S. tax on the disposition of the Company's stock if the Company does not qualify as a "domestically controlled" REIT.

A foreign person disposing of a "U.S. real property interest," which includes stock of a U.S. corporation whose assets consist principally of U.S. real property interests, is generally subject to U.S. federal income tax under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") on the gain recognized on the disposition, unless such foreign person is a "qualified foreign pension fund" or one of the certain publicly traded non-U.S. "qualified collective investment vehicles". Additionally, the transferee will be required to withhold 15.0% on the amount realized on the disposition if the foreign transferor is subject to U.S. federal income tax under FIRPTA. This 15.0% is creditable against the U.S. federal income tax liability of the foreign transferor in connection with such transferor's disposition of the Company's stock. FIRPTA does not apply, however, to the disposition of stock in a REIT if the REIT is "domestically controlled" (i.e., less than 50.0% of the REIT's capital stock, by value, has been owned directly or indirectly by persons who are not qualifying U.S. persons during a continuous five-year period ending on the date of disposition or, if shorter, during the entire period of the REIT's existence). We cannot be sure that the Company will qualify as a "domestically controlled" REIT. If the Company does not so qualify, gain realized by foreign investors on a sale of the Company's stock would be subject to U.S. income and withholding tax under FIRPTA, unless the Company's stock were traded on an established securities market and a foreign investor did not at any time during a specified testing period directly or indirectly own more than 10.0% of the value of the Company's outstanding stock.

MHI Holding increases our overall tax liability.

Our TRS Lessees are single-member limited liability companies that are wholly-owned, directly or indirectly, by MHI Holding, a taxable REIT subsidiary that is wholly-owned by the Operating Partnership. Each of our TRS Lessees is disregarded as an entity separate from MHI Holding for U.S. federal income tax purposes, such that the assets, liabilities, income, gains, losses, credits and deductions of our TRS Lessees are treated as the assets, liabilities, income, gains, losses, credits and deductions of MHI Holding for U.S. federal income tax purposes. MHI Holding is subject to federal and state income tax on its taxable income, which will consist of the revenues from the hotels leased by the Company's TRS Lessees, net of the operating expenses for such hotels and rent payments. Accordingly, although the Company's ownership of MHI Holding and the TRS Lessees will allow it to participate in the operating income from its hotels in addition to receiving rent, that operating income will be fully subject to income tax. The after-tax net income of MHI Holding, if any, will be available for distribution to the Company.

The Company will incur a 100.0% excise tax on its transactions with MHI Holding and the TRS Lessees that are not conducted on an arm's-length basis. For example, to the extent that the rent paid by the TRS Lessees exceeds an arm's-length rental amount, such amount potentially will be subject to this excise tax. The Company intends that all transactions among itself, MHI Holding and the TRS Lessees will be conducted on an arm's-length basis and, therefore, that the rent paid by the TRS Lessees will not be subject to this excise tax.

Our ability to use net operating loss carryforwards to reduce future tax payments may be limited or restricted or may not exist at all, and if we do not sustain our profitability, we may be required to put up a valuation allowance against our deferred tax assets.

At December 31, 2018, our financial statements reflected deferred tax assets totaling approximately \$5.1 million, of which approximately \$4.4 million relates to significant federal and state net operating losses (“NOLs”) generated by our TRS Lessee over the past three years. We are generally able to carry NOLs forward to reduce taxable income in future years. Our ability to use our NOLs to reduce future tax payments is dependent upon our ability to sustain profitability during the time period over which these NOLs may be used under applicable tax law. Moreover, changes to NOL rules made for taxable years beginning after December 31, 2017 under recently enacted tax legislation (discussed further below under the caption “Risk Factors—U.S. tax reform and related regulatory action could adversely affect you”), will also limit the use of existing NOLs to 80% of a corporation’s taxable income for a taxable year. This, along with the reduced corporate income tax rate, may decrease the value of the TRS Lessee’s NOLs. NOLs generated in 2018 and beyond cannot be carried back and may only be used in subsequent taxable years. A valuation allowance is required for deferred tax assets if, based on all available evidence, it is “more-likely-than-not” (defined as a likelihood of more than 50%) that all or a portion of the deferred tax assets will not be realized due to the inability to generate sufficient taxable income in certain financial statement periods. The net amount of deferred tax assets that are recorded on the financial statements must reflect the tax benefits that are expected to be realized using these criteria. We perform this analysis by evaluating a number of factors, including a demonstrated track record of past profitability, reasonable forecasts of future taxable income, and anticipated changes in the lease rental payments from the TRS Lessee to subsidiaries of the Operating Partnership. At December 31, 2018, we determined based on all available positive and negative evidence that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward. We made this determination considering reasonable tax strategies available to us capable of ensuring the realization of our deferred tax assets, anticipated changes in the lease rental payments and one-time losses that generated some of our net operating losses. However, there is no assurance that the TRS Lessee will be able to achieve profitability. The TRS Lessee’s ability to generate sustained profitability in the amounts necessary to realize our deferred tax assets against future taxable income depends upon general economic and market conditions, interest rates, and the TRS Lessee’s ability to meet our strategic plans. If the TRS Lessee is unable to generate adequate sustained profitability, we may be required to record a valuation allowance against some or all of our deferred tax assets, which would negatively impact our financial results.

Taxation of dividend income could make the Company’s stock less attractive to investors and reduce the market price of its stock.

The federal income tax laws governing REITs, or the administrative interpretations of those laws, may be amended at any time. Any new laws or interpretations may take effect retroactively and could adversely affect the Company or could adversely affect its stockholders. Currently, “qualified dividends,” which include dividends from domestic C corporations that are paid to non-corporate stockholders, are subject to a reduced maximum U.S. federal income tax rate of 20.0%, plus a 3.8% Medicare tax discussed below. Because REITs generally do not pay corporate-level taxes as a result of the dividends-paid deduction to which they are entitled, dividends from REITs generally are not treated as qualified dividends and thus do not qualify for a reduced tax rate. Moreover, while certain of our dividends distributed to non-corporate taxpayers in taxable years prior to January 1, 2026 qualify for a potential 20.0% deduction from the tax otherwise imposed on such income, there is no assurance that we will always distribute ordinary income dividends, or that Congress will not repeal such legislation. Non-corporate investors could view an investment in non-REIT corporations as more attractive than an investment in REITs because the dividends they would receive from non-REIT corporations would be subject to lower tax rates.

Investors may be subject to a 3.8% Medicare tax in connection with an investment in the Company’s stock.

The U.S. tax laws impose a 3.8% “Medicare tax” on the “net investment income” (i.e., interest, dividends, capital gains, annuities, and rents that are not derived in the ordinary course of a trade or business) of individuals with income exceeding \$200,000 (\$250,000 if married filing jointly or \$125,000 if married filing separately), and of estates and trusts. Dividends on the Company’s stock as well as gains from the disposition of the Company’s stock may be subject to the Medicare tax. Prospective investors should consult with their independent advisors as to the applicability of the Medicare tax to an investment in the Company’s stock in light of such investors’ particular circumstances.

Investors may be subject to U.S. withholding tax under the “Foreign Account Tax Compliance Act.”

On March 18, 2010, the Hiring Incentives to Restore Employment Act, or the HIRE Act, was enacted in the United States. The HIRE Act includes provisions known as the Foreign Account Tax Compliance Act, or FATCA, that generally impose a 30.0% U.S. withholding tax on “withholdable payments,” which consist of (i) U.S.-source dividends, interest, rents and other “fixed or determinable annual or periodical income” paid after June 30, 2014 and (ii) certain U.S.-source gross proceeds paid after December 31, 2018 to (a) “foreign financial institutions” unless (x) they enter into an agreement with the IRS to collect and disclose to the IRS information regarding their direct and indirect U.S. owners or (y) they comply with the terms of any FATCA intergovernmental agreement executed between the authorities in their jurisdiction and the U.S., and (b) “non-financial foreign entities” (i.e., foreign entities that are not foreign financial institutions) unless they certify certain information regarding their direct and indirect U.S. owners. Final regulations under FATCA were issued by the IRS on January 17, 2013, and have been subsequently supplemented by additional regulations and guidance. FATCA does not replace the existing U.S. withholding tax regime. However, the FATCA regulations contain coordination provisions to avoid double withholding on U.S.-source income.

A foreign investor that receives dividends on the Company’s stock or gross proceeds from a disposition of shares of the Company’s stock may be subject to FATCA withholding tax with respect to such dividends or gross proceeds.

Foreign investors will be subject to U.S. withholding tax on the receipt of ordinary dividends on the Company’s stock.

The portion of dividends received by a foreign investor payable out of the Company’s current and accumulated earnings and profits which are not attributable to capital gains and which are not effectively connected with a U.S. trade or business of the foreign investor will generally be subject to U.S. withholding tax at a statutory rate of 30.0%. This 30.0% withholding tax may be reduced by an applicable income tax treaty. The FATCA and nonresident withholding regulations are complex. Even if the 30.0% withholding is reduced or eliminated by treaty for payments made to a foreign investor, FATCA withholding of 30.0% could apply depending upon the foreign investor’s FATCA status. Foreign investors should consult with their independent advisors as to the U.S. withholding tax consequences to such investors with respect to their investment in the Company’s stock in light of their particular circumstances, as well as determining the appropriate documentation required to reduce or eliminate U.S. withholding tax.

Foreign investors will be subject to U.S. income tax on the receipt of capital gain dividends on the Company’s stock.

Under FIRPTA, distributions that we make to a foreign investor that are attributable to gains from our dispositions of U.S. real property interests (“capital gain dividends”) will be treated as income that is effectively connected with a U.S. trade or business, and therefore subject to U.S. federal income tax, in the hands of the foreign investor, unless such foreign person is a “qualified foreign pension fund” or one of certain publicly traded non-U.S. “qualified collective investment vehicles”. A foreign investor who is subject to tax under FIRPTA will be subject to U.S. federal income tax (at the rates applicable to U.S. investors) on any capital gain dividends, and will also be required to file U.S. federal income tax returns to report such capital gain dividends. Furthermore, capital gain dividends are subject to an additional 30.0% “branch profits tax” (which may be reduced by an applicable income tax treaty) in the hands of a foreign investor who is subject to tax under FIRPTA if such foreign investor is treated as a corporation for U.S. federal income tax purposes.

U.S. tax reform and related regulatory action could adversely affect you.

Because our operations are governed to a significant extent by the federal tax laws, new legislative or regulatory action could adversely affect investors in Company stock. The Tax Cuts and Jobs Act (“TCJA”) made significant changes to the U.S. federal tax system. Specifically, and as relevant to the Company and its subsidiaries, the TCJA reduced the maximum corporate tax rate from 35% to 21%, allows for full expensing of certain property, revised the net operating loss provisions, set limitations on certain types of interest deductions, and expanded limitations on deductions for executive compensation. The TCJA did not modify the existing REIT rules, and we still are not required to pay federal taxes provided we comply with the existing requirements to qualify as a REIT.

The following provisions of the TCJA may have an impact on the Company and investors in Company stock:

- **Interest deductibility.** The TCJA imposes a limitation on the deduction for certain business interest, subject to exceptions for electing real property trades or businesses provided the real property trade or business adopts the alternative depreciation system with respect to its property. While we believe the Company and its subsidiaries, and the Operating Partnership are each engaged in a real property trade or business, the matter is not free from doubt. As a result, if any of the Company, its subsidiaries, or the Operating Partnership cannot deduct all of their interest expense, or are ineligible to elect exemption from the rules, this will potentially increase the Company’s taxable income and potentially increase the amount of taxable dividends we distribute to investors of Company stock.
- **Reduced rate for pass-through entities.** For taxable years prior to January 1, 2026, the TCJA provides non-corporate taxpayers with a potential 20% deduction against taxable income with respect to certain income earned

through pass-through entities. REIT ordinary dividends, such as dividends the Company distributes to investors of its stock, automatically qualify for the deduction. In addition, the IRS has issued proposed regulations that provide ordinary dividends earned by a non-corporate taxpayer indirectly through a regulated investment company (within the meaning of Code section 851) will qualify for the potential 20.0% deduction against taxable income. Moreover, there is no assurance that Congress will not repeal the current favorable deduction applicable to ordinary dividends that we distribute.

- **Expanded limitations on deductions for executive compensation.** The TCJA expanded the scope of section 162(m), which limits deductions for annual compensation paid to certain employees of publicly trade corporations, including REITs. If a deduction is denied under this provision, this will increase our taxable income and potentially increase the amount of taxable dividends we distribute to investors of our stock.

Investors in our stock are strongly encouraged to consult with a tax advisor with respect to the potential impact the TCJA may have with respect to investing in our Company's stock.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

As of December 31, 2018, our portfolio consisted of the following properties (see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Operating Metrics, for definitions of Occupancy, ADR, and RevPAR):

Wholly-Owned Properties	Number of Rooms	Occupancy 2018	ADR 2018	RevPAR 2018	Occupancy 2017	ADR 2017	RevPAR 2017	Occupancy 2016	ADR 2016	RevPAR 2016
Crowne Plaza Tampa Westshore Tampa, Florida	222	71.9%	\$124.72	\$ 89.73	79.1%	\$119.85	\$ 94.81	74.6%	\$116.15	\$ 86.69
The DeSoto, Savannah, Georgia	246	61.6%	\$177.19	\$ 109.21	66.6%	\$159.50	\$ 106.15	71.5%	\$155.87	\$ 111.48
DoubleTree by Hilton Jacksonville Riverfront, Jacksonville, Florida	293	81.6%	\$139.84	\$ 114.06	79.9%	\$132.19	\$ 105.56	77.4%	\$126.67	\$ 98.06
DoubleTree by Hilton Laurel, Laurel, Maryland	208	66.8%	\$107.98	\$ 72.09	64.9%	\$107.77	\$ 69.91	60.5%	\$104.35	\$ 63.16
DoubleTree by Hilton Philadelphia Airport, Philadelphia, Pennsylvania	331	78.2%	\$139.25	\$ 108.88	75.5%	\$135.54	\$ 102.32	77.0%	\$144.92	\$ 111.66
DoubleTree by Hilton Raleigh Brownstone – University, Raleigh, North Carolina	190	74.8%	\$134.26	\$ 100.36	74.2%	\$133.24	\$ 98.91	70.0%	\$134.74	\$ 94.33
DoubleTree Resort by Hilton Hollywood Beach, Hollywood, Florida	311	69.2%	\$175.18	\$ 121.19	72.1%	\$170.76	\$ 123.12	79.6%	\$170.57	\$ 135.74
Georgian Terrace, Atlanta, Georgia	326	67.9%	\$186.28	\$ 126.56	70.6%	\$175.06	\$ 123.66	70.8%	\$160.89	\$ 113.88
Hotel Ballast Wilmington, Tapestry Collection by Hilton, Wilmington, North Carolina	272	63.9%	\$153.04	\$ 97.75	68.3%	\$148.69	\$ 101.62	70.5%	\$147.14	\$ 103.72
Hyatt Centric Arlington, Arlington, Virginia (1)	318	83.8%	\$181.38	\$ 152.04	84.0%	\$176.31	\$ 148.13	79.5%	\$170.19	\$ 135.24
Sheraton Louisville Riverside, Jeffersonville, Indiana	180	60.6%	\$122.62	\$ 74.25	63.8%	\$133.86	\$ 85.45	63.1%	\$137.34	\$ 86.60
The Whitehall, Houston, Texas	259	57.5%	\$146.01	\$ 83.95	58.1%	\$147.66	\$ 85.78	54.4%	\$140.70	\$ 76.56
Wholly-Owned Properties Total	3,156									
Condominium Hotel										
Hyde Resort & Residences	215 ⁽²⁾	49.8%	\$299.30	\$ 149.15	37.9%	\$282.20	\$ 106.84	n/a	n/a	n/a
Total Hotel & Participating Condominium Hotel Rooms	3,371									

(1) Includes operating results under previous ownership. Results for periods prior to the Company's ownership were provided by prior owners of the hotel and have not been audited or confirmed by the Company.

(2) We own the hotel commercial unit and operate a rental program. Reflects only those condominium units that were participating in the rental program as of December 31, 2018. At any given time, some portion of the units participating in our rental program may be occupied by the unit owners and unavailable for rent to hotel guests. We sometimes refer to each participating condominium unit as a "room".

Item 3. *Legal Proceedings*

We are not involved in any material litigation, nor to our knowledge, is any material litigation threatened against us. We have settled, during the period covered by this report, all significant claims made during the same period. We are involved in routine litigation arising out of the ordinary course of business, all of which is expected to be covered by insurance, and none of which is expected to have a material impact on our financial condition or results of operations.

Item 4. *Mine Safety Disclosure*

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Sotherly Hotels Inc.

Market Information

The Company's common stock trades on the NASDAQ ® Global Market under the symbol "SOHO". The closing price of the Company's common stock on the NASDAQ ® Global Market on March 1, 2019 was \$6.58 per share.

Stockholder Information

As of March 1, 2019, there were approximately 87 holders of record of the Company's common stock.

In order to comply with certain requirements related to the Company's qualification as a REIT, the Company's charter, subject to certain exceptions, limits the number of common shares that may be owned by any single person or affiliated group to 9.9% of the outstanding common shares.

Issuer Purchases of Equity Securities

On December 2, 2016, the Company's board of directors authorized a stock repurchase program under which the Company may purchase up to \$10.0 million of its outstanding common stock, par value \$0.01 per share, at prevailing prices on the open market or in privately negotiated transactions, at the discretion of management. The Company has used and expects to continue to use available working capital to fund purchases under the stock repurchase program. The repurchase program is authorized until December 31, 2019, unless extended by the board of directors. The repurchase program may be suspended or discontinued at any time, and the Company is not obligated to acquire any particular amount or number of shares. As of December 31, 2017, the Company had repurchased 882,820 shares of common stock at an average price of \$6.68 per share totaling approximately \$5.9 million. Through December 31, 2018 the Company repurchased the following amounts of common stock and the repurchased shares have been returned to the status of authorized but unissued shares of common stock:

Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Program
December 1- December 31, 2016	481,100	\$ 6.53	481,100	\$ 6,835,464
January 1- December 31, 2017	401,720	\$ 6.80	882,820	\$ 4,104,423
January 1- December 31, 2018	0	n/a	0	n/a

Affiliated Purchaser Purchases of Equity Securities

The Company adopted an Employee Stock Ownership Plan (“ESOP”) in December 2016, effective as of January 1, 2016. The Company sponsors and maintains the ESOP and related trust for the benefit of its eligible employees. The ESOP is funded by a loan from the Company, pursuant to which the ESOP may borrow up to \$5.0 million to purchase shares of the Company’s common stock. Through December 31, 2018 the ESOP purchased the following amounts of common stock:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Program
January 1 – January 31, 2017	352,300	\$ 6.99	352,300	\$ n/a
February 1 – February 28, 2017	330,200	7.25	330,200	n/a
March 1 – December 31, 2017	0	n/a	0	n/a
January 1 – January 31, 2018	0	n/a	0	n/a
Total	682,500	\$ 7.09	682,500	\$ n/a

Sotherly Hotels LP

Market Information

There is no established trading market for partnership units of the Operating Partnership. The Operating Partnership does not currently propose to offer partnership units to the public and does not currently expect that a public market for those units will develop.

Partnership Unitholder Information

As of March 1, 2019, there were 12 holders of the Operating Partnership’s partnership units, including Sotherly Hotels Inc.

Recent Sales of Unregistered Securities

From time to time, the Operating Partnership may issue and/or repurchase limited partnership units (common and/or preferred) to the Company, as required by the Amended and Restated Agreement of Limited Partnership of the Operating Partnership, to mirror the capital structure of the Company to reflect additional issuances by the Company and to preserve equitable ownership ratios.

Except for shares of Series C Partnership Units and common units issued to the Company in connection with the contribution to the Operating Partnership of the net proceeds of the offering of Series C Preferred Stock and common stock, there were no sales of unregistered securities in the Operating Partnership during 2018.

Sotherly Hotels Inc. and Sotherly Hotels LP

Dividend and Distribution Information

The Company elected to be taxed as a REIT commencing with our taxable year ending December 31, 2004. To maintain qualification as a REIT, we are required to make annual distributions to the Company’s stockholders of at least 90.0% of our REIT taxable income, excluding net capital gain, which does not necessarily equal net income as calculated in accordance with generally accepted accounting principles. Our ability to pay distributions to the Company’s stockholders will depend, in part, upon our receipt of distributions from our Operating Partnership which may depend upon receipt of lease payments with respect to our properties from our TRS Lessees, and in turn, upon the management of our properties by our hotel manager. Distributions to the Company’s stockholders will generally be taxable to the Company’s stockholders as ordinary income; however, because a portion of our investments will be equity ownership interests in hotels, which will result in depreciation and non-cash charges against our income, a portion of our distributions may constitute a tax-free return of capital. To the extent not inconsistent with maintaining our REIT status, our TRS Lessees may retain any after-tax earnings.

In order to maintain our qualification as a REIT, we must make distributions to our stockholders each year in an amount equal to at least:

- 90% of our REIT taxable income determined without regard to the dividends paid deduction and excluding net capital gains; plus
- 90% of the excess of our net income from foreclosure property over the tax imposed on such income by the Code; minus
- Any excess noncash income (as defined in the Code).

The following tables set forth information regarding the declaration, payment and income tax characterization of distributions by the Company on its common and preferred shares to Company's stockholders for fiscal year 2017 to 2018. The same table sets forth the Operating Partnership's distributions per common and preferred partnership units for fiscal year 2017 to 2018:

Dividend (Distribution) Payments - Common

Date Declared	For the Quarter Ended	Date Paid	Amount per Share and Unit	Ordinary Income	Return of Capital
January 2017	March 31, 2017	April 11, 2017	\$ 0.100	20.08%	79.92%
April 2017	June 30, 2017	July 11, 2017	\$ 0.105	20.08%	79.92%
July 2017	September 30, 2017	October 11, 2017	\$ 0.110	20.08%	79.92%
October 2017	December 31, 2017	January 11, 2018	\$ 0.110	20.08%	79.92%
January 2018	March 31, 2018	April 11, 2018	\$ 0.115	0.00%	100.00%
April 2018	June 30, 2018	July 11, 2018	\$ 0.120	0.00%	100.00%
July 2018	September 30, 2018	October 11, 2018	\$ 0.125	0.00%	100.00%
October 2018	December 31, 2018	January 11, 2019	\$ 0.125	0.00%	100.00%

Dividend (Distribution) Payments - Series B Preferred Stock

Date Declared	For the Quarter Ended	Date Paid	Amount per Share and Unit	Ordinary Income	Return of Capital
January 2017	March 31, 2017	April 17, 2017	\$ 0.500	20.08%	79.92%
April 2017	June 30, 2017	July 17, 2017	\$ 0.500	20.08%	79.92%
July 2017	September 30, 2017	October 17, 2017	\$ 0.500	20.08%	79.92%
October 2017	December 31, 2017	January 17, 2018	\$ 0.500	20.08%	79.92%
January 2018	March 31, 2018	April 17, 2018	\$ 0.500	86.01%	13.99%
April 2018	June 30, 2018	July 17, 2018	\$ 0.500	86.01%	13.99%
July 2018	September 30, 2018	October 17, 2018	\$ 0.500	86.01%	13.99%
October 2018	December 31, 2018	January 17, 2019	\$ 0.500	86.01%	13.99%

Dividend (Distribution) Payments - Series C Preferred Stock

Date Declared	For the Quarter Ended	Date Paid	Amount per Share and Unit	Ordinary Income	Return of Capital
October 2017	December 31, 2017	January 17, 2018	\$ 0.443	20.08%	79.92%
January 2018	March 31, 2018	April 17, 2018	\$ 0.492	86.01%	13.99%
April 2018	June 30, 2018	July 17, 2018	\$ 0.492	86.01%	13.99%
July 2018	September 30, 2018	October 17, 2018	\$ 0.492	86.01%	13.99%
October 2018	December 31, 2018	January 17, 2019	\$ 0.492	86.01%	13.99%

The amount of future common stock distributions will be based upon quarterly operating results, general economic conditions, requirements for capital improvements, the availability of debt and equity capital, the Code's annual distribution requirements, and other factors, which the Company's board of directors deems relevant. The amount, timing and frequency of distributions will be authorized by the Company's board of directors and declared by us based upon a variety of factors deemed relevant by our directors, and no assurance can be given that our distribution policy will not change in the future.

Item 6. Selected Financial Data

The following table sets forth selected historical financial data for Sotherly Hotels Inc. and Sotherly Hotels LP for the years ended December 31, 2018, 2017, 2016, 2015, and 2014. The financial results for the DoubleTree Resort by Hilton Hollywood Beach, in which we had a 25.0% indirect interest, are not consolidated through July 31, 2015, as we accounted for our investment under the

equity method of accounting. However, from August 1, 2015 through December 31, 2015 and for subsequent fiscal years, we did consolidate the financial results for the DoubleTree Resort by Hilton Hollywood Beach, as a result of our acquisition of the remaining 75.0% interest in the hotel. The following selected historical financial data was derived from audited consolidated financial statements contained elsewhere in this Annual Report on Form 10-K and in prior filings. The Company's financial statements: for the years ended December 31, 2018, 2017 and 2016, have been audited by Dixon Hughes Goodman LLP and for the years ended December 31, 2015 and 2014, have been audited by Grant Thornton LLP, our independent registered public accounting firms, for such periods. The audited historical financial statements include reclassifications and all adjustments, consisting of normal recurring adjustments, which we consider necessary for a fair presentation of our financial condition and the results of operations as of those dates and for those periods under accounting principles generally accepted in the United States of America.

The information presented below is only a summary and does not provide all of the information contained in our consolidated financial statements, including notes thereto, and should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

SOTHERLY HOTELS INC.
SELECTED HISTORICAL FINANCIAL DATA

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014
Statement of Operations					
Total Revenues	\$ 178,173,121	\$ 154,266,693	\$ 152,845,752	\$ 138,533,476	\$ 122,939,919
Total Operating Expenses excluding Depreciation, Amortization, Disposal Gain and Impairment of Investments in Hotel Properties, net	(136,670,418)	(119,613,294)	(118,854,236)	(109,153,366)	(95,290,304)
Depreciation, Amortization, Disposal Gain and Impairment of Investments in Hotel Properties, net	(21,396,392)	(18,489,511)	(15,384,390)	(14,050,060)	(15,144,284)
Net Operating Income	20,106,311	16,163,888	18,607,126	15,330,050	12,505,331
Interest Income	352,951	218,656	115,785	50,461	19,865
Interest Expense	(19,953,746)	(15,727,628)	(17,735,107)	(16,515,827)	(14,636,870)
Other Income (Expense) – net	(644,324)	1,112,377	(1,455,289)	6,196,936	(354,558)
Income Tax Benefit (Provision)	(469,349)	(1,737,804)	1,367,634	1,336,033	1,727,723
Net Income (Loss)	(608,157)	29,489	900,149	6,397,653	(738,509)
Net (Income) Loss Attributable to Noncontrolling Interest	718,093	413,014	26,567	(1,040,987)	153,838
Net Income (Loss) Attributable to the Company	109,936	442,503	926,716	5,356,666	(584,671)
Distributions to Preferred Stockholders	(5,829,914)	(3,781,639)	(1,144,889)	—	—
Net Income/(Loss) Attributable to Common Stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)	\$ 5,356,666	\$ (584,671)
Statement of Cash Flows					
Cash provided by Operations – net	\$ 26,162,948	\$ 15,843,077	\$ 17,976,226	\$ 10,792,448	\$ 14,943,694
Cash used in Investing – net	(100,899,047)	(19,326,664)	(14,699,277)	(42,535,459)	(69,987,952)
Cash provided by Financing – net	79,175,338	549,709	15,798,218	24,614,643	63,503,194
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 4,439,239	\$ (2,933,878)	\$ 19,075,167	\$ (7,128,368)	\$ 8,458,936
Balance Sheet					
Investments in Hotel Properties, Net	\$ 435,725,814	\$ 357,799,512	\$ 348,593,912	\$ 354,963,242	\$ 260,192,153
Investment in Hotel Properties Held for Sale, Net	—	—	5,333,000	—	—
Total Assets (1)	493,482,847	409,953,340	406,019,564	388,972,239	294,414,755
Mortgage Loans, net	364,828,845	297,318,816	282,708,289	270,331,724	203,071,186
Unsecured Notes, net	23,894,658	—	24,308,713	50,460,106	49,715,183
Total Liabilities	411,216,475	315,778,310	324,680,276	336,113,871	266,904,898
Noncontrolling Interest (1)	441,706	1,154,775	2,329,175	3,855,237	4,132,662
Total Sotherly Hotels Inc. Stockholders' Equity (1)	\$ 81,824,666	\$ 93,020,255	\$ 79,010,113	\$ 49,003,131	\$ 23,377,195
Operating Data					
Average Number of Available Rooms	3,293	2,995	3,011	2,828	2,622
Total Number of Available Room Nights	1,202,025	1,096,170	1,102,026	1,032,353	957,060
Occupancy Percentage (2)	69.1%	68.8%	69.8%	69.9%	70.3%
Average Daily Rate (ADR) (2)	\$ 158.02	\$ 147.77	\$ 140.63	\$ 134.21	\$ 125.77
RevPAR (2)	\$ 109.20	\$ 101.70	\$ 98.18	\$ 93.80	\$ 88.42
Additional Financial Data					
FFO Available to Common Stockholders(3)	\$ 14,040,554	\$ 12,418,252	\$ 15,139,650	\$ 14,103,844	\$ 14,765,677
Adjusted FFO Available to Common Stockholders(3)	15,922,584	15,664,335	15,100,188	14,904,608	14,142,080
Hotel EBITDA (4)	47,683,665	40,989,325	40,012,581	36,447,390	32,084,957
Income (Loss) Per Basic Common Share	\$ (0.42)	\$ (0.24)	\$ (0.01)	\$ 0.43	\$ (0.06)

(1) As of the period end.

(2) Occupancy Percent is calculated by dividing the total daily number of rooms sold by the total daily number of rooms available. ADR is calculated by dividing the total daily room revenue by the total daily number of rooms sold. RevPAR is calculated by dividing the total daily room revenue by the total daily number of rooms available.

- (3) Industry analysts and investors use Funds from Operations (“FFO”) as a supplemental operating performance measure of an equity REIT. FFO Available to Common Stockholders and Unitholders is calculated in accordance with the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts (“NAREIT”). FFO, as defined by NAREIT, represents net income or loss determined in accordance with generally accepted accounting principles (“GAAP”), excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated operating real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after adjustment for any noncontrolling interest from unconsolidated partnerships and joint ventures. Adjusted FFO Available to Common Stockholders and Unitholders accounts for certain additional items that are not in NAREIT’s definition of FFO, including changes in deferred income taxes, any unrealized gain (loss) on its hedging instruments or warrant derivative, loan impairment losses, losses on early extinguishment of debt, aborted offering costs, franchise termination costs, loan modification fees, costs associated with the departure of executive officers, litigation settlement, over-assessed real estate taxes on appeal, change in control gains or losses and acquisition transaction costs.
- (4) Hotel EBITDA represents the portion of net income or loss excluding: (1) interest expense, (2) interest income, (3) income tax provision or benefit, (4) equity in the income or loss of equity investees, (5) unrealized gains and losses on derivative instruments not included in other comprehensive income, (6) gains and losses on disposal of assets, (7) realized gains and losses on investments, (8) impairment of long-lived assets or investments, (9) loss on early debt extinguishment, (10) gains or losses on change in control, (11) corporate general and administrative expense, (12) depreciation and amortization, (13) gains and losses on involuntary conversions of assets, (14) distributions to preferred stockholders and (15) other operating revenue not related to our wholly-owned portfolio.

SOTHERLY HOTELS LP
SELECTED HISTORICAL FINANCIAL DATA

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014
Statement of Operations					
Total Revenues	\$ 178,173,121	\$ 154,266,693	\$ 152,845,752	\$ 138,533,476	\$ 122,939,919
Total Operating Expenses excluding Depreciation, Amortization, Disposal Gain and Impairment of Investments in Hotel Properties, net	(136,670,418)	(119,613,294)	(118,854,236)	(109,153,366)	(95,290,304)
Depreciation, Amortization, Disposal Gain and Impairment of Investments in Hotel Properties, net	(21,396,392)	(18,489,511)	(15,384,390)	(14,050,060)	(15,144,284)
Net Operating Income	20,106,311	16,163,888	18,607,126	15,330,050	12,505,331
Interest Income	352,951	218,656	115,785	50,461	19,865
Interest Expense	(19,953,746)	(15,727,628)	(17,735,107)	(16,515,827)	(14,636,870)
Other Income (Expense) – net	(644,324)	1,112,377	(1,455,289)	6,196,936	(354,558)
Income Tax Benefit (Provision)	(469,349)	(1,737,804)	1,367,634	1,336,033	1,727,723
Net Income (Loss)	(608,157)	29,489	900,149	6,397,653	(738,509)
Distributions to Preferred Unitholders	(5,829,914)	(3,781,639)	(1,144,889)	—	—
Net Income/(Loss) Available to Operating Partnership Unit Holders	\$ (6,438,071)	\$ (3,752,150)	\$ (244,740)	\$ 6,397,653	\$ (738,509)

Statement of Cash Flows

Cash provided by Operations – net	\$ 26,245,988	\$ 15,805,264	\$ 17,976,226	\$ 10,792,448	\$ 14,943,694
Cash used in Investing – net	(100,694,488)	(23,977,633)	(14,699,277)	(42,535,459)	(69,987,952)
Cash provided by Financing – net	78,887,739	5,238,491	15,798,218	24,614,643	63,503,194
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 4,439,239	\$ (2,933,878)	\$ 19,075,167	\$ (7,128,368)	\$ 8,458,936

Balance Sheet

Investments in Hotel Properties, Net	\$ 435,725,814	\$ 357,799,512	\$ 348,593,912	\$ 354,963,242	\$ 260,192,153
Investment in Hotel Properties Held for Sale, Net	—	—	5,333,000	—	—
Total Assets (1)	497,929,257	414,604,309	406,019,564	388,972,239	294,414,755
Mortgage Loans, net	364,828,845	297,318,816	282,708,289	270,331,724	203,071,186
Unsecured Notes, net	23,894,658	—	24,308,713	50,460,106	49,715,183
Total Liabilities	411,273,022	315,823,854	324,680,276	336,113,871	266,904,898
Total Sotherly Hotels LP - Partners' Capital (1)	\$ 86,656,235	\$ 98,780,455	\$ 79,010,113	\$ 49,003,131	\$ 23,377,195

Operating Data

Average Number of Available Rooms	3,293	2,995	3,011	2,828	2,622
Total Number of Available Room Nights	1,202,025	1,096,170	1,102,026	1,032,353	957,060
Occupancy Percentage (2)	69.1%	68.8%	69.8%	69.9%	70.3%
Average Daily Rate (ADR) (2)	\$ 158.02	\$ 147.77	\$ 140.63	\$ 134.21	\$ 125.77
RevPAR (2)	\$ 109.20	\$ 101.70	\$ 98.18	\$ 93.80	\$ 88.42

Additional Financial Data

FFO Available to Common Unit holders(3)	\$ 14,040,554	\$ 12,418,252	\$ 15,139,650	\$ 14,103,844	\$ 14,765,677
Adjusted FFO Available to Common Unit holders(3)	15,922,584	15,664,335	15,100,188	14,904,608	14,142,080
Hotel EBITDA (4)	47,683,665	40,989,325	40,012,581	36,447,390	32,084,957
Income (Loss) Per Basic Common Unit	\$ (0.40)	\$ (0.23)	\$ (0.01)	\$ 0.43	\$ (0.06)

(1) As of the period end.

(2) Occupancy Percent is calculated by dividing the total daily number of rooms sold by the total daily number of rooms available. ADR is calculated by dividing the total daily room revenue by the total daily number of rooms sold. RevPAR is calculated by dividing the total daily room revenue by the total daily number of rooms available.

(3) Industry analysts and investors use Funds from Operations (“FFO”) as a supplemental operating performance measure of an equity REIT. FFO Available to Common Stockholders and Unitholders is calculated in accordance with the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts (“NAREIT”). FFO, as defined by NAREIT, represents net income or loss determined in accordance with generally accepted accounting principles (“GAAP”), excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated operating real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after adjustment for any noncontrolling interest from unconsolidated partnerships and joint ventures.

Adjusted FFO Available to Common Stockholders and Unitholders accounts for certain additional items that are not in NAREIT’s definition of FFO, including changes in deferred income taxes, any unrealized gain (loss) on its hedging instruments or warrant derivative, loan impairment losses, losses on early extinguishment of debt, aborted offering costs, franchise termination costs, loan modification fees, costs associated with the departure of executive officers, litigation settlement, over-assessed real estate taxes on appeal, change in control gains or losses and acquisition transaction costs.

- (4) Hotel EBITDA represents the portion of net income or loss excluding: (1) interest expense, (2) interest income, (3) income tax provision or benefit, (4) equity in the income or loss of equity investees, (5) unrealized gains and losses on derivative instruments not included in other comprehensive income, (6) gains and losses on disposal of assets, (7) realized gains and losses on investments, (8) impairment of long-lived assets or investments, (9) loss on early debt extinguishment, (10) gains or losses on change in control, (11) corporate general and administrative expense, (12) depreciation and amortization, (13) gains and losses on involuntary conversions of assets, (14) distributions to preferred stockholders and (15) other operating revenue not related to our wholly-owned portfolio.

The following is the Company's and the Operating Partnership's reconciliation of net loss to FFO and Adjusted FFO for the years ended December 31, 2018, 2017, 2016, 2015, and 2014.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014
Net Income/(Loss) Available to the Common Stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)	\$ 5,356,666	\$ (584,671)
Add: Net Income (Loss) Attributable to the Noncontrolling Interest	(718,093)	(413,014)	(26,567)	1,040,987	(153,838)
Depreciation and Amortization	20,884,643	16,999,619	15,019,071	13,591,495	11,969,284
Equity in Depreciation and Amortization of Joint Venture	—	—	—	259,279	529,053
Impairment of Investment in Hotel Properties, Net	—	—	—	500,000	3,175,000
Gain on Change in Control	—	—	—	(6,603,148)	—
Gain on Involuntary Conversion of Assets	(917,767)	(2,242,876)	—	—	(169,151)
Loss (Gain) on Sale or Asset Disposal	511,749	1,413,659	365,319	(41,435)	—
FFO Available to Common Stockholders and Unitholders	\$ 14,040,554	\$ 12,418,252	\$ 15,139,650	\$ 14,103,844	\$ 14,765,677
(Increase) Decrease in Deferred Income Taxes	319,939	1,498,222	(1,558,966)	(1,780,571)	(1,961,663)
Acquisition Costs	—	—	—	634,376	155,187
Loss on Starwood Settlement	—	—	—	324,271	—
Over-Assessed Real Estate Taxes Under Appeal	—	—	—	497,733	—
Loan Modification Fees	—	—	64,215	243,229	—
Franchise Termination Fee	—	—	—	—	351,800
Realized and Unrealized (Gain) Loss on Hedging Activities (A)	808,958	28,384	37,384	108,819	—
Loss on Aborted Offering Costs	—	541,129	—	—	—
Loss on Early Debt Extinguishment (A)	753,133	1,178,348	1,417,905	772,907	831,079
Adjusted FFO Available to Common Stockholders and Unitholders	\$ 15,922,584	\$ 15,664,335	\$ 15,100,188	\$ 14,904,608	\$ 14,142,080

(A) Includes equity in unrealized (gain)/loss on hedging activities and loss on early extinguishment of debt of joint venture.

The following is a reconciliation of net income/(loss) to Hotel EBITDA for the years ended December 31, 2018, 2017, 2016, 2015, and 2014.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015	Year Ended December 31, 2014
Net Income/(Loss) Available to the Common Stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)	\$ 5,356,666	\$ (584,671)
Add: Net Income (Loss) Attributable to the Noncontrolling Interest	(718,093)	(413,014)	(26,567)	1,040,987	(153,838)
Interest Expense	19,953,746	15,727,628	17,735,107	16,515,827	14,636,870
Interest Income	(352,951)	(218,656)	(115,785)	(50,461)	(19,865)
Distributions to Preferred Stockholders	5,829,914	3,781,639	1,144,889	—	—
Income Tax Provision (Benefit)	469,349	1,737,804	(1,367,634)	(1,336,033)	(1,727,723)
Depreciation and Amortization	20,884,643	16,999,619	15,019,071	13,591,495	11,969,284
Equity in (Earnings) Loss of Joint Venture	—	—	—	(475,514)	(307,370)
Loss (Gain) on Sale or Asset Disposal	511,749	1,413,659	365,319	(41,435)	—
Gain on Involuntary Conversion of Assets	(917,767)	(2,242,876)	—	—	(169,151)
Realized and Unrealized Loss (Gain) on Hedging Activities	808,958	28,384	37,384	108,819	—
Loss on Early Debt Extinguishment	753,133	1,178,348	1,417,905	772,907	831,079
Impairment of Investment in Hotel Properties, Net	—	—	—	500,000	3,175,000
Corporate General and Administrative Expenses	6,180,962	6,335,926	6,021,065	7,268,256	5,085,949
Gain on Change in Control	—	—	—	(6,603,148)	—
Net Lease Rental Income	—	—	—	—	(350,000)
Other Fee Income	—	—	—	(200,976)	(300,607)
Hotel EBITDA	<u>\$ 47,683,665</u>	<u>\$ 40,989,325</u>	<u>\$ 40,012,581</u>	<u>\$ 36,447,390</u>	<u>\$ 32,084,957</u>

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company is a self-managed and self-administered lodging REIT incorporated in Maryland in August 2004 to pursue opportunities in the full-service, primarily upscale and upper-upscale segments of the hotel industry located in primary and secondary markets in the mid-Atlantic and southern United States. Since January 1, 2016, we have completed the following acquisitions and dispositions:

- On January 30, 2017, we acquired the hotel commercial unit of the Hyde Resort & Residences, a 400-unit condominium-hotel located in the Hollywood, Florida market.
- On February 7, 2017, we closed on the sale of the Crowne Plaza Hampton Marina.
- On March 1, 2018, we acquired the 318-room Hyatt Centric Arlington hotel located in Arlington, Virginia for an aggregate purchase price of approximately \$79.7 million, including seller credits. The Hyatt Centric Arlington hotel is subject to a long-term ground lease agreement that covers all of the land underlying the hotel.

As of December 31, 2018, our hotel portfolio consisted of twelve full-service, primarily upscale and upper-upscale hotels with 3,156 rooms, nine of which operate under well-known brands such as Hilton, Crowne Plaza, DoubleTree, Hyatt and Sheraton, and three of which are independent hotels, and the hotel commercial condominium unit of the Hyde Resort & Residences condominium hotel. As of December 31, 2018, our portfolio consisted of the following hotel properties:

Property	Number of Rooms	Location	Date of Acquisition	Chain/Class Designation
Wholly-owned Hotels				
Crowne Plaza Tampa Westshore	222	Tampa, FL	October 29, 2007	Upscale
The DeSoto	246	Savannah, GA	December 21, 2004	Upper Upscale ⁽¹⁾
DoubleTree by Hilton Jacksonville Riverfront	293	Jacksonville, FL	July 22, 2005	Upscale
DoubleTree by Hilton Laurel	208	Laurel, MD	December 21, 2004	Upscale
DoubleTree by Hilton Philadelphia Airport	331	Philadelphia, PA	December 21, 2004	Upscale
DoubleTree by Hilton Raleigh Brownstone-University	190	Raleigh, NC	December 21, 2004	Upscale
DoubleTree Resort by Hilton Hollywood Beach	311	Hollywood, FL	August 9, 2007	Upscale
Georgian Terrace	326	Atlanta, GA	March 27, 2014	Upper Upscale ⁽¹⁾
Hotel Ballast Wilmington, Tapestry Collection by Hilton	272	Wilmington, NC	December 21, 2004	Upscale
Hyatt Centric Arlington	318	Arlington, VA	March 1, 2018	Upper Upscale
Sheraton Louisville Riverside	180	Jeffersonville, IN	September 20, 2006	Upper Upscale
The Whitehall	259	Houston, TX	November 13, 2013	Upper Upscale ⁽¹⁾
Hotel Rooms Subtotal	<u>3,156</u>			
Condominium Hotel				
Hyde Resort & Residences	215 ⁽²⁾	Hollywood, FL	January 30, 2017	Luxury ⁽¹⁾
Total Hotel & Participating Condominium Hotel Rooms	<u><u>3,371</u></u>			

(1) Operated as an independent hotel.

(2) We own the hotel commercial unit and operate a rental program. Reflects only those condominium units that were participating in the rental program as of December 31, 2018. At any given time, some portion of the units participating in our rental program may be occupied by the unit owner(s) and unavailable for rental to hotel guests. We sometimes refer to each participating condominium unit as a "room".

We conduct substantially all our business through the Operating Partnership, Sotherly Hotels LP. The Company is the sole general partner of the Operating Partnership and owns an approximate 88.9% interest in the Operating Partnership, with the remaining interest being held by limited partners who were contributors of our initial hotel properties and related assets.

To qualify as a REIT, neither the Company nor the Operating Partnership can operate our hotels. Therefore, our wholly-owned hotel properties are leased to our TRS Lessees that are wholly-owned subsidiaries of the Operating Partnership, which then engage hotel management companies to operate the hotels under a management agreement. Our TRS Lessees have engaged Chesapeake Hospitality and Highgate Hotels to manage our hotels. Our TRS Lessees, and their parent, MHI Hospitality TRS Holding, Inc., are

consolidated into each of our financial statements for accounting purposes. The earnings of MHI Hospitality TRS Holding, Inc. are subject to taxation similar to other C corporations.

Key Operating Metrics

In the hotel industry, room revenue is considered the most important category of revenue and drives other revenue categories such as food, beverage, catering, parking and telephone. There are three key performance indicators used in the hotel industry to measure room revenues:

- Occupancy, or the number of rooms sold, usually expressed as a percentage of total rooms available;
- Average daily rate, or ADR, which is total room revenue divided by the number of rooms sold; and
- Revenue per available room, or RevPAR, which is total room revenue divided by the total number of available rooms.

RevPAR changes that are primarily driven by changes in occupancy have different implications for overall revenues and profitability than changes that are driven primarily by changes in ADR. For example, an increase in occupancy at a hotel would lead to additional variable operating costs (such as housekeeping services, laundry, utilities, room supplies, franchise fees, management fees, credit card commissions and reservations expense), but could also result in increased non-room revenue from the hotel's restaurant, banquet or parking facilities. Changes in RevPAR that are primarily driven by changes in ADR typically have a greater impact on operating margins and profitability as they do not generate all the additional variable operating costs associated with higher occupancy.

We also use FFO, Adjusted FFO and Hotel EBITDA as measures of our operating performance. See "Non-GAAP Financial Measures".

Results of Operations

Comparison of Year Ended December 31, 2018 to Year Ended December 31, 2017

The following table illustrates the key operating metrics for the years ended December 31, 2018 and 2017 for our wholly-owned hotels and the Hyde Resort & Residences, during each respective reporting period ("composite portfolio" properties), as well as the key operating metrics for the eleven wholly-owned properties that were under our control during all of 2018 ("same-store" properties). Accordingly, the same-store data does not reflect the performance of the Crowne Plaza Hampton Marina, which was sold in February 2017, the Hyatt Centric Arlington, which was acquired in February 2018 and the Hyde Resort & Residences, which was acquired in January 2017.

	Year Ended December 31, 2018		Year Ended December 31, 2017	
	Composite	Same-Store	Composite	Same-Store
Occupancy %	69.1%	69.0%	68.8%	70.6%
ADR	\$ 158.02	\$ 148.57	\$ 147.77	\$ 144.21
RevPAR	\$ 109.20	\$ 102.52	\$ 101.70	\$ 101.88

Revenue. Total revenue for the year ended December 31, 2018 was approximately \$178.2 million, an increase of approximately \$23.9 million, or 15.5%, from total revenue for the year ended December 31, 2017 of approximately \$154.3 million. The increase in revenue for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, on March 1, 2018, which increased revenues by approximately \$18.1 million. In addition, our interest in the Hyde Resort & Residences condominium hotel, which started operations on January 30, 2017, has continued to ramp up and accounted for an increase of approximately \$2.7 million for the period. There was also a net aggregate increase in revenues of approximately \$3.1 million for the period from the remaining properties.

Room revenues at our properties for the year ended December 31, 2018 increased approximately \$15.3 million, or 14.4%, to approximately \$121.0 million compared to room revenues for the year ended December 31, 2017 of approximately \$105.7 million. The increase in room revenue for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, on March 1, 2018, which increased room revenues by approximately \$14.8 million. In addition, there was a net aggregate increase in room revenues of approximately \$0.5 million for the period from the remaining properties.

Food and beverage revenues at our properties for the year ended December 31, 2018 increased approximately \$3.6 million, or 10.5%, to approximately \$38.1 million compared to food and beverage revenues of approximately \$34.5 million for the year ended December 31, 2017. The increase in food and beverage revenues for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, on March 1, 2018, which increased food and beverage revenues by approximately

\$2.3 million. There was also a net increase in food and beverage revenues of approximately \$1.3 million; resulting from increases of approximately \$0.9 million at our properties with newly renovated restaurants in Wilmington, North Carolina; Savannah, Georgia and Laurel, Maryland and an aggregate increase in food and beverage revenues of approximately \$0.4 million for the period from the remaining properties.

Other operating revenues for the year ended December 31, 2018 increased approximately \$5.0 million, or 35.8 %, to approximately \$19.0 million compared to other operating revenues for the year ended December 31, 2017 of approximately \$14.0 million. The increase in revenue from other operating departments for the twelve months ended December 31, 2018 resulted mainly from the continued ramp up of operations at the Hyde Resort & Residences, accounting for an increase of approximately \$2.7 million for the period and from the acquisition of the Hyatt Centric Arlington, on March 1, 2018, which increased other operating departments revenues by approximately \$1.0 million. In addition, there was a net aggregate increase in other operating departments revenues of approximately \$1.3 million for the period from the remaining properties.

Hotel Operating Expenses. Hotel operating expenses, which consist of room expenses, food and beverage expenses, other direct expenses, indirect expenses, and management fees, increased approximately \$17.2 million, or 15.2%, for the year ended December 31, 2018 to approximately \$130.5 million compared to hotel operating expenses for the year ended December 31, 2017 of approximately \$113.3 million. The increase in hotel operating expenses for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, which increased hotel operating expenses by approximately \$12.7 million. Our interest in the Hyde Resort & Residences condominium hotel also accounted for an increase in hotel operating expenses of approximately \$1.9 million for the period. In addition, there was a net aggregate increase in hotel operating expenses of approximately \$2.6 million for the period from our remaining properties.

Rooms expense at our properties for the year ended December 31, 2018 increased approximately \$3.6 million, or 13.7%, to approximately \$30.3 million compared to rooms expense of approximately \$26.7 million for the year ended December 31, 2017. The net increase in rooms expense for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, which increased room expenses by approximately \$3.2 million. In addition, there was a net aggregate increase in room expenses of approximately \$0.4 million for the period, from the remaining properties.

Food and beverage expenses at our properties for the year ended December 31, 2018 increased approximately \$3.5 million, or 14.3%, to approximately \$28.1 million compared to food and beverage expense of approximately \$24.6 million for the year ended December 31, 2017. There was a net aggregate increase in food and beverage expenses for the twelve months ended December 31, 2018 resulting from; increases of approximately \$0.9 million at our properties with newly renovated restaurants in Wilmington, North Carolina; Savannah, Georgia and Laurel, Maryland; from the acquisition of the Hyatt Centric Arlington, which increased food and beverage expenses by approximately \$2.0 million from a net increase in food and beverage expenses of approximately \$0.6 million for the period at the remaining properties.

Expenses from other operating departments increased approximately \$2.0 million, or 45.7%, to approximately \$6.4 million for the year ended December 31, 2018 compared to expenses from other operating departments of approximately \$4.4 million for the year ended December 31, 2017. The increase in expense from other operating departments for the twelve months ended December 31, 2018 resulted mainly from our interest in the Hyde Resort & Residences condominium hotel, accounted for an increase of approximately \$1.0 million for the period. In addition, there was a net aggregate increase in other operating departments expenses of approximately \$1.0 million for the twelve-month period, from the remaining properties.

Indirect expenses at our properties for the year ended December 31, 2018 increased approximately \$8.0 million, or 13.9%, to approximately \$65.6 million compared to indirect expenses of approximately \$57.6 million for the year ended December 31, 2017. Sales and marketing costs, franchise fees, utilities, repairs and maintenance, insurance, management fees, real and personal property taxes as well as general and administrative costs at the property level are included in indirect expenses. The increase in indirect expenses for the twelve months ended December 31, 2018 resulted mainly from the acquisition of the Hyatt Centric Arlington, which increased indirect costs by approximately \$7.2 million. In addition, there was a net aggregate increase in indirect expenses of approximately \$0.8 million for this twelve-month period from the remaining properties.

Depreciation and Amortization. Depreciation and amortization for the year ended December 31, 2018 increased approximately \$3.9 million, or 22.9 %, to approximately \$20.9 million compared to depreciation and amortization expense of approximately \$17.0 million for the year ended December 31, 2017. The increase was mostly attributable to increases in the depreciation related to our properties being renovated in Wilmington, North Carolina and Tampa, Florida, that accounted for increases of approximately \$1.3 million for the period and from the acquisition of the Hyatt Centric Arlington, which increased depreciation by approximately \$2.2 million. In addition, there was a net aggregate increase in depreciation and amortization expense of approximately \$0.4 million for this twelve-month period from the remaining properties.

Gain / Loss on Disposal of Assets. During the year ended December 31, 2018, we recorded a net loss on disposal of assets of approximately \$0.5 million, compared to a net loss on disposal of assets of approximately \$1.4 million for the year ended December 31, 2017.

Corporate General and Administrative. Corporate general and administrative expenses for the year ended December 31, 2018 decreased approximately \$0.1 million, or 2.4%, to approximately \$6.2 million compared to corporate general and administrative expenses of approximately \$6.3 million for the year ended December 31, 2017. The decrease in corporate general and administrative expenses was mainly due to reduced legal costs of approximately \$0.1 million and the absence of aborted offering costs for 2018 as compared to aborted offering costs of approximately \$0.5 million for 2017, which were offset by increased salaries by approximately \$0.2 million, increased audit fees by approximately \$0.1 million and increases in other costs by approximately \$0.1 million.

Interest Expense. Interest expense for the year ended December 31, 2018 increased approximately \$4.2 million, or 26.9%, to approximately \$19.9 million compared to approximately \$15.7 million of interest expense for the year ended December 31, 2017. The increase in interest expense for the twelve months ended December 31, 2018, was substantially related to the new mortgage on the Hyatt Centric Arlington and deferred financing costs associated with the mortgage on that property accounting for an increase of approximately \$2.4 million, compared to the twelve months ended December 31, 2017. There was also a net aggregate increase of approximately \$1.6 million of interest expenses with increases on mortgages for Wilmington, North Carolina; Savannah, Georgia; Raleigh, North Carolina; Philadelphia, Pennsylvania; Jacksonville, Florida; Tampa, Florida and Houston Texas, which was offset by decreases on mortgages for Laurel, Maryland; Hollywood, Florida; and Atlanta, Georgia. In addition, there was an increase in unsecured note interest for the twelve months ended December 31, 2018 by approximately \$0.2 million, compared to the twelve months ended December 31, 2017.

Loss on Early Debt Extinguishment. The loss on early debt extinguishment for the year ended December 31, 2018 decreased approximately \$0.4 million, or 36.1%, to approximately \$0.8 million compared to a loss on debt extinguishment of approximately \$1.2 million for the year ended December 31, 2017. During the twelve months ended December 31, 2018, we refinanced the mortgage loans we had on the DoubleTree by Hilton Raleigh Brownstone University, the DoubleTree by Hilton Philadelphia Airport and the Hyatt Centric Arlington with an approximate aggregate loss on early debt extinguishment of approximately \$0.8 million.

During the twelve months ended December 31, 2017, we refinanced a variable rate mortgage loan we had with Bank of the Ozarks on the DoubleTree by Hilton Jacksonville Riverfront, with a new fixed rate loan from Bank of America. The amount of accumulated un-amortized loan costs of approximately \$0.2 million was written off and we redeemed our 7% Notes which reflect the majority of the loss on early debt extinguishment of approximately \$1.0 million.

Unrealized Loss on Hedging Activities. During July 2018, we purchased an interest rate cap for \$204,756 and we purchased an interest rate SWAP liability for \$294,176. As of December 31, 2018, the fair market value of the interest rate caps was \$94,697 compared to the fair market value of \$5,213, as of December 31, 2017. As of December 31, 2018, the fair market value of the interest rate SWAP was a liability of \$984,677. The unrealized loss on hedging activities during the year ended December 31, 2018 and 2017, was \$808,958 and \$28,384, respectively.

Gain on Involuntary Conversion of Assets. Gain on involuntary conversion of assets for the year ended December 31, 2018 decreased approximately \$1.3 million to approximately \$0.9 million compared to gain on involuntary conversion of assets of approximately \$2.2 million for the year ended December 31, 2017. During 2017, we experienced electrical damage to The Whitehall property that resulted in a one-time involuntary conversion in the amount of approximately \$0.6 million, which was realized in the first quarter of 2018, and damage to the DoubleTree by Hilton Hollywood Beach Resort property for approximately \$0.3 million.

Income Tax (Provision) Benefit. The income tax provision for the year ended December 31, 2018 decreased approximately \$1.2 million, or 73.0%, to approximately \$0.5 million compared to an income tax provision of approximately \$1.7 million for the year ended December 31, 2017. The income tax provision was primarily derived from the operations of our TRS Lessees. Our TRS Lessees realized a net operating income for the year ended December 31, 2018 compared to a net operating loss for the year ended December 31, 2017, resulting in an income tax provision instead of an income tax benefit. However, at December 31, 2017 there was a one-time charge of approximately \$2.7 million resulting from a change in the federal income tax rate, due to the TCJA. At December 31, 2018 and 2017, deferred tax assets total approximately \$5.1 and \$5.5 million, respectively, of which approximately \$4.4 and \$4.9 million, respectively, relate to net operating losses of our TRS Lessee. At December 31, 2018, we determined, based on all available positive and negative evidence, that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward. We will continue to regularly evaluate the likelihood that we will be able to realize our deferred tax assets and the need for a valuation allowance for the deferred tax assets.

Net (Loss) Income. Net loss for the year ended December 31, 2018 increased approximately \$0.6 million, or 2,162.3%, to approximately \$(0.6) million compared to net income of approximately \$29.5 thousand for the year ended December 31, 2017, as a result of the operating results discussed above.

Distributions to Preferred Stockholders. During the year ended December 31, 2018, we recorded distributions to preferred stockholders of approximately \$5.8 million, compared to approximately \$3.8 million distributions to preferred stockholders for the year ended December 31, 2017. As of December 31, 2018 and 2017, we accrued approximately \$1.5 million and \$1.4 million, respectively, as dividends on the preferred stock. These increases were due to the issuance of Series C Preferred Stock in September 2018.

Comparison of Year Ended December 31, 2017 to Year Ended December 31, 2016

The following table illustrates the key operating metrics for the years ended December 31, 2017 and 2016 for our wholly-owned hotels and the Hyde Resort & Residences during each respective reporting period (“composite portfolio” properties) as well as the key operating metrics for the eleven wholly-owned properties that were under our control during all of 2016 (“same-store” properties). Accordingly, the same-store data does not reflect the performance of the Hyde Resort & Residences, which was acquired on January 30, 2017.

Year Ended December 31, 2017		Year Ended December 31, 2016	
Composite	Same-Store	Composite	Same-Store
68.8%	70.6%	69.8%	70.7%
\$ 147.77	\$ 144.21	\$ 140.63	\$ 142.71
\$ 101.70	\$ 101.88	\$ 98.18	\$ 100.91

Revenue. Total revenue for the year ended December 31, 2017 was approximately \$154.3 million, an increase of approximately \$1.4 million, or 0.9%, from total revenue for the year ended December 31, 2016 of approximately \$152.8 million. The increase in revenue for the year ended December 31, 2017 resulted mainly from management fees earned at the Hyde Resort & Residences condominium hotel, which commenced operations on January 30, 2017, accounting for an increase of approximately \$4.0 million for the period and by increases in revenues of approximately \$4.7 million for the period at our properties in Laurel, Maryland; Jacksonville, Florida; Tampa, Florida; Houston, Texas and Atlanta, Georgia. These increases in revenue were offset by the sale of our property in Hampton, Virginia which reduced revenues by approximately \$4.8 million; the impact of renovation activities at our properties in Wilmington, North Carolina; Savannah, Georgia and Hollywood Beach, Florida which had reduced revenues of approximately \$1.2 million in the aggregate; and by decreases in revenue realized by our properties in Raleigh, North Carolina; Philadelphia, Pennsylvania and Jeffersonville, Indiana of approximately \$1.3 million in the aggregate.

Room revenues at our properties for the year ended December 31, 2017 decreased approximately \$2.5 million, or 2.3%, to approximately \$105.7 million compared to room revenues for the year ended December 31, 2016 of approximately \$108.2 million. The decrease in room revenue for the year ended December 31, 2017 resulted mainly from the sale of our property in Hampton, Virginia which reduced revenues by approximately \$3.2 million. In addition, our properties impacted by renovation activities in Wilmington, North Carolina; Savannah, Georgia and Hollywood Beach, Florida had reduced revenues of approximately \$2.2 million in the aggregate. Room revenue decreases of approximately \$1.3 million in the aggregate were also realized by our properties in Philadelphia, Pennsylvania and Jeffersonville, Indiana. These decreases in room revenues for the year ended December 31, 2017 were offset by room revenue increases of approximately \$4.2 million in the aggregate at our properties in Raleigh, North Carolina; Laurel, Maryland; Jacksonville, Florida; Tampa, Florida; Houston, Texas and Atlanta, Georgia, which on a combined basis reflected a 1.7% decrease in occupancy, as compared to the same period in 2016.

Food and beverage revenues at our properties for the year ended December 31, 2017 decreased approximately \$0.9 million, or 2.5%, to approximately \$34.5 million compared to food and beverage revenues of approximately \$35.4 million for the year ended December 31, 2016. The decrease in food and beverage revenues for the year ended December 31, 2017, resulted mainly from the sale of our property in Hampton, Virginia which reduced revenues by approximately \$1.4 million. Food and beverage revenue decreases of approximately \$0.7 million were also realized by our properties in Raleigh, North Carolina; Jeffersonville, Indiana; Tampa, Florida; and Atlanta, Georgia. These decreases were offset by an increase in food and beverage revenues of approximately \$1.2 million at our properties in Wilmington, North Carolina, Savannah, Georgia; Philadelphia, Pennsylvania; Laurel, Maryland; Jacksonville, Florida; Hollywood Beach, Florida and Houston, Texas.

Other operating revenues for the year ended December 31, 2017 increased approximately \$4.8 million, or 51.4%, to approximately \$14.0 million compared to other operating revenues for the year ended December 31, 2016 of approximately \$9.3 million. The increase in revenue from other operating departments for the year ended December 31, 2017 resulted mainly from the start of operations at the Hyde Resort & Residences, accounting for an increase of approximately \$4.0 million for the period and \$0.3

million received by the Hollywood Beach, Florida property for construction interruption payments relating to the construction of a new building next to the property.

Hotel Operating Expenses. Hotel operating expenses, which consist of room expenses, food and beverage expenses, other direct expenses, indirect expenses, and management fees, increased approximately \$0.4 million, or 0.4%, for the year ended December 31, 2017 to approximately \$113.3 million compared to hotel operating expenses for the year ended December 31, 2016 of approximately \$112.8 million. The increase in hotel operating expenses for the year ended December 31, 2017 was substantially related to the start of operations at the Hyde Resort & Residences, accounting for an increase in expenses of approximately \$4.3 million for the period, which was offset by a decrease in expenses of approximately \$4.6 million after the sale of our property in Hampton, Virginia. This net decrease of approximately \$0.3 million was offset by a net increase in hotel operating expenses of approximately \$0.7 million for the period at all of our other properties.

Rooms expense at our properties for the year ended December 31, 2017 decreased approximately \$1.6 million, or 5.7%, to approximately \$26.7 million compared to rooms expense of approximately \$28.3 million for the year ended December 31, 2016. After a \$0.6 million reclassification reduced rooms expenses and increased indirect costs during the year ended December 31, 2016, the remaining decrease in rooms expense, resulted mainly from a decrease in expenses of approximately \$1.3 million following the sale of our property in Hampton, Virginia. In addition, rooms expenses decreased by approximately \$0.9 million in the aggregate at our properties in Wilmington, North Carolina; Savannah, Georgia; Raleigh, North Carolina; Philadelphia, Pennsylvania; Hollywood Beach, Florida; Jeffersonville, Indiana and Tampa, Florida, which were offset by increases at our properties in Laurel, Maryland; Jacksonville, Florida; Houston, Texas and Atlanta, Georgia by approximately \$0.6 million in the aggregate.

Food and beverage expenses at our properties for the year ended December 31, 2017 increased approximately \$0.2 million, or 0.9%, to approximately \$24.6 million compared to food and beverage expense of approximately \$24.4 million for the year ended December 31, 2016. The increase in food and beverage expenses for the year ended December 31, 2017 was substantially related to increases for food and beverage expenses of approximately \$1.7 million in the aggregate at our properties in Savannah, Georgia; Laurel, Maryland; Jacksonville, Florida; Hollywood Beach, Florida and Houston, Texas, offset by a decrease in expenses of approximately \$1.1 million following the sale of our property in Hampton, Virginia along with decreases of approximately \$0.4 million in the aggregate at our remaining properties.

Expenses from other operating departments increased approximately \$2.0 million, or 80.6%, to approximately \$4.4 million for the year ended December 31, 2017 compared to expenses from other operating departments of approximately \$2.4 million for the year ended December 31, 2016. The increase in expense from other operating departments for the year ended December 31, 2017 resulted mainly from the acquired interest and new operations in Hollywood Beach, Florida, accounting for an increase of approximately \$2.5 million for the period, offset by a net decrease of approximately \$0.5 million at our other properties.

Indirect expenses at our properties for the year ended December 31, 2017 decreased approximately \$0.1 million, or 0.2%, to approximately \$57.6 million compared to indirect expenses of approximately \$57.7 million for the year ended December 31, 2016. Sales and marketing costs, franchise fees, utilities, repairs and maintenance, insurance, management fees, real and personal property taxes as well as general and administrative costs at the property level are included in indirect expenses. After a \$0.6 million reclassification reduced rooms expenses and increased indirect costs during the year ended December 31, 2016, most of the increase in indirect expenses related to expenses that increase proportionally with increases in occupancy and/or revenue, including management fees and franchise fees. Specifically, increases in indirect expenses were substantially related to our acquisition of the Hyde Resort in Hollywood Beach, Florida, accounting for an increase of approximately \$1.8 million for the period, compared to the year ended December 31, 2016. Additionally, there were increases in indirect expenses at our properties in Wilmington, North Carolina, Savannah, Georgia; Raleigh, North Carolina; Laurel, Maryland; Jacksonville, Florida; Tampa, Florida; Houston, Texas and Atlanta, Georgia of approximately \$1.9 million in the aggregate. These increases were offset by a decrease in expenses of approximately \$2.3 million following the sale of our property in Hampton, Virginia and by decreases of indirect expenses at our properties in Philadelphia, Pennsylvania and Hollywood Beach, Florida, by approximately \$1.5 million in the aggregate.

Depreciation and Amortization. Depreciation and amortization for the year ended December 31, 2017 increased approximately \$2.0 million, or 13.2%, to approximately \$17.0 million compared to depreciation and amortization expense of approximately \$15.0 million for the year ended December 31, 2016. The increase was mostly attributable to increases in depreciation and amortization related to our renovated properties in Wilmington, North Carolina; Savannah, Georgia and Hollywood Beach, Florida in the amount of \$2.2 million in the aggregate, and from our acquisition of the Hyde Resort property for approximately \$0.1 million along with increases at all the remaining properties by approximately \$0.1 million in the aggregate, offset by the reduction from our sold property in Hampton, Virginia by approximately \$0.4 million.

Gain / Loss on Disposal of Assets. During the year ended December 31, 2017, we recorded a net loss on disposal of assets of approximately \$1.5 million, compared to a net loss on disposal of assets of approximately \$0.4 million for the year ended December

31, 2016. The approximate \$1.1 million increase in net loss on disposal of assets resulted mainly from the renovated properties in Savannah, Georgia and Hollywood Beach, Florida. These hotels were also impacted by Hurricane Irma and realized a loss on disposal of assets of approximately \$1.4 million in the aggregate. These loss increases were offset by a gain on disposal of our Hampton, Virginia property by approximately \$0.1 million and a one-time gain of approximately \$0.1 million for defective materials.

Corporate General and Administrative. Corporate general and administrative expenses for the year ended December 31, 2017 increased approximately \$0.3 million, or 5.2%, to approximately \$6.3 million compared to corporate general and administrative expenses of approximately \$6.0 million for the year ended December 31, 2016. The increase in corporate general and administrative expenses was mainly due to an increase in aborted offering costs of approximately \$0.5 million, which was offset by reductions in accounting fees of approximately \$0.1 million and legal fees of approximately \$0.1 million.

Interest Expense. Interest expense for the year ended December 31, 2017 decreased approximately \$2.0 million, or 11.3%, to approximately \$15.7 million compared to approximately \$17.7 million of interest expense for the year ended December 31, 2016. The decrease in interest expense for the year ended December 31, 2017, was substantially related to the redemption of the 8% senior unsecured notes (the "8% Notes") in August of 2016 and the redemption of the 7% Notes in November of 2017, resulting in the aggregate reduction of approximately \$1.6 million. We also reduced our Hampton, Virginia and Houston, Texas loans by approximately \$9.0 million in the aggregate resulting in a reduction of interest by approximately \$0.4 million.

Loss on Early Debt Extinguishment. The loss on early debt extinguishment for the year ended December 31, 2017 decreased approximately \$0.2 million, or 16.9%, to approximately \$1.2 million compared to a loss on debt extinguishment of approximately \$1.4 million for the year ended December 31, 2016. During the year ended December 31, 2017, we redeemed our 7% Notes which reflect the majority of the loss on early debt extinguishment of approximately \$1.0 million.

Unrealized Loss on Hedging Activities. During August 2015, we purchased an interest rate cap for \$179,800. As of December 31, 2017, the fair market value of the interest rate cap is \$5,213 compared to the fair market value of \$33,597, as of December 31, 2016. The unrealized loss on hedging activities during the year ended December 31, 2017 and 2016, was \$28,384 and \$37,384, respectively.

Gain on Involuntary Conversion of Assets. Gain on involuntary conversion of assets for the year ended December 31, 2017 increased approximately \$2.2 million to approximately \$2.2 million compared to gain on involuntary conversion of assets of \$0 for the year ended December 31, 2016. During October 2016, Hurricane Matthew damaged real and personal property at our Hampton, Virginia and Savannah, Georgia properties, and we had a one-time involuntary conversion in the amount of approximately \$1.0 million. In September 2017, Hurricane Irma damaged real and personal property at our properties in Jacksonville, Florida and Tampa, Florida, resulting in a one-time involuntary conversion in the amount of approximately \$0.4 million. We experienced electrical damage to The Whitehall property that resulted in a one-time involuntary conversion in the amount of approximately \$0.8 million.

Income Tax (Provision) Benefit. The income tax provision for the year ended December 31, 2017 increased approximately \$3.1 million, or 227.1%, to approximately \$1.7 million compared to an income tax benefit of approximately \$1.4 million for the year ended December 31, 2016. The income tax provision was primarily derived from the operations of our TRS Lessees. Our TRS Lessees realized a lower operating loss for the year ended December 31, 2017 compared to the year ended December 31, 2016, resulting in a lower income tax benefit. However, there was a one-time charge of approximately \$2.7 million resulting from a change in the federal income tax rate, due to the TCJA. At December 31, 2017, deferred tax assets total approximately \$5.5 million, of which approximately \$4.9 million relate to net operating losses of our TRS Lessee. At December 31, 2017, we determined, based on all available positive and negative evidence, that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward. We will continue to regularly evaluate the likelihood that we will be able to realize our deferred tax assets and the need for a valuation allowance for the deferred tax assets.

Net Income. Net income for the year ended December 31, 2017 decreased approximately \$0.9 million, or 96.7%, to approximately \$29.5 thousand compared to net income of approximately \$0.9 million for the year ended December 31, 2016, as a result of the operating results discussed above.

Distributions to Preferred Stockholders. During the year ended December 31, 2017, we recorded distributions to preferred stockholders of approximately \$3.8 million, compared to approximately \$1.1 million distributions to preferred stockholders for the year ended December 31, 2016. As of December 31, 2017 and 2016, we accrued approximately \$1.4 million and \$0.8 million, respectively, as dividends on the preferred stock. These increases were due to the issuance of Series C Preferred Stock in October 2017.

Sources and Uses of Cash

The following narrative discusses our sources and uses of cash for the year ended December 31, 2018.

Operating Activities. Our principal source of cash to meet our operating requirements, including distributions to unit holders of the Operating Partnership and holders of our preferred and common stock, as well as debt service (excluding debt maturities), is the operations of our hotels. Cash flow provided by operating activities for the year ended December 31, 2018 was approximately \$26.2 million. We expect that cash on hand and the net cash provided by operations will be adequate to fund our operating requirements, monthly and quarterly scheduled payments of principal and interest (excluding any balloon payments due upon maturity of a debt) and the payment of dividends (distributions) to the stockholders of the Company (the unitholders of the Operating Partnership) in accordance with federal income tax laws which require us to make annual distributions, as “qualifying distributions,” to the Company’s stockholders of at least 90.0% of its REIT taxable income (determined without regard to the dividends-paid deduction and by excluding its net capital gains, and reduced by certain non-cash items).

Investing Activities. During the year ended December 31, 2018, we used approximately \$79.7 million to acquire the Hyatt Centric Arlington, \$22.1 million on capital expenditures, of which, approximately \$5.7 million related to the routine replacement of furniture, fixtures and equipment and \$11.5 million relating primarily to the renovations of our hotels in Wilmington, North Carolina, Hollywood, Florida and Tampa, Florida and, in addition, we acquired a parcel of land, which had previously been leased, and that constituted most of our available parking lot at our property in Raleigh, North Carolina for approximately \$3.5 million. During the year we received approximately \$0.9 million of insurance proceeds as involuntary conversions of assets, primarily at our Houston, Texas and Hollywood, Florida properties. The Operating Partnership received approximately \$0.2 million in ESOP loan payments.

Financing Activities. Cash flow provided by financing activities of the Company for the year ended December 31, 2018 was approximately \$79.2 million for the Company and approximately \$78.9 million for the Operating Partnership. This inflow principally consisted of mortgage proceeds of \$175.8 million, proceeds from unsecured debt of \$25.0 million and proceeds from the sale of common and preferred stock of approximately \$1.6 million, offset by mortgage loan payments of approximately \$107.2 million, dividend and distribution payments of approximately \$12.1 for the Company and approximately \$12.4 million for the Operating Partnership and payments of deferred financing costs of approximately \$3.8 million.

On February 12, 2018, the Company and the Operating Partnership closed on a sale and issuance by the Operating Partnership of an aggregate \$25.0 million of the 7.25% Notes, unconditionally guaranteed by the Company, for net proceeds after all estimated expenses of approximately \$23.3 million. The Operating Partnership used the net proceeds from this offering, together with existing cash on hand and \$57.0 million of asset-level mortgage indebtedness, to finance the acquisition of the Hyatt Centric Arlington and for working capital.

On March 1, 2018, we entered into a loan agreement, a first and second promissory note (“Note A” and “Note B”, respectively), and other loan documents, including a guarantee by the Operating Partnership, to secure an aggregate \$57.0 million mortgage (the “Mortgage Loan”) on the Hyatt Centric Arlington hotel with Fifth Third Bank. Pursuant to the Mortgage Loan documents, Note A was in the amount of \$50.0 million; had a term of 3 years, with two 1-year extension options, each of which subject to certain criteria; bore a floating interest rate of 1-month LIBOR plus 3.00%; and amortized on a 25-year schedule. Pursuant to the Mortgage Loan documents, Note B was in the amount of \$7.0 million; had a term of 1-year, with two 1-year extension options, each of which subject to certain criteria; bore a floating interest rate of 3-month LIBOR plus 5.00%; and required monthly principal payments of \$100,000 during the initial 1-year term, \$150,000 during the first 1-year extended term, and \$250,000 during the second 1-year extended term, with interest payments due monthly on the outstanding principal amount during all three terms.

On July 27, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the DoubleTree by Hilton Raleigh Brownstone-University with MetLife Commercial Mortgage Originator, LLC. The mortgage has an initial principal balance of \$18.3 million, with an additional \$5.2 million available upon the satisfaction of certain conditions. The mortgage has an initial term of 4 years with a 1-year extension and bears a floating rate of interest equal to the 1-month LIBOR rate plus 4.00%. The mortgage requires monthly interest-only payments and, following a 12-month lockout, can be prepaid with a penalty during its second year and without penalty thereafter. We entered into an interest-rate cap agreement to limit our exposure through August 1, 2022 to increases in LIBOR exceeding 3.25% on a notional amount of \$23.5 million. We used a portion of the proceeds to repay the existing first mortgage on the DoubleTree by Hilton Raleigh Brownstone-University, to pay closing costs and intend to use the balance of the proceeds for general corporate purposes.

On July 31, 2018, we entered into a second amendment to the loan and security agreement; an amended, restated and consolidated mortgage loan note; and other related documents with its existing lender, TD Bank, N.A., to amend the terms of our mortgage loan on the DoubleTree by Hilton Philadelphia Airport. Concurrent with the loan modification, we also entered into a 5-year swap agreement with The Toronto-Dominion Bank. Pursuant to the amended loan documents: (i) the principal balance of the loan was increased from approximately \$30.0 million to \$42.2 million; (ii) the loan’s maturity date was extended to July 31, 2023; (iii)

the loan bears a floating interest rate equal to the 1-month LIBOR rate plus 2.27% (the “Loan Rate”); (iv) the loan amortizes on a 30-year schedule with payments of principal and interest beginning immediately; (v) the loan can be prepaid without penalty; and (vi) the loan will no longer be fully guaranteed by the Operating Partnership, but the Operating Partnership has guaranteed certain standard “bad boy” carveouts. Pursuant to the swap agreement: (i) the Loan Rate has been swapped for a fixed interest rate of 5.237%; notional amounts of the swap approximate the declining balance of the loan; and (iii) we are responsible for any potential termination fees associated with early termination of the swap agreement. We used a portion of the proceeds to repay in full the existing Note B to the mortgage loan on our Hyatt Centric Arlington and to pay closing costs associated with the amendment and used the balance of the proceeds for general corporate purposes.

On August 31, 2018, we entered into a Sales Agency Agreement, with Sandler O’Neill & Partners, L.P. (“Sandler O’Neill”), under which the Company may sell from time to time through Sandler O’Neill, as sales agent, shares of the Company’s common stock, par value \$0.01 per share, having an aggregate gross sales price of up to \$5.0 million and up to 400,000 shares of the Company’s 7.875% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share. Through December 31, 2018, the Company sold 88,297 shares of common stock and 52,141 shares of Series C Preferred Stock, for an aggregate net total of approximately \$1.8 million. We used the proceeds for issuance costs and general corporate purposes.

On September 18, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the Hyatt Centric Arlington with MetLife Real Estate Lending LLC. Pursuant to the loan documents, the Mortgage Loan has an initial principal balance of \$50.0 million; has a term of 10 years; bears a fixed interest rate of 5.25%; amortizes on a 30-year schedule; and following a 5-year lockout, can be prepaid with penalty in years 6-10 and without penalty during the final 4 months of the term. The Company used the proceeds to repay the existing first mortgage on the Hyatt Centric Arlington, to pay closing costs, and for general corporate purposes.

The following narrative discusses our sources and uses of cash for the year ended December 31, 2017.

Operating Activities. Our principal source of cash to meet our operating requirements, including distributions to unit holders of the Operating Partnership and holders of our preferred and common stock, as well as debt service (excluding debt maturities), is the operations of our hotels. Cash flow provided by operating activities for the year ended December 31, 2017 was approximately \$15.8 million. We expect that cash on hand and the net cash provided by operations will be adequate to fund our operating requirements, monthly and quarterly scheduled payments of principal and interest (excluding any balloon payments due upon maturity of a debt) and the payment of dividends (distributions) to the stockholders of the Company (the unitholders of the Operating Partnership) in accordance with federal income tax laws which require us to make annual distributions, as “qualifying distributions,” to the Company’s stockholders of at least 90.0% of its REIT taxable income (determined without regard to the dividends-paid deduction and by excluding its net capital gains, and reduced by certain non-cash items).

Investing Activities. During the year ended December 31, 2017, we used approximately \$4.0 million to acquire our interest in the Hyde Resort and Residences, \$23.2 million on capital expenditures, of which, approximately \$5.6 million related to the routine replacement of furniture, fixtures and equipment and \$17.6 million related to the renovation of our hotels in Wilmington, North Carolina, Savannah, Georgia and Hollywood Beach, Florida. The Operating Partnership made advances to the Company, net after periodic principal payments of approximately \$4.7 million. We also received approximately \$5.4 million from the sale of the Crowne Plaza Hampton Riverside and proceeds from insurance conversions of approximately \$2.3 million.

Financing Activities. Cash flow provided by financing activities of the Company for the year ended December 31, 2017 was approximately \$0.5 million for the Company and approximately \$5.2 million for the Operating Partnership. This inflow principally consisted of proceeds from mortgage loans of \$40.5 million and the sale of preferred stock of approximately \$30.5 million, offset by redemption of the 7% Notes for \$25.3 million, payments on mortgage loans of approximately \$26.0 million, repurchase of common stock for approximately \$3.7 million, dividend and distribution payments of approximately \$9.7 million, a loan by the Company to the ESOP of approximately \$4.9 million and payments of deferred financing costs of approximately \$0.8 million.

On June 29, 2017, we entered into a promissory note and other loan documents to secure a \$35.5 million mortgage on the DoubleTree by Hilton Jacksonville Riverfront with Wells Fargo Bank, N.A. Pursuant to the loan documents, the loan has a maturity date of July 11, 2024, bears a fixed interest rate of 4.88%, amortizes on a 30-year schedule, and is subject to a prepayment premium following a prepayment lockout period. The Company used a portion of the proceeds to repay the existing first mortgage on the DoubleTree by Hilton Jacksonville Riverfront, to pay closing costs and for general corporate purposes.

On October 11, 2017, the Company closed a sale and issuance of 1,200,000 shares of its Series C Preferred Stock, for net proceeds after expenses of approximately \$28.1 million. On October 17, 2017, the Company closed a sale and issuance of an additional 100,000 shares of its Series C Preferred Stock, for net proceeds of approximately \$2.5 million, pursuant to the underwriters’ partial exercise of an option granted by the Company to purchase additional shares. The Company contributed the net proceeds from

the offering to its Operating Partnership for an equivalent number of Series C Cumulative Redeemable Perpetual Preferred Units (the “Series C Preferred Units”). We used the net proceeds to redeem in full the Operating Partnership’s 7.0% Notes and for working capital.

On November 15, 2017, the Operating Partnership redeemed the entire \$25.3 million principal amount of its 7% Notes, at a redemption price equal to 101% of the principal amount of the 7% Notes, plus any accrued and unpaid interest to, but not including, the redemption date.

Capital Expenditures

We anticipate that our need for recurring capital expenditures for the replacement and refurbishment of furniture, fixtures and equipment over the next 12 to 24 months will be at historical norms for our properties and the industry. Historically, we have aimed to maintain overall capital expenditures, except for those required by our franchisors as a condition to a franchise license or license renewal, at 4.0% of gross revenue. In addition, during fiscal year 2019 we expect total renovation capital expenditures of approximately \$3.7 million related to our property in Tampa, Florida.

We expect capital expenditures for the recurring replacement or refurbishment of furniture, fixtures and equipment at our properties will be funded by our replacement reserve accounts, other than costs that we incur to make capital improvements required by our franchisors. Reserve accounts are escrowed accounts with funds deposited monthly and reserved for capital improvements or expenditures with respect to all of our hotels. We currently deposit an amount equal to 4.0% of gross revenue for The DeSoto, the Hotel Ballast Wilmington, Tapestry Collection by Hilton, the DoubleTree Resort by Hilton Hollywood Beach, The DoubleTree by Hilton Jacksonville Riverside, the DoubleTree by Hilton Raleigh Brownstone-University, The Whitehall and the Georgian Terrace as well as 4.0% of room revenues for the DoubleTree by Hilton Philadelphia Airport on a monthly basis.

Liquidity and Capital Resources

As of December 31, 2018, we had cash, cash equivalents and restricted cash of approximately \$37.9 million, of which approximately \$4.1 million was in restricted reserve accounts for capital improvements, real estate tax and insurance escrows. We expect that our cash on hand combined with our cash flow from our hotels should be adequate to fund continuing operations, recurring capital expenditures for the refurbishment and replacement of furniture, fixtures and equipment, and monthly scheduled payments of principal and interest (excluding any balloon payments due upon maturity of the indentures or mortgage debt).

We intend to continue to invest in hotel properties as suitable opportunities arise. The success of our acquisition strategy depends, in part, on our ability to access additional capital through other sources. There can be no assurance that we will continue to make investments in properties that meet our investment criteria. Additionally, we may choose to dispose of certain hotels as a means to provide liquidity.

We expect to meet our liquidity requirements for hotel property acquisitions, property redevelopment, investments in new joint ventures and debt maturities, and the retirement of maturing mortgage debt, through 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, the selective disposition of non-core assets, and cash on hand. We remain committed to a flexible capital structure and strive to maintain prudent debt leverage.

Other than monthly mortgage loan principal payments, our only mortgage debt obligation maturing in 2019 is the \$18.3 million mortgage on the Crowne Plaza Tampa Westshore, which may be extended for two additional 1-year periods subject to certain terms and conditions. We have approximately \$33.2 million in debt obligations maturing in 2021, which reflects the mortgage on the DoubleTree by Hilton Laurel, accounting for reductions for future monthly principal payments, and maturity of the 7.25% Notes.

On June 1, 2017, we entered into an agreement to purchase the commercial unit of the planned Hyde Beach House Resort & Residences, a condominium hotel under development in Hollywood, Florida, for a price of \$5.1 million from 4000 South Ocean Property Owner, LLLP. In connection with the agreement, we also entered into a pre-opening services agreement whereby the seller has agreed to pay the Company approximately \$0.8 million in connection with certain pre-opening activities to be undertaken prior to the closing. The Company has agreed to purchase inventories at closing consistent with the management and operation of the hotel and the related condominium association for an additional amount and has further agreed to enter into a lease agreement for the parking garage and poolside cabanas associated with the hotel; and to enter into a management agreement relating to the operation and management of the hotel’s condominium association. The Company anticipates that the closing of the transaction and the execution of related agreements will take place by the end of 2019, once construction of the hotel has been substantially completed. The closing of the transaction is subject to various closing conditions as described in the purchase agreement.

On February 12, 2018, the Company and the Operating Partnership closed on a sale and issuance by the Operating Partnership of an aggregate \$25.0 million of the 7.25% Notes, unconditionally guaranteed by the Company, for net proceeds after all estimated expenses of approximately \$23.3 million. The Operating Partnership used the net proceeds from this offering, together with existing cash on hand and \$57.0 million of asset-level mortgage indebtedness, to finance the acquisition of the Hyatt Centric Arlington and for working capital.

On March 1, 2018, we acquired the 318-room Hyatt Centric Arlington hotel located in Arlington, Virginia for an aggregate purchase price of approximately \$79.7 million, including seller credits. On March 1, 2018, we entered into a loan agreement, a first and second promissory note (“Note A” and “Note B”, respectively), and other loan documents, including a guarantee by the Operating Partnership, to secure an aggregate \$57.0 million mortgage (the “Mortgage Loan”) on the Hyatt Centric Arlington hotel with Fifth Third Bank. Pursuant to the Mortgage Loan documents, Note A was in the amount of \$50.0 million; had a term of 3 years, with two 1-year extension options, each of which subject to certain criteria; bore a floating interest rate of 1-month LIBOR plus 3.00%; and amortized on a 25-year schedule. Pursuant to the Mortgage Loan documents, Note B was in the amount of \$7.0 million; had a term of 1-year, with two 1-year extension options, each of which subject to certain criteria; bore a floating interest rate of 3-month LIBOR plus 5.00%; and required monthly principal payments of \$100,000 during the initial 1-year term, \$150,000 during the first 1-year extended term, and \$250,000 during the second 1-year extended term, with interest payments due monthly on the outstanding principal amount during all three terms. The full amount of the loan proceeds, together with proceeds of the 7.25% Notes offering and cash on hand, were used to finance the acquisition of the Hyatt Centric Arlington.

On July 27, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the DoubleTree by Hilton Raleigh Brownstone-University with MetLife Commercial Mortgage Originator, LLC. The mortgage has an initial principal balance of \$18.3 million, with an additional \$5.2 million available upon the satisfaction of certain conditions. The mortgage has an initial term of 4 years with a 1-year extension and bears a floating rate of interest equal to the 1-month LIBOR rate plus 4.00%. The mortgage requires monthly interest-only payments and, following a 12-month lockout, can be prepaid with a penalty during its second year and without penalty thereafter. We entered into an interest-rate cap agreement to limit our exposure through August 1, 2022 to increases in LIBOR exceeding 3.25% on a notional amount of \$23.5 million. We used a portion of the proceeds to repay the existing first mortgage on the DoubleTree by Hilton Raleigh Brownstone-University, to pay closing costs and intend to use the balance of the proceeds for general corporate purposes.

On July 31, 2018, we entered into a second amendment to the loan and security agreement; an amended, restated and consolidated mortgage loan note; and other related documents with its existing lender, TD Bank, N.A., to amend the terms of our mortgage loan on the DoubleTree by Hilton Philadelphia Airport. Concurrent with the loan modification, we also entered into a 5-year swap agreement with The Toronto-Dominion Bank. Pursuant to the amended loan documents: (i) the principal balance of the loan was increased from approximately \$30.0 million to \$42.2 million; (ii) the loan’s maturity date was extended to July 31, 2023; (iii) the loan bears a floating interest rate equal to the 1-month LIBOR rate plus 2.27% (the “Loan Rate”); (iv) the loan amortizes on a 30-year schedule with payments of principal and interest beginning immediately; (v) the loan can be prepaid without penalty; and (vi) the loan will no longer be fully guaranteed by the Operating Partnership, but the Operating Partnership has guaranteed certain standard “bad boy” carveouts. Pursuant to the swap agreement: (i) the Loan Rate has been swapped for a fixed interest rate of 5.237%; notional amounts of the swap approximate the declining balance of the loan; and (iii) we are responsible for any potential termination fees associated with early termination of the swap agreement. We used a portion of the proceeds to repay in full the existing Note B to the mortgage loan on our Hyatt Centric Arlington and to pay closing costs associated with the amendment and will use the balance of the proceeds for general corporate purposes.

On August 31, 2018, we entered into a Sales Agency Agreement, with Sandler O’Neill & Partners, L.P. (“Sandler O’Neill”), under which the Company may sell from time to time through Sandler O’Neill, as sales agent, shares of the Company’s common stock, par value \$0.01 per share, having an aggregate gross sales price of up to \$5.0 million and up to 400,000 shares of the Company’s 7.875% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share. Through December 31, 2018, the Company sold 88,297 shares of common stock and 52,141 shares of Series C Preferred Stock, for an aggregate net total of approximately \$1.8 million. We used the proceeds to pay issuance costs and for general corporate purposes.

On September 18, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the Hyatt Centric Arlington with MetLife Real Estate Lending LLC. Pursuant to the loan documents, the Mortgage Loan has an initial principal balance of \$50.0 million; has a term of 10 years; bears a fixed interest rate of 5.25%; amortizes on a 30-year schedule; and following a 5-year lockout, can be prepaid with penalty in years 6-10 and without penalty during the final 4 months of the term. The Company used the proceeds to repay the existing first mortgage on the Hyatt Centric Arlington, to pay closing costs, and for general corporate purposes.

On December 12, 2018, the Company’s Board of Directors authorized the extension of the Company’s stock repurchase program, under which the Company may purchase up to \$10.0 million of its outstanding common stock, par value \$0.01 per share, at prevailing prices on the open market or in privately negotiated transactions, at the discretion of management. The Company’s stock

repurchase program was originally announced in December 2016 and was extended on the same terms. The Company expects to use available working capital to fund purchases under the stock repurchase program and intends to complete the repurchase program prior to December 31, 2019, unless extended by the Board of Directors. For the years ended December 31, 2018, 2017 and 2016, the Company repurchased zero, 401,720 and 481,100 shares of common stock, respectively, for approximately \$0.0 million, \$2.7 million and \$3.2 million, respectively. The repurchased shares have been returned to the status of authorized but unissued shares of common stock.

Financial Covenants

Mortgage Loans

Our mortgage loan agreements contain various financial covenants. Failure to comply with these financial covenants could result from, among other things, changes in the local competitive environment, general economic conditions and disruption caused by renovation activity or major weather disturbances.

If we violate the financial covenants contained in these agreements, we may attempt to negotiate waivers of the violations or amend the terms of the applicable mortgage loan agreement with the lender; however, we can make no assurance that we would be successful in any such negotiation or that, if successful in obtaining waivers or amendments, such waivers or amendments would be on attractive terms. Some mortgage loan agreements provide alternate cure provisions which may allow us to otherwise comply with the financial covenants by obtaining an appraisal of the hotel, prepaying a portion of the outstanding indebtedness or by providing cash collateral until such time as the financial covenants are met by the collateralized property without consideration of the cash collateral. Alternate cure provisions which include prepaying a portion of the outstanding indebtedness or providing cash collateral may have a material impact on our liquidity.

If we are unable to negotiate a waiver or amendment or satisfy alternate cure provisions, if any, or unable to meet any alternate cure requirements and a default were to occur, we would possibly have to refinance the debt through additional debt financing, private or public offerings of debt securities, or additional equity financing.

Under the terms of our non-recourse secured mortgage loan agreements, failure to comply with the financial covenants in the loan agreement triggers cash flows from the property to be directed to the lender, which may limit our overall liquidity as that cash flow would not be available to us.

At December 31, 2018, we were in compliance with all debt covenants, current on all loan payments and not otherwise in default under any of our mortgage loans, with the exception of the mortgage on Crowne Plaza Tampa Westshore. At December 31, 2018, we failed to meet the Debt Service Coverage Ratio ("DSCR") covenant under the mortgage on Crowne Plaza Tampa Westshore. We are currently in discussions with the existing lender to modify or refinance the mortgage on similar terms, with an extension of the maturity date and a reduced DSCR requirement. Notwithstanding the modification discussions, the existing loan agreement contains a balancing provision that allows us to either pay down the principal balance of the loan or offer cash collateral sufficient to meet the DSCR requirement. We anticipate that a payment to the lender of approximately \$1.9 million would be required to bring us into compliance under the DSCR requirement pursuant to that balancing provision of the loan agreement.

Unsecured Notes

The indenture for the 7.25% Notes, issued on February 12, 2018, contains certain covenants and restrictions that require us to meet certain financial ratios. We are not permitted to incur any Debt (other than Intercompany Debt), each as defined in the indenture, if, immediately after giving effect to the incurrence of such Debt and to the application of the proceeds thereof, the ratio of the aggregate principal amount of all outstanding Debt to Adjusted Total Asset Value, as defined in the indenture, would be greater than 0.65 to 1.0. In addition, we are not permitted to incur any Debt if the ratio of Stabilized Consolidated Income Available for Debt Service to Stabilized Consolidated Interest Expense, each as defined in the indenture, on the date on which such additional Debt is to be incurred, on a pro-forma basis, after giving effect to the incurrence of such Debt and to the application of the proceeds thereof, would be less than 1.50 to 1.0.

These financial measures are not calculated in accordance with GAAP and are presented below for the sole purpose of evaluating our compliance with the key financial covenants of our 7.25% Notes as they were or would have been applicable at December 31, 2018 and 2017.

	December 31, 2018	December 31, 2017
Ratio of Stabilized Consolidated Income Available for Debt Service to Stabilized Consolidated Interest Expense		
Net (Loss) Income ⁽¹⁾	\$ (608,157)	\$ 29,489
Interest expense ⁽¹⁾	19,953,746	15,727,628
Loss on early debt extinguishment	753,133	1,178,348
Unrealized (gain)loss on hedging activities	808,958	28,384
Gain on involuntary conversion	(917,767)	(2,242,876)
Loss (gain) on sale of assets	-	(76,233)
Income tax benefit ⁽¹⁾	469,349	1,737,804
Loss on disposal of assets	511,749	1,489,892
Depreciation and amortization ⁽¹⁾	20,884,643	16,999,619
Corporate general and administrative expenses ⁽¹⁾	6,180,962	6,335,926
Consolidated income available for debt service ⁽¹⁾	48,036,616	41,207,981
Less: income of non-stabilized assets ⁽¹⁾	(20,946,112)	(10,695,682)
Stabilized Consolidated Income Available for Debt Service ⁽¹⁾	\$ 27,090,504	\$ 30,512,299
Interest expense ^{(1) (2)}	\$ 19,953,746	\$ 15,980,616
Amortization of issuance costs ⁽¹⁾	(872,696)	(751,728)
Consolidated interest expense ⁽¹⁾	19,081,050	15,228,888
Less: interest expense of non-stabilized assets ⁽¹⁾	(8,138,649)	(4,954,635)
Stabilized Consolidated Interest Expense ⁽¹⁾	\$ 10,942,401	\$ 10,274,253
Ratio of Stabilized Consolidated Income Available for Debt Service to Stabilized Consolidated Interest Expense		
	2.48	2.97
Threshold Ratio Minimum	1.50	1.50
Ratio of Debt to Adjusted Total Asset Value:		
Mortgage loans	\$ 367,613,880	\$ 299,051,772
Unsecured notes	25,000,000	-
Total debt	\$ 392,613,880	\$ 299,051,772
Stabilized Consolidated Income Available for Debt Service ⁽¹⁾	\$ 27,090,504	\$ 30,512,299
Capitalization rate	7.5%	7.5%
	361,206,726	406,830,653
Non-stabilized assets	287,500,000	172,000,000
Total cash	37,868,281	33,429,042
Adjusted Total Asset Value	\$ 686,575,007	\$ 612,259,695
Ratio of Debt to Adjusted Total Asset Value	0.57	0.49
Threshold Ratio Maximum	0.65	0.65

(1) Represents the four preceding calendar quarters.

(2) As permitted by the indenture, The DeSoto, the Hotel Ballast Wilmington, Tapestry Collection by Hilton, the DoubleTree Resort Hollywood Beach and the Hyatt Centric Arlington hotels, for the period ended December 31, 2018, and The DeSoto, the DoubleTree Resort Hollywood Beach and The Whitehall hotels for the period ended December 31, 2017, are considered non-stabilized assets for purposes of the financial covenants.

Mortgage Debt

As of December 31, 2018, we had a principal mortgage debt balance of approximately \$367.6 million. The following table sets forth our mortgage debt obligations on our hotels.

Property	December 31, 2018	Prepayment Penalties	Maturity Date	Amortization Provisions	Interest Rate
Crowne Plaza Tampa Westshore ⁽¹⁾	\$ 18,307,000	None	6/30/2019	⁽¹⁾	LIBOR plus 3.75 %
The DeSoto ⁽²⁾	33,824,350	Yes	7/1/2026	25 years	4.25%
DoubleTree by Hilton Jacksonville Riverfront ⁽³⁾	34,773,546	Yes	7/11/2024	30 years	4.88%
DoubleTree by Hilton Laurel ⁽⁴⁾	8,845,299	Yes	8/5/2021	25 years	5.25%
DoubleTree by Hilton Philadelphia Airport ⁽⁵⁾	42,026,986	None	7/31/2023	30 years	LIBOR plus 2.27 %
DoubleTree by Hilton Raleigh- Brownstone University ⁽⁶⁾	18,300,000	Yes	7/27/2022	⁽⁶⁾	LIBOR plus 4.00 %
DoubleTree Resort by Hilton Hollywood Beach ⁽⁷⁾	57,064,824	n/a	10/1/2025	30 years	4.913%
Georgian Terrace ⁽⁸⁾	44,202,968	n/a	6/1/2025	30 years	4.42%
Hotel Ballast Wilmington, Tapestry Collection by Hilton ⁽⁹⁾	34,236,104	Yes	1/1/2027	25 years	4.25%
Hyatt Centric Arlington ⁽¹⁰⁾	49,885,045	Yes	9/18/2028	30 years	5.25%
Sheraton Louisville Riverside ⁽¹¹⁾	11,414,300	Yes	12/1/2026	25 years	4.27%
The Whitehall ⁽¹²⁾	14,733,458	Yes	2/26/2023	25 years	LIBOR plus 3.50 %
Total Mortgage Principal Balance	367,613,880				
Deferred financing costs, net	(2,951,327)				
Unamortized premium on loan	166,292				
Total Mortgage Loans	\$ 364,828,845				

- (1) The note bears a floating interest rate of 1-month LIBOR plus 3.75% subject to a floor rate of 3.75%; with monthly principal payments of \$23,100; the note provides that the mortgage can be extended for two additional periods of one year each, subject to certain conditions.
- (2) The note amortizes on a 25-year schedule after an initial 1-year interest-only period (which expired in August 2017), and is subject to a pre-payment penalty except for any pre-payments made within 120 days of the maturity date.
- (3) The note may not be prepaid until August 2019, after which it is subject to a pre-payment penalty until March 2024. Prepayment can be made without penalty thereafter.
- (4) The note is subject to a pre-payment penalty until April 2021. Prepayment can be made without penalty thereafter.
- (5) The note bears a floating interest rate of 1-month LIBOR plus 2.27%, and we entered into a swap agreement to fix the rate at 5.237%. Under the swap agreement, notional amounts approximate the declining balance of the loan and we are responsible for any potential termination fees associated with early termination of the swap agreement.

- (6) The note provides initial proceeds of \$18.3 million, with an additional \$5.2 million available upon the satisfaction of certain conditions; has an initial term of 4 years with a 1-year extension; bears a floating interest rate of the 1-month LIBOR plus 4.00%; requires interest only monthly payments; and following a 12-month lockout, can be prepaid with penalty in year 2 and without penalty thereafter. We entered into an interest-rate cap agreement to limit our exposure through August 1, 2022 to increases in LIBOR exceeding 3.25% on a notional amount of \$23,500,000.
- (7) With limited exception, the note may not be prepaid until June 2025.
- (8) With limited exception, the note may not be prepaid until February 2025.
- (9) The note amortizes on a 25-year schedule after an initial 1-year interest-only period, and is subject to a pre-payment penalty except for any pre-payments made within 120 days of the maturity date.
- (10) Following a 5-year lockout, the note can be prepaid with penalty in years 6-10 and without penalty during the final 4 months of the term.
- (11) The note bears a fixed interest rate of 4.27% for the first 5 years of the loan, with an option for the lender to reset the interest rate after 5 years.
- (12) The note bears a floating interest rate of the 1-month LIBOR plus 3.5%, subject to a floor rate of 4.0% and is subject to prepayment penalties subject to a declining scale from 3.0% penalty on or before the first anniversary date, a 2.0% penalty during the second anniversary year and a 1.0% penalty after the third anniversary date.

Contractual Obligations

The following table outlines our contractual obligations as of December 31, 2018, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands).

Contractual Obligations	Payments due by period (in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Mortgage loans, including interest	\$ 455,028	\$ 41,954	\$ 51,883	\$ 107,898	\$ 253,293
Ground, building, parking garage, office and equipment leases	5,466	475	719	703	3,569
Totals	<u>\$ 460,494</u>	<u>\$ 42,429</u>	<u>\$ 52,602</u>	<u>\$ 108,601</u>	<u>\$ 256,862</u>

In connection with the acquisition of our six initial hotel properties, we entered into tax indemnity agreements that required us to indemnify the contributors of our initial properties against tax liabilities in the event we sold any of those properties in a taxable transaction during a 10-year period. The tax indemnity agreements expired on or about December 22, 2014. Our obligations under the contribution agreements may effectively preclude us from reducing our consolidated indebtedness below approximately \$11.0 million.

Distributions to Stockholders and Holders of Units in the Operating Partnership. The Company has elected to be taxed as a REIT commencing with our taxable year ending December 31, 2004. To maintain qualification as a REIT, the Company is required to make annual distributions to its stockholders of at least 90.0% of our REIT taxable income, (excluding net capital gain, which does not necessarily equal net income as calculated in accordance with generally accepted accounting principles). The Company's ability to pay distributions to its stockholders will depend, in part, upon its receipt of distributions from the Operating Partnership which may depend upon receipt of lease payments with respect to our properties from our TRS Lessees, and in turn, upon the management of our properties by our hotel manager. Distributions to the Company's stockholders will generally be taxable to the Company's stockholders as ordinary income; however, because a portion of our investments will be equity ownership interests in hotels, which will result in depreciation and non-cash charges against our income, a portion of our distributions may constitute a non-taxable return of capital. To the extent not inconsistent with maintaining the Company's REIT status, our TRS Lessees may retain any after-tax earnings.

Distributions to Preferred Stockholders and Holder of Preferred partnership units in the Operating Partnership. The Company is obligated to pay distributions to its holders of the Company's preferred stock and the Operating Partnership is obligated to pay its preferred unit holder, the Company. Holders of the Company's Series B Preferred Stock and Series C Preferred Stock are entitled to receive distributions when authorized by the Company's board of directors out of assets legally available for the payment of distributions. The amount of annual dividends on our outstanding preferred shares is approximately \$5.8 million and the aggregate liquidation preference with respect to our outstanding preferred shares is approximately \$74.1 million. The preferred stock is not redeemable by the holders, has no maturity date and is not convertible into any other security of the Company or its affiliates, except in the event of a change of control.

The Company's ability to pay distributions to its stockholders will depend, in part, upon its receipt of distributions from the Operating Partnership which may depend upon receipt of lease payments with respect to our properties from our TRS Lessees, and in turn, upon the management of our properties by our hotel managers. Distributions to the Company's stockholders will generally be taxable to the Company's stockholders as ordinary income; however, because a portion of our investments will be equity ownership interests in hotels, which will result in depreciation and non-cash charges against our income, a portion of our distributions may constitute a non-taxable return of capital. To the extent not inconsistent with maintaining the Company's REIT status, our TRS Lessees may retain any after-tax earnings.

The amount, timing and frequency of distributions will be authorized by the Company's board of directors and declared by the Company based upon a variety of factors deemed relevant by its directors, and no assurance can be given that the distribution policy will not change in the future.

Inflation

We generate revenues primarily from lease payments from our TRS Lessees and net income from the operations of our TRS Lessees. Therefore, we rely primarily on the performance of the individual properties and the ability of the management company to increase revenues and to keep pace with inflation. Operators of hotels, in general, possess the ability to adjust room rates daily to keep pace with inflation. However, competitive pressures at some or all of our hotels may limit the ability of the management company to raise room rates.

Our expenses, including hotel operating expenses, administrative expenses, real estate taxes and property and casualty insurance are subject to inflation. These expenses are expected to grow with the general rate of inflation, except for energy, liability insurance, property and casualty insurance, property tax rates, employee benefits, and some wages, which are expected to increase at rates higher than inflation.

Geographic Concentration and Seasonality

Our hotels are located in Florida, Georgia, Indiana, Maryland, North Carolina, Pennsylvania, Texas and Virginia. As a result, we are particularly susceptible to adverse market conditions in these geographic areas, including industry downturns, relocation of businesses and any oversupply of hotel rooms or a reduction in lodging demand. Adverse economic developments in the markets in which we have a concentration of hotels, or in any of the other markets in which we operate, or any increase in hotel supply or decrease in lodging demand resulting from the local, regional or national business climate, could materially and adversely affect us.

The operations of our hotel properties have historically been seasonal. The months of April and May are traditionally strong, as is October. The periods from mid-November through mid-February are traditionally slow with the exception of hotels located in certain markets, namely Florida and Texas, which experience significant room demand during this period.

Competition

The hotel industry is highly competitive with various participants competing on the basis of price, level of service and geographic location. Each of our hotels is located in a developed area that includes other hotel properties. The number of competitive hotel properties in a particular area could have a material adverse effect on occupancy, ADR and RevPAR of our hotels or at hotel properties acquired in the future. We believe that brand recognition, location, the quality of the hotel, consistency of services provided, and price, are the principal competitive factors affecting our hotels.

Critical Accounting Policies

The critical accounting policies are described below. We consider these policies critical because they involve difficult management judgments and assumptions, are subject to material change from external factors or are pervasive and are significant to fully understand and evaluate our reported financial results.

Investment in Hotel Properties. Hotel properties are stated at cost, net of any impairment charges, and are depreciated using the straight-line method over an estimated useful life of 7-39 years for buildings and improvements and 3-10 years for furniture and equipment. In accordance with generally accepted accounting principles, the controlling interests in hotels comprising our accounting predecessor, MHI Hotels Services Group, and noncontrolling interests held by the controlling holders of our accounting predecessor in hotels, which were acquired from third parties contributed to us in connection with the Company's initial public offering, are recorded at historical cost basis. Noncontrolling interests in those entities that comprise our accounting predecessor and the interests in hotels, other than those held by the controlling members of our accounting predecessor, acquired from third parties are recorded at fair value at the time of acquisition.

We review our hotel properties for impairment whenever events or changes in circumstances indicate the carrying value of the hotel properties may not be recoverable. Events or circumstances that may cause us to perform our review include, but are not limited to, adverse permanent changes in the demand for lodging at our properties due to declining national or local economic conditions and/or new hotel construction in markets where our hotels are located. When such conditions exist, management performs a recoverability analysis to determine if the estimated undiscounted future cash flows from operating activities and the estimated proceeds from the ultimate disposition of a hotel property exceed its carrying value. If the estimated undiscounted future cash flows are found to be less than the carrying amount of the hotel property, an adjustment to reduce the carrying value to the related hotel property's estimated fair market value would be recorded and an impairment loss recognized.

In performing the recoverability analysis, we project future operating cash flows based upon significant assumptions regarding growth rates, occupancy, room rates, economic trends, property-specific operating costs and future capital expenditures required to maintain the hotel in its current operating condition. We also project cash flows from the eventual disposition of the hotel based upon various factors including property-specific capitalization rates, ratio of selling price to gross hotel revenues and the selling price per room.

Revenue Recognition. Hotel revenues, including room, food, beverage and other hotel revenues, are recognized as the related services are delivered. We generally consider accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If we determine that amounts are uncollectible, which would generally be the result of a customer's bankruptcy or other economic downturn, such amounts will be charged against operations when that determination is made.

Income Taxes. We record a valuation allowance to reduce deferred tax assets to an amount that we believe is more likely than not to be realized. Because of expected future taxable income of our TRS Lessee, we have not recorded a valuation allowance to reduce our net deferred tax asset as of December 31, 2018. We regularly evaluate the likelihood that our TRS Lessee will be able to realize its deferred tax assets and the continuing need for a valuation allowance. At December 31, 2018, we determined, based on all available positive and negative evidence, that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward. A number of factors played a critical role in this determination, including:

- a demonstrated track record of past profitability and utilization of past NOL carryforwards,
- reasonable forecasts of future taxable income, and
- anticipated changes in the lease rental payments from the TRS Lessee to subsidiaries of the Operating Partnership.

Should unanticipated adverse financial trends occur, or other negative evidence develop, a valuation allowance may be necessary in the future against some or all of our deferred tax assets.

Recent Accounting Pronouncements

For a summary of recently adopted and newly issued accounting pronouncements, please refer to the *New Accounting Pronouncements* section of Note 2, *Summary of Significant Accounting Policies*, in the Notes to Consolidated Financial Statements.

Non-GAAP Financial Measures

We consider FFO Available to Common Stockholders and Unitholders, Adjusted FFO Available to Common Stockholders and Unitholders and Hotel EBITDA, all of which are non-GAAP financial measures, to be key supplemental measures of our performance and could be considered along with, not alternatives to, net income (loss) as a measure of our performance. These measures do not represent cash generated from operating activities determined by generally accepted accounting principles ("GAAP") or amounts available for our discretionary use and should not be considered alternative measures of net income, cash flows from operations or any other operating performance measure prescribed by GAAP.

FFO and Adjusted FFO. Industry analysts and investors use Funds from Operations ("FFO"), as a supplemental operating performance measure of an equity REIT. FFO is calculated in accordance with the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT"). FFO, as defined by NAREIT, represents net income or loss determined in accordance with GAAP, excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated operating real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after adjustment for any noncontrolling interest from unconsolidated partnerships and joint ventures. Historical cost accounting for real estate assets in accordance with GAAP 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, many investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by itself.

We consider FFO to be a useful measure of adjusted net income (loss) for reviewing comparative operating and financial performance because we believe FFO is most directly comparable to net income (loss), which remains the primary measure of performance, because by excluding gains or losses related to sales of previously depreciated operating real estate assets and excluding real estate asset depreciation and amortization, FFO assists in comparing the operating performance of a company's real estate between periods or as compared to different companies. Although FFO is intended to be a REIT industry standard, other companies may not calculate FFO Available to Common Stockholders and Unitholders in the same manner as we do, and investors should not assume that FFO Available to Common Stockholders and Unitholders as reported by us is comparable to FFO as reported by other REITs.

We further adjust FFO Available to Common Stockholders and Unitholders for certain additional items that are not in NAREIT's definition of FFO, including changes in deferred income taxes, any unrealized gain (loss) on hedging instruments or warrant derivative, loan impairment losses, losses on early extinguishment of debt, aborted offering costs, loan modification fees, franchise termination costs, costs associated with the departure of executive officers, litigation settlement, over-assessed real estate taxes on appeal, change in control gains or losses and acquisition transaction costs. We exclude these items as we believe it allows for meaningful comparisons between periods and among other REITs and is more indicative than FFO of the on-going performance of our business and assets. Our calculation of Adjusted FFO Available to Common Stockholders and Unitholders may be different from similar measures calculated by other REITs.

The following is a reconciliation of net income (loss) to FFO and Adjusted FFO for the years ended December 31, 2018, 2017, and 2016.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Net Loss Available to the Common Stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)
Add: Net Loss Attributable to the Noncontrolling Interest	(718,093)	(413,014)	(26,567)
Depreciation and Amortization	20,884,643	16,999,619	15,019,071
Loss on Sale or Disposal of Assets	511,749	1,413,659	365,319
Gain on Involuntary Conversion of Asset	(917,767)	(2,242,876)	—
FFO Available to Common Stockholders and Unitholders	\$ 14,040,554	\$ 12,418,252	\$ 15,139,650
Decrease (Increase) in Deferred Income Taxes	319,939	1,498,222	(1,558,966)
Loan Modification Fees	—	—	64,215
Unrealized Loss on Hedging Activities	808,958	28,384	37,384
Loss on Aborted Offering Costs	—	541,129	—
Loss on Early Debt Extinguishment	753,133	1,178,348	1,417,905
Adjusted FFO Available to Common Stockholders and Unitholders	<u>\$ 15,922,584</u>	<u>\$ 15,664,335</u>	<u>\$ 15,100,188</u>

Hotel EBITDA. We define Hotel EBITDA as net income or loss excluding: (1) interest expense, (2) interest income, (3) income tax provision or benefit, (4) equity in the income or loss of equity investees, (5) unrealized gains and losses on derivative instruments not included in other comprehensive income, (6) gains and losses on disposal of assets, (7) realized gains and losses on investments, (8) impairment of long-lived assets or investments, (9) loss on early debt extinguishment, (10) gains or losses on change in control, (11) corporate general and administrative expense, (12) depreciation and amortization, (13) gains and losses on involuntary conversions of assets (14) distributions to preferred stockholders and (15) other operating revenue not related to our wholly-owned portfolio. We believe this provides a more complete understanding of the operating results over which our wholly-owned hotels and its operators have direct control. We believe Hotel EBITDA provides investors with supplemental information on the on-going operational performance of our hotels and the effectiveness of third-party management companies operating our business on a property-level basis.

Our calculation of Hotel EBITDA may be different from similar measures calculated by other REITs.

The following is a reconciliation of net loss to Hotel EBITDA for the years ended December 31, 2018, 2017, and 2016.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Net Loss Available to Common Stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)
Add: Net Loss Attributable to the Noncontrolling Interest	(718,093)	(413,014)	(26,567)
Interest Expense	19,953,746	15,727,628	17,735,107
Interest Income	(352,951)	(218,656)	(115,785)
Distributions to Preferred Stockholders	5,829,914	3,781,639	1,144,889
Income Tax Provision (Benefit)	469,349	1,737,804	(1,367,634)
Depreciation and Amortization	20,884,643	16,999,619	15,019,071
Unrealized Loss on Hedging Activities	808,958	28,384	37,384
Loss on Debt Extinguishment	753,133	1,178,348	1,417,905
Loss on Sale or Disposal of Assets	511,749	1,413,659	365,319
Gain on Involuntary Conversion of Asset	(917,767)	(2,242,876)	—
Corporate General and Administrative Expenses	6,180,962	6,335,926	6,021,065
Hotel EBITDA	<u>\$47,683,665</u>	<u>\$40,989,325</u>	<u>\$40,012,581</u>

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The effects of potential changes in interest rates are discussed below. Our market risk discussion includes “forward-looking statements” and represents an estimate of possible changes in fair value or future earnings that could occur assuming hypothetical future movements in interest rates. These disclosures are not precise indicators of expected future losses, but only indicators of reasonably possible losses. As a result, actual future results may differ materially from those presented. The analysis below presents the sensitivity of the market value of our financial instruments to selected changes in market interest rates.

To meet in part our long-term liquidity requirements, we will borrow funds at a combination of fixed and variable rates. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. From time to time we may enter into interest rate hedge contracts such as collars and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We do not intend to hold or issue derivative contracts for trading or speculative purposes.

As of December 31, 2018, we had approximately \$341.3 million of fixed-rate debt, including the mortgage on our Philadelphia, Pennsylvania hotel, which is fixed by an interest rate swap to 5.237% and approximately \$51.3 million of variable-rate debt. The weighted-average interest rate on the fixed-rate debt was 4.96%. A change in market interest rates on the fixed portion of our debt would impact the fair value of the debt but have no impact on interest incurred or cash flows. Our variable-rate debt is exposed to changes in interest rates, specifically the changes in 1-month LIBOR. Assuming that the aggregate amount outstanding on the mortgages on the Crowne Plaza Tampa Westshore, DoubleTree by Hilton Raleigh Brownstone and the mortgage on The Whitehall remains at approximately \$51.3 million, the balance at December 31, 2018, the impact on our annual interest incurred and cash flows of a one percent increase in 1-month LIBOR would be approximately \$0.5 million.

As of December 31, 2017, we had approximately \$238.3 million of fixed-rate debt and approximately \$60.7 million of variable-rate debt. The weighted-average interest rate on the fixed-rate debt was 4.61%. A change in market interest rates on the fixed portion of our debt would impact the fair value of the debt but have no impact on interest incurred or cash flows. Our variable-rate debt is exposed to changes in interest rates, specifically the changes in 1-month LIBOR. However, to the extent that 1-month LIBOR does not exceed the 1-month LIBOR floor on the mortgage on the DoubleTree by Hilton Philadelphia Airport of 0.50%, a portion of our variable-rate debt would not be exposed to changes in interest rates. Assuming that the aggregate amount outstanding on the mortgages on the Crowne Plaza Tampa Westshore, DoubleTree by Hilton Philadelphia Airport and the mortgage on The Whitehall remains at approximately \$60.7 million, the balance at December 31, 2017, the impact on our annual interest incurred and cash flows of a one percent increase in 1-month LIBOR would be approximately \$0.6 million.

Item 8. Financial Statements and Supplementary Data

See Index to Financial Statements and Financial Statement Schedules on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Sotherly Hotels Inc.

Disclosure Controls and Procedures

The Company's management, under the supervision and participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act), as of December 31, 2018. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2018, its disclosure controls and procedures were effective and designed to ensure that (i) information required to be disclosed in its reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and instructions, and (ii) information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

The Company's management, including its Chief Executive Officer and Chief Financial Officer, does not expect that the Company's disclosure controls and procedures or its internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of the controls can provide absolute assurance that all control issues and instances of fraud, if any, within Sotherly Hotels Inc. have been detected.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(e) under the Exchange Act). The Company's management assessed the effectiveness over internal control over financial reporting as of December 31, 2018. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") 2013 *Internal Control-Integrated Framework*. The Company's management has concluded that, as of December 31, 2018, the Company's internal control over financial reporting is effective based on these criteria.

Dixon Hughes Goodman LLP, a registered independent public accounting firm, has audited our consolidated financial statements included in the Annual Report on Form 10-K and, as part of its audit, has issued its report on the effectiveness of our internal control over financial reporting.

Changes in Internal Control over Financial Reporting

There was no change in Sotherly Hotels Inc.'s internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during Sotherly Hotels Inc.'s last fiscal quarter that materially affected, or is reasonably likely to materially affect, Sotherly Hotels Inc.'s internal control over financial reporting.

Sotherly Hotels LP

Disclosure Controls and Procedures

The Operating Partnership's management, under the supervision and participation of the Chief Executive Officer and Chief Financial Officer of Sotherly Hotels Inc., as general partner, has evaluated the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act), as of December 31, 2018. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2018, the disclosure controls and procedures were effective and designed to ensure that (i) information required to be disclosed in the reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and instructions, and (ii) information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

The Operating Partnership's management, including the Chief Executive Officer and Chief Financial Officer of Sotherly Hotels Inc., as general partner, does not expect that the disclosure controls and procedures or the internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of the controls can provide absolute assurance that all control issues and instances of fraud, if any, within Sotherly Hotels LP have been detected.

Management's Report on Internal Control over Financial Reporting

The Operating Partnership's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(e) under the Exchange Act). Management assessed the effectiveness over internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 2013 *Internal Control-Integrated Framework*. Management has concluded that, as of December 31, 2018, the Operating Partnership's internal control over financial reporting is effective based on these criteria.

This annual report does not include an attestation report of the Operating Partnership's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Operating Partnership's independent registered public accounting firm pursuant to the exemption provided to issuers that are not "large accelerated filers" or "accelerated filers" under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Changes in Internal Control over Financial Reporting

There was no change in Sotherly Hotels LP's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during Sotherly Hotels LP's last fiscal quarter that materially affected, or is reasonably likely to materially affect, Sotherly Hotels LP's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

The information required by Items 10-14 is incorporated by reference to the Company's proxy statement for the 2019 annual meeting of stockholders (to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year covered by this report).

Item 10. *Directors, Executive Officers and Corporate Governance*

The Company has adopted a code of business conduct and ethics, including a conflicts of interest policy that applies to its principal executive officer, principal financial officer, principal accounting officer or controller performing similar functions. We intend to maintain the highest standards of ethical business practices and compliance with all laws and regulations applicable to our business. A copy of the Company's Code of Business Conduct is posted on the Company's external website at www.sotherlyhotels.com. The Company and the Operating Partnership intend to post to its website any amendments to or waivers of its code. The Operating Partnership is managed by the Company, its sole general partner and parent company. Consequently, the Operating Partnership does not have its own separate directors or executive officers.

Information on the Company's directors is incorporated by reference to the sections captioned "Proposal I – Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" contained in the Company's 2019 Proxy Statement.

Item 11. *Executive Compensation*

The information required by this item is incorporated by reference to the section captioned "Director and Executive Compensation" contained in the Company's 2019 Proxy Statement.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

(a) SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

Information required by this item is incorporated herein by reference to the section captioned "Principal Holders" of the Company's 2019 Proxy Statement.

(b) SECURITY OWNERSHIP OF MANAGEMENT

Information required by this item is incorporated herein by reference to the section captioned "Principal Holders" of the Company's 2019 Proxy Statement.

(c) CHANGES IN CONTROL

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

(d) SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

Set forth below is information as of December 31, 2018 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

EQUITY COMPENSATION PLAN INFORMATION

	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE
Equity compensation plans approved by security holders:			
2013 Plan ⁽¹⁾	N/A	N/A	586,650
Equity compensation plans not approved by security holders:			
None	N/A	N/A	N/A
Total	N/A	N/A	586,650

(1) On January 1, 2018, we granted 25,000 shares of restricted stock to our CFO, which vest in equal amounts of 5,000 shares over a five-year period during his employment on December 31 of each year, commencing December 31, 2018 and ending December 31, 2022.

On February 5, 2018, we granted 15,000 shares (3,000 each) of restricted stock to our independent directors that were fully vested on December 31, 2018. Also, on February 5, 2018, we granted an additional 2,250 shares of unrestricted stock to director G. Scott Gibson IV in consideration for his service during 2017.

On February 11, 2019, we granted 12,750 shares of restricted stock to our independent directors, of which 12,000 will vest on December 31, 2019 and 750 will vest on April 30, 2019. On February 22, 2019, we granted an additional 250 shares of restricted stock to one of our independent directors, which will vest on April 30, 2019. These shares are included in the number of securities remaining available for future issuance at December 31, 2018.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by this item is incorporated by reference to the sections captioned “Certain Relationships and Related Transactions” and “Proposal I – Election of Directors” in the Company’s 2019 Proxy Statement.

Item 14. *Principal Accountant Fees and Services*

The information required by this item is incorporated by reference to the section captioned “Proposal II – Ratification of Appointment of Accountants” in the Company’s 2019 Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

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All other schedules for which provision is made in Regulation S-X are either not required to be included herein under the related instructions or are inapplicable or the related information is included in the footnotes to the applicable financial statement and, therefore, have been omitted.

The following exhibits are filed as part of this Form 10-K:

Exhibits

- 3.1 Articles of Amendment and Restatement of the Company (incorporated by reference to the document previously filed as Exhibit 3.1 to the Company's Pre-Effective Amendment No. 1 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on October 20, 2004 (File No. 333-118873)).
- 3.1A Articles of Amendment to the Articles of Amendment and Restatement of the Company, effective as of April 16, 2013 (incorporated by reference to the document previously filed as Exhibit 3.7 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 16, 2013).
- 3.1B Articles of Amendment to the Articles of Amendment and Restatement of the Company, effective as of August 12, 2016 (incorporated by reference to the document previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on August 15, 2016).
- 3.2 Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.3 to the Company's Pre-Effective Amendment No. 5 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 13, 2004 (File No. 333-118873)).
- 3.2A Amendment No. 1 to the Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.6 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 18, 2011).

Exhibits

- 3.2B Amendment No. 2 to the Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.3 to the Operating Partnership's Pre-Effective Amendment No. 1 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on August 9, 2013 (File No. 333-189821)).
- 3.2C Amendment No. 3 to the Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on August 23, 2016).
- 3.2D Amendment No. 4 to the Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on October 11, 2017).
- 3.2E Amendment No. 5 to the Amended and Restated Agreement of Limited Partnership of Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 3.2E to our current report on Form 8-K filed with the Securities and Exchange Commission on August 31, 2018).
- 3.3 Articles Supplementary of Sotherly Hotels Inc. (incorporated by reference to the document previously filed as Exhibit 3.4 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 18, 2011).
- 3.4 Second Amended and Restated Bylaws of the Company, effective as of April 16, 2013 (incorporated by reference to the document previously filed as Exhibit 3.8 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 16, 2013).
- 3.5 Articles Supplementary designating the Series B Preferred Stock of the Company, effective as of August 19, 2016 (incorporated by reference to the document previously filed as Exhibit 3.5 to the Company's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on August 22, 2016).
- 3.6 Articles Supplementary designating the Series C Preferred Stock of the Company, effective as of October 5, 2017 (incorporated by reference to the document previously filed as Exhibit 3.5 to the Company's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on October 10, 2017).
- 3.7 Articles Supplementary dated August 30, 2018 (incorporated by reference to the document previously filed as Exhibit 3.7 to our current report on Form 8-K filed with the Securities and Exchange Commission on August 31, 2018).
- 4.0 Form of Common Stock Certificate (incorporated by reference to the document previously filed as Exhibit 4.0 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission on March 22, 2017).
- 4.1 Form of Specimen Certificate of Series B Preferred Stock of the Company (incorporated by reference to the document previously filed as Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on August 22, 2016).
- 4.2 Form of Specimen Certificate of Series C Preferred Stock of the Company (incorporated by reference to the document previously filed as Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on October 10, 2017).
- 4.3 Indenture by and among Sotherly Hotels Inc., Sotherly Hotels LP and Wilmington Trust, National Association, as trustee, dated February 12, 2018 (incorporated by reference to the document previously filed as Exhibit 4.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on February 12, 2018).
- 4.4 First Supplemental Indenture by and among Sotherly Hotels Inc., Sotherly Hotels LP and Wilmington Trust, National Association, as trustee, dated February 12, 2018 (incorporated by reference to the document previously filed as Exhibit 4.2 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on February 12, 2018).
- 4.5 7.25% Senior Unsecured Note due 2021 and Notation of Guarantee (incorporated by reference to the document previously filed as Exhibit 4.9 to our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2018, filed with the Securities and Exchange Commission on May 10, 2018).

Exhibits

- 10.1 Form of Restricted Stock Award Agreement between Sotherly Hotels Inc. and Participant (incorporated by reference to the document previously filed as Exhibit 10.1A to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, filed with the Securities and Exchange Commission on March 25, 2009). *
- 10.2 Executive Employment Agreement between Sotherly Hotels Inc. and Andrew M. Sims, dated January 12, 2015 (incorporated by reference to the document previously filed as Exhibit 10.2A to our Current Report on Form 8-K filed with the Securities and Exchange Commission on January 13, 2015). *
- 10.3 Executive Employment Agreement between Sotherly Hotels Inc. and Anthony E. Domalski, dated as of January 1, 2018 (incorporated by reference to the document previously filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 5, 2018). *
- 10.4 Contribution Agreement dated August 23, 2004 by and between the owners of Capitol Hotel Associates L.P., L.L.P. and Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 10.6 to the Company's Pre-Effective Amendment No. 6 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 15, 2004 (File No. 333-118873)).
- 10.5 Contribution Agreement dated August 23, 2004 by and between the owners of Savannah Hotel Associates LLC and Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 10.7 to the Company's Pre-Effective Amendment No. 6 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 15, 2004 (File No. 333-118873)).
- 10.6 Contribution Agreement dated August 23, 2004 by and between KDCA Partnership, MAVAS LLC, and Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 10.8 to the Company's Pre-Effective Amendment No. 5 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 13, 2004 (File No. 333-118873)).
- 10.7 Contribution Agreement dated September 8, 2004 by and between Elpizo Limited Partnership, Phileo Land Corporation and Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 10.9 to the Company's Pre-Effective Amendment No. 5 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 13, 2004 (File No. 333-118873)).
- 10.8 Management Restructuring Agreement by and between MHI Hospitality TRS, LLC, MHI Hotels Services, LLC and Sotherly Hotels LP (incorporated by reference to the document previously filed as Exhibit 10.14 to the Company's Pre-Effective Amendment No. 3 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on November 15, 2004 (File No. 333-118873)).
- 10.9 Contribution Agreement by and between MHI Hotels Services, LLC, MHI Hotels, LLC and MHI Hotels Two, Inc. (incorporated by reference to the document previously filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2011, filed with the Securities and Exchange Commission on November 9, 2011).
- 10.10 Executive Employment Agreement, dated as of January 1, 2016, between Sotherly Hotels Inc. and David R. Folsom (incorporated by reference to the document previously filed as Exhibit 10.20A to our Current Report on Form 8-K filed with the Securities and Exchange Commission on January 4, 2016). *
- 10.11 Sotherly Hotels Inc. 2013 Long-Term Incentive Plan (incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on March 20, 2013). *
- 10.12 Master Agreement by and among Sotherly Hotels Inc., Sotherly Hotels LP, MHI Hospitality TRS, LLC and MHI Hotels Services LLC (incorporated by reference to the document previously filed as Exhibit 10.52 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2014).
- 10.13 Commercial Unit Purchase Agreement between Sotherly Hotels Inc. and 4000 South Ocean Property Owner, LLLP, dated as of June 1, 2017 (incorporated by reference to the document previously filed as Exhibit 10.29 to our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017, filed with the Securities and Exchange Commission on August 10, 2017).
- 10.14 Addendum to Commercial Unit Purchase Agreement between Sotherly Hotels Inc. and 4000 South Ocean Property Owner, LLLP, dated as of June 1, 2017 (incorporated by reference to the document previously filed as Exhibit 10.30 to our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017, filed with the Securities and Exchange Commission on August 10, 2017).
- 10.15 Hotel Purchase and Sale Agreement by and between RP/HH Rosslyn Hotel Owner, LP and Sotherly Hotels LP, dated as

Exhibits

of December 13, 2017 (incorporated by reference to the document previously filed as Exhibit 10.31 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2018).

- 10.16 First Amendment to Hotel Purchase and Sale Agreement by and between RP/HH Rosslyn Hotel Owner, LP and Sotherly Hotels LP, dated as of January 11, 2018 (incorporated by reference to the document previously filed as Exhibit 10.32 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2018).
- 21.1 List of Subsidiaries of Sotherly Hotels Inc.
- 21.2 List of Subsidiaries of Sotherly Hotels LP.
- 23.1 Consent of Dixon Hughes Goodman LLP.
- 23.2 Consent of Dixon Hughes Goodman LLP.
- 31.1 Certification of Chief Executive Officer pursuant to Exchange Act Rule 13(a)-14 and 15(d)-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act Rule 13(a)-14 and 15(d)-14, as adopted, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of Chief Executive Officer pursuant to Exchange Act Rule 13(a)-14 and 15(d)-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.4 Certification of Chief Financial Officer pursuant to Exchange Act Rule 13(a)-14 and 15(d)-14, 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 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 of the Sarbanes-Oxley Act of 2002.
- 32.4 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

* Denotes management contract and/or compensatory plan/arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 15, 2019

SOTHERLY HOTELS LP,

by its General Partner,
SOTHERLY HOTELS INC.

By: /s/ ANDREW M. SIMS
Andrew M. Sims
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u> /s/ ANDREW M. SIMS</u> Andrew M. Sims	Chief Executive Officer and Chairman of the Board of Directors of the General Partner	March 15, 2019
<u> /s/ DAVID R. FOLSOM</u> David R. Folsom	President, Chief Operating Officer and Director of the General Partner	March 15, 2019
<u> /s/ ANTHONY E. DOMALSKI</u> Anthony E. Domalski	Chief Financial Officer of the General Partner	March 15, 2019
<u> /s/ HERSCHEL J. WALKER</u> Herschel J. Walker	Director of the General Partner	March 15, 2019
<u> /s/ DAVID J. BEATTY</u> David J. Beatty	Director of the General Partner	March 15, 2019
<u> /s/ EDWARD S. STEIN</u> Edward S. Stein	Director of the General Partner	March 15, 2019
<u> /s/ ANTHONY C. ZINNI</u> Anthony C. Zinni	Director of the General Partner	March 15, 2019
<u> /s/ G. SCOTT GIBSON IV</u> G. Scott Gibson IV	Director of the General Partner	March 15, 2019

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of
Sotherly Hotels Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Sotherly Hotels Inc. and subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes, including the financial statement schedule listed in the index appearing under Item 15 (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on the criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2019, expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Dixon Hughes Goodman LLP

We have served as the Company's auditor since 2016.

Tysons, Virginia
March 15, 2019

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of
Sotherly Hotels Inc.

Opinion on Internal Control Over Financial Reporting

We have audited Sotherly Hotels Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company as of December 31, 2018 and 2017 and for each of the three years in the period ended December 31, 2018, and our report dated March 15, 2019, expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Dixon Hughes Goodman LLP

Tyson, Virginia
March 15, 2019

SOTHERLY HOTELS INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

	<u>December 31, 2018</u>	<u>December 31, 2017</u>
ASSETS		
Investment in hotel properties, net	\$ 435,725,814	\$ 357,799,512
Cash and cash equivalents	33,792,773	29,777,845
Restricted cash	4,075,508	3,651,197
Accounts receivable, net	6,766,696	5,587,077
Accounts receivable - affiliate	262,572	394,026
Prepaid expenses, inventory and other assets	5,262,884	7,292,565
Favorable lease assets, net	2,465,421	—
Deferred income taxes	5,131,179	5,451,118
TOTAL ASSETS	<u>\$ 493,482,847</u>	<u>\$ 409,953,340</u>
LIABILITIES		
Mortgage loans, net	\$ 364,828,845	\$ 297,318,816
Unsecured notes, net	23,894,658	—
Accounts payable and accrued liabilities	16,268,096	13,813,623
Advance deposits	2,815,283	1,572,388
Dividends and distributions payable	3,409,593	3,073,483
TOTAL LIABILITIES	<u>\$ 411,216,475</u>	<u>\$ 315,778,310</u>
Commitments and contingencies (See Note 6)	—	—
EQUITY		
Sotherly Hotels Inc. stockholders' equity		
Preferred stock, \$0.01 par value, 11,000,000 shares authorized;		
8.0% Series B cumulative redeemable perpetual preferred stock, liquidation preference \$25 per share, 1,610,000 shares issued and outstanding at December 31, 2018 and 2017, respectively	16,100	16,100
7.875% Series C cumulative redeemable perpetual preferred stock, liquidation preference \$25 per share, 1,352,141 and 1,300,000 shares issued and outstanding at December 31, 2018 and 2017, respectively	13,521	13,000
Common stock, par value \$0.01, 49,000,000 shares authorized, 14,209,378 shares and 14,078,831 shares issued and outstanding at December 31, 2018 and 2017, respectively	142,093	140,788
Additional paid-in capital	147,085,112	146,249,339
Unearned ESOP shares	(4,379,742)	(4,633,112)
Distributions in excess of retained earnings	(61,052,418)	(48,765,860)
Total Sotherly Hotels Inc. stockholders' equity	81,824,666	93,020,255
Noncontrolling interest	441,706	1,154,775
TOTAL EQUITY	<u>82,266,372</u>	<u>94,175,030</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 493,482,847</u>	<u>\$ 409,953,340</u>

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

SOTHERLY HOTELS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	2018	2017	2016
REVENUE			
Rooms department	\$ 120,993,460	\$ 105,727,372	\$ 108,199,151
Food and beverage department	38,134,813	34,513,695	35,384,530
Other operating departments	19,044,848	14,025,626	9,262,071
Total revenue	178,173,121	154,266,693	152,845,752
EXPENSES			
Hotel operating expenses			
Rooms department	30,334,309	26,673,727	28,300,126
Food and beverage department	28,090,145	24,585,923	24,357,248
Other operating departments	6,419,502	4,405,515	2,438,860
Indirect	65,645,500	57,612,203	57,736,937
Total hotel operating expenses	130,489,456	113,277,368	112,833,171
Depreciation and amortization	20,884,643	16,999,619	15,019,071
Loss on disposal of assets	511,749	1,489,892	365,319
Corporate general and administrative	6,180,962	6,335,926	6,021,065
Total operating expenses	158,066,810	138,102,805	134,238,626
NET OPERATING INCOME	20,106,311	16,163,888	18,607,126
Other income (expense)			
Interest expense	(19,953,746)	(15,727,628)	(17,735,107)
Interest income	352,951	218,656	115,785
Loss on early extinguishment of debt	(753,133)	(1,178,348)	(1,417,905)
Unrealized loss on hedging activities	(808,958)	(28,384)	(37,384)
Gain on sale of assets	—	76,233	—
Gain on involuntary conversion of assets	917,767	2,242,876	—
Net (loss) income before income taxes	(138,808)	1,767,293	(467,485)
Income tax benefit (provision)	(469,349)	(1,737,804)	1,367,634
Net (loss) income	(608,157)	29,489	900,149
Less: Net loss attributable to noncontrolling interest	718,093	413,014	26,567
Net income attributable to the Company	109,936	442,503	926,716
Distributions to preferred stockholders	(5,829,914)	(3,781,639)	(1,144,889)
Net loss available to common stockholders	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)
Net loss per share available to common stockholders			
Basic	\$ (0.42)	\$ (0.24)	\$ (0.01)
Weighted average number of common shares outstanding			
Basic	13,517,488	13,829,100	14,896,994

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

SOTHERLY HOTELS INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Preferred Stock		Common Stock		Additional Paid-In Capital	Unearned ESOP Shares	Distributions in Excess of Retained Earnings	Noncontrolling Interest	Total
	Shares	Par Value	Shares	Par Value					
Balances at December 31, 2015	<u>—</u>	<u>\$ —</u>	<u>14,490,714</u>	<u>\$ 144,907</u>	<u>\$ 82,749,058</u>	<u>\$ —</u>	<u>\$ (33,890,834)</u>	<u>\$ 3,855,237</u>	<u>\$52,858,368</u>
Net income (loss)	—	—	—	—	—	—	926,716	(26,567)	900,149
Issuance of Series B Preferred Stock	1,610,000	16,100	—	—	37,750,431	—	—	—	37,766,531
Issuance of unrestricted common stock awards	—	—	24,250	242	128,040	—	—	—	128,282
Issuance of restricted common stock awards	—	—	12,000	120	63,360	—	—	—	63,480
Repurchase of common stock	—	—	(481,100)	(4,811)	(3,159,725)	—	—	—	(3,164,536)
Conversion of Operating Partnership units into shares of common stock	—	—	422,687	4,227	843,998	—	—	(848,225)	—
Amortization of restricted stock award	—	—	—	—	19,920	—	—	—	19,920
Preferred stock dividends declared	—	—	—	—	—	—	(1,144,889)	—	(1,144,889)
Common stockholders' dividends and distributions declared	—	—	—	—	—	—	(5,436,747)	(651,270)	(6,088,017)
Balances at December 31, 2016	<u>1,610,000</u>	<u>\$ 16,100</u>	<u>14,468,551</u>	<u>\$ 144,685</u>	<u>\$118,395,082</u>	<u>\$ —</u>	<u>\$ (39,545,754)</u>	<u>\$ 2,329,175</u>	<u>\$81,339,288</u>
Net income	—	—	—	—	—	—	442,503	(413,014)	29,489
Issuance of Series C Preferred Stock	1,300,000	13,000	—	—	30,475,660	—	—	—	30,488,660
Issuance of restricted common stock awards	—	—	12,000	120	89,040	—	—	—	89,160
Repurchase of common stock	—	—	(401,720)	(4,017)	(2,727,024)	—	—	—	(2,731,041)
Purchase of shares by ESOP	—	—	—	—	—	(4,874,758)	—	—	(4,874,758)
Amortization of ESOP shares	—	—	—	—	(3,339)	241,646	—	—	238,307
Amortization of restricted stock award	—	—	—	—	19,920	—	—	—	19,920
Preferred stock dividends declared	—	—	—	—	—	—	(3,781,639)	—	(3,781,639)
Common stockholders' dividends and distributions declared	—	—	—	—	—	—	(5,880,970)	(761,386)	(6,642,356)
Balances at December 31, 2017	<u>2,910,000</u>	<u>\$ 29,100</u>	<u>14,078,831</u>	<u>\$ 140,788</u>	<u>\$146,249,339</u>	<u>\$(4,633,112)</u>	<u>\$ (48,765,860)</u>	<u>\$ 1,154,775</u>	<u>\$94,175,030</u>
Net loss	—	—	—	—	—	—	109,936	(718,093)	(608,157)
Issuance of unrestricted common stock awards	—	—	2,250	23	13,455	—	—	—	13,478
Issuance of restricted common stock awards	—	—	40,000	400	89,450	—	—	—	89,850
Issuance of common stock	—	—	88,297	882	573,292	—	—	—	574,174
Issuance of Series C Preferred Stock	52,141	521	—	—	1,004,542	—	—	—	1,005,063
Amortization of ESOP shares	—	—	—	—	(9,645)	253,370	—	—	243,725
Amortization of restricted stock award	—	—	—	—	32,100	—	—	—	32,100
Adjustment to minority interest in operating partnership	—	—	—	—	(867,421)	—	—	867,421	—
Preferred stock dividends declared	—	—	—	—	—	—	(5,829,914)	—	(5,829,914)
Common stockholders' dividends and distributions declared	—	—	—	—	—	—	(6,566,580)	(862,397)	(7,428,977)
Balances at December 31, 2018	<u>2,962,141</u>	<u>\$ 29,621</u>	<u>14,209,378</u>	<u>\$ 142,093</u>	<u>\$147,085,112</u>	<u>\$(4,379,742)</u>	<u>\$ (61,052,418)</u>	<u>\$ 441,706</u>	<u>\$82,266,372</u>

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

SOTHERLY HOTELS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	2018	2017	2016
Cash flows from operating activities:			
Net (loss) income	\$ (608,157)	\$ 29,489	\$ 900,149
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	20,884,643	16,999,619	15,019,071
Amortization of deferred financing costs	1,020,396	776,410	1,147,864
Amortization of mortgage premium	(24,681)	(24,681)	(24,682)
Gain on involuntary conversion of assets	(917,767)	(2,242,876)	—
Unrealized loss on derivative instrument	808,958	28,384	37,384
Loss on sale or disposal of assets	511,749	1,413,659	365,319
Loss on early extinguishment of debt	753,133	1,178,348	1,417,905
ESOP and stock - based compensation	379,153	347,387	211,682
Changes in assets and liabilities:			
Accounts receivable	(885,929)	(1,492,119)	(56,573)
Prepaid expenses, inventory and other assets	1,620,941	(2,780,246)	(334,063)
Deferred income taxes	319,939	1,498,222	(1,558,966)
Accounts payable and other accrued liabilities	1,148,869	1,244,731	(35,188)
Advance deposits	1,020,670	(743,399)	663,947
Accounts receivable - affiliate	131,454	(389,851)	222,377
Net cash provided by operating activities	<u>26,163,371</u>	<u>15,843,077</u>	<u>17,976,226</u>
Cash flows from investing activities:			
Acquisitions of hotel properties	(79,732,716)	(3,986,849)	—
Improvements and additions to hotel properties	(22,104,775)	(23,155,738)	(14,912,677)
Proceeds from the sale of hotel property	—	5,434,856	—
Proceeds from involuntary conversion	917,767	2,275,666	—
Proceeds from the sale or disposal of assets	20,677	105,401	213,400
Net cash used in investing activities	<u>(100,899,047)</u>	<u>(19,326,664)</u>	<u>(14,699,277)</u>
Cash flows from financing activities:			
Proceeds of mortgage debt	175,800,000	40,500,000	102,700,000
Proceeds from mortgage loan receivable	—	—	2,600,711
Proceeds of unsecured debt	25,000,000	—	—
Proceeds from issuance of common stock, net	574,174	—	—
Proceeds from issuance of preferred stock, net	1,005,063	30,488,660	37,766,531
Redemption of unsecured notes	—	(25,300,000)	(27,600,000)
Payments on mortgage loans	(107,237,891)	(25,990,271)	(89,619,564)
Settlement or repurchase of common stock	—	(3,708,891)	(2,061,407)
Payments of deferred financing costs	(3,816,848)	(837,991)	(1,796,351)
Funding of ESOP stock purchase	—	(4,874,758)	—
Dividends and distributions paid	(6,319,669)	(5,945,401)	(5,851,813)
Preferred dividends paid	(5,829,914)	(3,781,639)	(339,889)
Net cash provided by financing activities	<u>79,174,915</u>	<u>549,709</u>	<u>15,798,218</u>
Net increase (decrease) in cash, cash equivalents and restricted cash	4,439,239	(2,933,878)	19,075,167
Cash, cash equivalents and restricted cash at the beginning of the period	33,429,042	36,362,920	17,287,753
Cash, cash equivalents and restricted cash at the end of the period	<u>\$ 37,868,281</u>	<u>\$ 33,429,042</u>	<u>\$ 36,362,920</u>
Supplemental disclosures:			
Cash paid during the period for interest	<u>\$ 18,325,563</u>	<u>\$ 15,253,059</u>	<u>\$ 16,881,223</u>
Cash paid during the period for income taxes	<u>\$ 173,753</u>	<u>\$ 162,677</u>	<u>\$ 192,965</u>
Non-cash investing and financing activities:			

Settlements for repurchase of common stock in accounts payable and accrued liabilities	<u>\$ -</u>	<u>\$ 125,279</u>	<u>\$ 1,103,129</u>
Change in amount of improvements to hotel property in accounts payable and accrued liabilities	<u>\$ 222,989</u>	<u>\$ 151,499</u>	<u>\$ 431,858</u>
Change in amount of non-controlling interest and additional paid-in-capital	<u>\$ 867,421</u>	<u>\$ -</u>	<u>\$ -</u>

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors of the General Partner of
Sotherly Hotels LP

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Sotherly Hotels LP and subsidiaries (the "Partnership") as of December 31, 2018 and 2017, the related consolidated statements of operations, changes in partners' capital, and cash flows for each of the years in the three year period ended December 31, 2018, and the related notes, including the financial statement schedule listed in the index appearing under Item 15 (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on the Partnership's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Partnership in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Partnership is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Dixon Hughes Goodman LLP

We have served as the Partnership's auditor since 2016.

Tysons, Virginia
March 15, 2019

SOTHERLY HOTELS LP
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

	<u>December 31, 2018</u>	<u>December 31, 2017</u>
ASSETS		
Investment in hotel properties, net	\$ 435,725,814	\$ 357,799,512
Cash and cash equivalents	33,792,773	29,777,845
Restricted cash	4,075,508	3,651,197
Accounts receivable, net	6,766,696	5,587,077
Accounts receivable - affiliate	262,572	394,026
Loan receivable - affiliate	4,446,410	4,650,969
Prepaid expenses, inventory and other assets	5,262,884	7,292,565
Favorable lease assets, net	2,465,421	—
Deferred income taxes	5,131,179	5,451,118
TOTAL ASSETS	<u>\$ 497,929,257</u>	<u>\$ 414,604,309</u>
LIABILITIES		
Mortgage loans, net	\$ 364,828,845	\$ 297,318,816
Unsecured notes, net	23,894,658	—
Accounts payable and other accrued liabilities	16,268,100	13,813,623
Advance deposits	2,815,283	1,572,388
Dividends and distributions payable	3,466,136	3,119,027
TOTAL LIABILITIES	<u>\$ 411,273,022</u>	<u>\$ 315,823,854</u>
Commitments and contingencies (see Note 6)	—	—
PARTNERS' CAPITAL		
Preferred units, \$0.01 par value, 11,000,000 units authorized;		
8.0% Series B cumulative redeemable perpetual preferred units, liquidation preference \$25 per unit, 1,610,000 units issued and outstanding at December 31, 2018 and 2017, respectively	37,766,531	37,766,531
7.875% Series C cumulative redeemable perpetual preferred units, liquidation preference \$25 per unit, 1,352,141 and 1,300,000 units issued and outstanding at December 31, 2018 and 2017, respectively	31,493,723	30,488,660
General Partner: 159,876 units and 158,570 units issued and outstanding as of December 31, 2018 and 2017, respectively	452,165	586,725
Limited Partners: 15,827,642 units and 15,698,401 units issued and outstanding as of December 31, 2018 and 2017, respectively	16,943,816	29,938,539
TOTAL PARTNERS' CAPITAL	<u>86,656,235</u>	<u>98,780,455</u>
TOTAL LIABILITIES AND PARTNERS' CAPITAL	<u>\$ 497,929,257</u>	<u>\$ 414,604,309</u>

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

SOTHERLY HOTELS LP
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	2018	2017	2016
REVENUE			
Rooms department	\$ 120,993,460	\$ 105,727,372	\$ 108,199,151
Food and beverage department	38,134,813	34,513,695	35,384,530
Other operating departments	19,044,848	14,025,626	9,262,071
Total revenue	178,173,121	154,266,693	152,845,752
EXPENSES			
Hotel operating expenses			
Rooms department	30,334,309	26,673,727	28,300,126
Food and beverage department	28,090,145	24,585,923	24,357,248
Other operating departments	6,419,502	4,405,515	2,438,860
Indirect	65,645,500	57,612,203	57,736,937
Total hotel operating expenses	130,489,456	113,277,368	112,833,171
Depreciation and amortization	20,884,643	16,999,619	15,019,071
Loss on disposal of assets	511,749	1,489,892	365,319
Corporate general and administrative	6,180,962	6,335,926	6,021,065
Total operating expenses	158,066,810	138,102,805	134,238,626
NET OPERATING INCOME	20,106,311	16,163,888	18,607,126
Other income (expense)			
Interest expense	(19,953,746)	(15,727,628)	(17,735,107)
Interest income	352,951	218,656	115,785
Loss on early extinguishment of debt	(753,133)	(1,178,348)	(1,417,905)
Unrealized loss on hedging activities	(808,958)	(28,384)	(37,384)
Gain on sale of assets	—	76,233	—
Gain on involuntary conversion of assets	917,767	2,242,876	—
Net (loss) income before income taxes	(138,808)	1,767,293	(467,485)
Income tax benefit (provision)	(469,349)	(1,737,804)	1,367,634
Net (loss) income	(608,157)	29,489	900,149
Distributions to preferred unit holder	(5,829,914)	(3,781,639)	(1,144,889)
Net loss available to operating partnership unit holders	\$ (6,438,071)	\$ (3,752,150)	\$ (244,740)
Net loss attributable per operating partner unit			
Basic and diluted	\$ (0.40)	\$ (0.23)	\$ (0.01)
Weighted average number of operating partner units outstanding			
Basic and diluted	15,923,978	16,224,005	16,710,935

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

SOTHERLY HOTELS LP
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' CAPITAL
YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	Preferred Units			General Partner		Limited Partner		Total
	Units	Series B Amounts	Series C Amounts	Units	Amounts	Units	Amounts	
Balances at December 31, 2015	—	\$ —	\$ —	166,915	\$ 774,295	16,524,626	\$52,084,073	\$52,858,368
Issuance of common partnership units	—	—	—	363	1,918	35,887	189,844	191,762
Issuance of Preferred Series B units	1,610,000	37,766,531	—	—	—	—	—	37,766,531
Repurchased common units	—	—	—	(4,811)	(31,645)	(476,289)	(3,132,891)	(3,164,536)
Amortization of restricted units award	—	—	—	—	149	—	19,771	19,920
Preferred units distributions declared	—	(1,144,889)	—	—	—	—	—	(1,144,889)
Partnership units distributions declared	—	—	—	—	(60,881)	—	(6,027,136)	(6,088,017)
Net income	—	1,144,889	—	—	(2,447)	—	(242,293)	900,149
Balances at December 31, 2016	1,610,000	\$37,766,531	\$ —	162,467	\$ 681,389	16,084,224	\$42,891,368	\$81,339,288
Issuance of common partnership units	—	—	—	120	892	11,880	88,268	89,160
Issuance of Preferred Series C units	1,300,000	—	30,488,660	—	—	—	—	30,488,660
Repurchased common units	—	—	—	(4,017)	(27,310)	(397,703)	(2,703,731)	(2,731,041)
Amortization of restricted units award	—	—	—	—	199	—	19,721	19,920
Unit based compensation	—	—	—	—	—	—	200,494	200,494
Preferred units distributions declared	—	(3,220,000)	(561,639)	—	—	—	—	(3,781,639)
Partnership units distributions declared	—	—	—	—	(68,740)	—	(6,805,136)	(6,873,876)
Net income	—	3,220,000	561,639	—	295	—	(3,752,445)	29,489
Balances at December 31, 2017	2,910,000	\$37,766,531	\$30,488,660	158,570	\$ 586,725	15,698,401	\$29,938,539	\$98,780,455
Issuance of common partnership units	—	—	—	1,306	6,775	129,241	670,727	677,502
Issuance of preferred units	52,141	—	1,005,063	—	—	—	—	1,005,063
Amortization of restricted units award	—	—	—	—	321	—	31,779	32,100
Unit based compensation	—	—	—	—	—	—	326,766	326,766
Preferred units distributions declared	—	(3,220,000)	(2,609,914)	—	—	—	—	(5,829,914)
Partnership units distributions declared	—	—	—	—	(77,276)	—	(7,650,304)	(7,727,580)
Net loss	—	3,220,000	2,609,914	—	(64,380)	—	(6,373,691)	(608,157)
Balances at December 31, 2018	2,962,141	\$37,766,531	\$31,493,723	159,876	\$ 452,165	15,827,642	\$16,943,816	\$86,656,235

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

SOTHERLY HOTELS LP
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

	2018	2017	2016
Cash flows from operating activities:			
Net (loss) income	\$ (608,157)	\$ 29,489	\$ 900,149
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	20,884,643	16,999,619	15,019,071
Amortization of deferred financing costs	1,020,396	776,410	1,147,864
Amortization of mortgage premium	(24,681)	(24,681)	(24,682)
Gain on involuntary conversion of assets	(917,767)	(2,242,876)	—
Unrealized loss on derivative instrument	808,958	28,384	37,384
Loss on sale or disposal of assets	511,749	1,413,659	365,319
Loss on early extinguishment of debt	753,133	1,178,348	1,417,905
ESOP and unit - based compensation	462,193	309,574	211,682
Changes in assets and liabilities:			
Accounts receivable	(885,929)	(1,492,119)	(56,573)
Prepaid expenses, inventory and other assets	1,620,941	(2,780,246)	(334,063)
Deferred income taxes	319,939	1,498,222	(1,558,966)
Accounts payable and other accrued liabilities	1,148,869	1,244,731	(35,188)
Advance deposits	1,020,670	(743,399)	663,947
Accounts receivable - affiliate	131,454	(389,851)	222,377
Net cash provided by operating activities	<u>26,246,411</u>	<u>15,805,264</u>	<u>17,976,226</u>
Cash flows from investing activities:			
Acquisitions of hotel properties	(79,732,716)	(3,986,849)	-
Improvements and additions to hotel properties	(22,104,775)	(23,155,738)	(14,912,677)
Proceeds from the sale of hotel property	—	5,434,856	—
ESOP loan advances	—	(4,874,758)	—
ESOP loan payments received	204,559	223,789	—
Proceeds from involuntary conversion	917,767	2,275,666	—
Proceeds from the sale or disposal of assets	20,677	105,401	213,400
Net cash used in investing activities	<u>(100,694,488)</u>	<u>(23,977,633)</u>	<u>(14,699,277)</u>
Cash flows from financing activities:			
Proceeds of mortgage debt	175,800,000	40,500,000	102,700,000
Proceeds from mortgage loan receivable	—	—	2,600,711
Proceeds of unsecured debt	25,000,000	—	—
Proceeds from issuance of common units, net	574,174	—	—
Proceeds from issuance of preferred units, net	1,005,063	30,488,660	37,766,531
Settlement or repurchase of common units	—	(3,708,891)	(2,061,407)
Redemption of unsecured notes	—	(25,300,000)	(27,600,000)
Payments on mortgage loans	(107,237,891)	(25,990,271)	(89,619,564)
Payments of deferred financing costs	(3,816,848)	(837,991)	(1,796,351)
Distributions and dividends paid	(6,607,268)	(6,131,377)	(5,851,813)
Preferred dividends paid	(5,829,914)	(3,781,639)	(339,889)
Net cash provided by financing activities	<u>78,887,316</u>	<u>5,238,491</u>	<u>15,798,218</u>
Net increase (decrease) in cash, cash equivalents and restricted cash	4,439,239	(2,933,878)	19,075,167
Cash, cash equivalents and restricted cash at the beginning of the period	33,429,042	36,362,920	17,287,753
Cash, cash equivalents and restricted cash at the end of the period	<u>\$ 37,868,281</u>	<u>\$ 33,429,042</u>	<u>\$ 36,362,920</u>
Supplemental disclosures:			
Cash paid during the period for interest	<u>\$ 18,318,331</u>	<u>\$ 15,253,059</u>	<u>\$ 16,881,223</u>
Cash paid during the period for income taxes	<u>\$ 173,753</u>	<u>\$ 162,677</u>	<u>\$ 192,965</u>
Non-cash investing and financing activities:			

Settlements for repurchase of common units in accounts payable and accrued liabilities	<u>\$ -</u>	<u>\$ 125,279</u>	<u>\$ 1,103,129</u>
Change in amount of improvements to hotel property in accounts payable and accrued liabilities	<u>\$ 222,989</u>	<u>\$ 151,499</u>	<u>\$ 431,858</u>

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

SOTHERLY HOTELS INC.

SOTHERLY HOTELS LP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sotherly Hotels Inc., formerly MHI Hospitality Corporation, (the “Company”) is a self-managed and self-administered lodging real estate investment trust (“REIT”) that was incorporated in Maryland on August 20, 2004 to own full-service, primarily upscale and upper-upscale hotels located in primary and secondary markets in the mid-Atlantic and southern United States. Currently, the Company is focused on the acquisition, renovation, upbranding and repositioning of upscale to upper-upscale full-service hotels in the southern United States. The Company’s portfolio, as of December 31, 2018, consists of investments in twelve hotel properties, comprising 3,156 rooms and one hotel commercial condominium unit which forms a part of a 400 room condominium-hotel. All of the Company’s hotels, except for The DeSoto, the Georgian Terrace, The Whitehall and the Hyde Resort & Residences, operate under the Hilton, Crowne Plaza, DoubleTree, Hyatt and Sheraton brands.

The Company commenced operations on December 21, 2004 when it completed its initial public offering (“IPO”) and thereafter consummated the acquisition of six hotel properties. Substantially all of the Company’s assets are held by, and all of its operations are conducted through, Sotherly Hotels LP, (the “Operating Partnership”).

Pursuant to the terms of the Amended and Restated Agreement of Limited Partnership (the “Partnership Agreement”), the Company, as general partner, is not entitled to compensation for its services to the Operating Partnership. The Company, as general partner, conducts substantially all of its operations through the Operating Partnership and the Company’s administrative expenses are the obligations of the Operating Partnership. Additionally, the Company is entitled to reimbursement for any expenditure incurred by it on the Operating Partnership’s behalf.

For the Company to qualify as a REIT, it cannot operate hotels. Therefore, the Operating Partnership, which, at December 31, 2018, was approximately 88.9% owned by the Company, and its subsidiaries, lease its hotels to direct and indirect subsidiaries of MHI Hospitality TRS Holding, Inc., MHI Hospitality TRS, LLC and certain of its subsidiaries, (collectively, “MHI TRS”), each of which is a wholly-owned subsidiary of the Operating Partnership. For the years ended December 31, 2018, 2017 and 2016, MHI TRS engaged an eligible independent hotel management company, MHI Hotels Services, LLC, which does business as Chesapeake Hospitality (“Chesapeake Hospitality”) and Highgate Hotels, L.P. (“Highgate Hotels”), to operate the hotels under a management contract. MHI TRS is treated as a taxable REIT subsidiary for federal income tax purposes.

All references in these “Notes to Consolidated Financial Statements” to “we,” “us” and “our” refer to the Company, its Operating Partnership and its subsidiaries and predecessors, collectively, unless the context otherwise requires or where otherwise indicated.

Significant transactions occurring during the current and two prior fiscal years include the following:

On March 21, 2016, we entered into an agreement with the existing lender to extend the maturity of the mortgage on The Whitehall until November 2017.

On June 27, 2016, we entered into a promissory note and other loan documents to secure a \$35.0 million mortgage on the Hilton Savannah DeSoto with MONY Life Insurance Company. The mortgage term is ten years maturing July 1, 2026, subject to certain criteria. The mortgage bears a fixed interest rate of 4.25%. The mortgage amortizes on a 25-year schedule after a 1-year interest-only period. We used the proceeds to repay the existing first mortgage on the Hilton Savannah DeSoto and to pay closing costs, and used the balance of the proceeds to fund ongoing renovations at the hotel and for general corporate purposes.

On June 30, 2016, we entered into a loan agreement and other loan documents, including a guaranty of payment by the Operating Partnership, to secure a \$19.0 million mortgage on the Crowne Plaza Tampa Westshore with Fifth Third Bank. The mortgage term has an initial term of three years, and may be extended for two additional periods of one year each, subject to certain conditions. The mortgage bears a floating interest rate of the 30-day LIBOR plus 3.75%, subject to a floor rate of 3.75%. The note has monthly principal payments of \$23,100 and provides that the mortgage can be extended for two additional periods of one year each, subject to certain conditions. We used the proceeds to repay the existing first mortgage on the Crowne Plaza Tampa Westshore and to pay closing costs and used the balance of the proceeds for general corporate purposes.

On August 23, 2016, the Company sold 1,610,000 shares of 8.0% Series B Cumulative Redeemable Perpetual Preferred Stock (the “Series B Preferred Stock”), for net proceeds after all expenses of approximately \$37.8 million, which it contributed to the Operating Partnership for an equivalent number of preferred partnership units.

On September 30, 2016, we redeemed the entire \$27.6 million aggregate principal amount of our outstanding 8.0% senior unsecured notes (the “8% Notes”).

On October 12, 2016, we entered into a loan agreement to secure a \$20.5 million mortgage on The Whitehall with the International Bank of Commerce. Pursuant to the loan documents, the loan provided initial proceeds of \$15.0 million, with an additional \$5.5 million available upon the satisfaction of certain conditions, has a term of five years, bears a floating interest rate of the one month LIBOR plus 3.5%, subject to a floor rate of 4.0%, amortizes on an 18-year schedule after a 2-year interest only period, is subject to prepayment fees, and is guaranteed by Sotherly Hotels LP.

On November 3, 2016, we entered into a loan agreement to refinance the mortgage on the Sheraton Louisville Riverside with Symetra Life Insurance Company. Pursuant to the loan documents, the loan provided proceeds of \$12.0 million, has a maturity date of December 1, 2026, bears a fixed interest rate of 4.27% for the first 5 years of the loan with an option for the lender to reset that rate after 5 years, amortizes on a 25-year schedule, is subject to prepayment fees, and is guaranteed by Sotherly Hotels LP up to 50% of the unpaid principal balance, interest, and other amounts owed.

On November 3, 2016, we entered into a loan agreement to modify and extend the mortgage on the Crowne Plaza Hampton Marina with TowneBank. Pursuant to the amended loan documents, the loan continues to bear a fixed interest rate of 5.00%, has a maturity date of November 1, 2019, and beginning on December 1, 2016 requires monthly principal payments of \$15,367 plus interest.

On December 1, 2016, we entered into a promissory note and other loan documents to secure a \$35.0 million mortgage on the Hotel Ballast Wilmington, Tapestry Collection by Hilton with MONY Life Insurance Company. Pursuant to the loan documents, the loan: provides initial proceeds of \$30.0 million, with an additional \$5.0 million available upon the satisfaction of certain conditions. The mortgage term is ten years maturing January 1, 2027, subject to certain criteria. The mortgage bears a fixed interest rate of 4.25%. The mortgage amortizes on a 25-year schedule after a 1-year interest-only period. We used the proceeds to repay the existing first mortgage on the Hotel Ballast Wilmington, Tapestry Collection by Hilton and to pay closing costs, and will use the balance of the proceeds to fund ongoing renovations at the hotel and for general corporate purposes.

On December 2, 2016, the Company’s Board of Directors authorized a stock repurchase program under which the Company may purchase up to \$10.0 million of its outstanding common stock, par value \$0.01 per share, at prevailing prices on the open market or in privately negotiated transactions, at the discretion of management. For the years ended December 31, 2018, 2017 and 2016, the Company repurchased no shares in 2018, 401,720 and 481,100 shares of common stock, respectively, for approximately \$0, \$2.7 million and \$3.2 million, respectively. The repurchased shares have been returned to the status of authorized but unissued shares of common stock. The Company used available working capital to fund purchases under the stock repurchase program and intends to complete the repurchase program prior to December 31, 2019, unless extended by the Board of Directors.

On December 29, 2016, the Company adopted an Employee Stock Ownership Plan (“ESOP”), effective as of January 1, 2016. The Company sponsors and maintains the ESOP and related trust for the benefit of its eligible employees. The ESOP is funded by a loan from the Company, pursuant to which the ESOP may borrow up to \$5.0 million to purchase shares of the Company’s common stock. From January 3, 2017 to February 28, 2017 the ESOP purchased 682,500 shares of common stock at an aggregate cost of approximately \$4.9 million, which it borrowed from the Company under the loan.

Coincident with the execution of the loan from the Company to the ESOP, the Operating Partnership committed to fund a loan to the Company to allow the Company to loan funds to the ESOP, for the purpose as stated above.

On January 30, 2017, we closed on the purchase of the commercial condominium unit of the Hyde Resort & Residences, a 400-unit condominium hotel located in the Hollywood, Florida market, for an aggregate price of approximately \$4.8 million from 4111 South Ocean Drive, LLC. In connection with the closing of the transaction, we entered into a lease agreement for the 400-space parking garage and meeting rooms associated with the condominium hotel, agreements relating to the operation and management of the hotel condominium association and a condominium unit rental program, and a pre-opening services agreement whereby the seller paid us a fee of approximately \$0.8 million for certain pre-opening related preparations.

On February 7, 2017, we closed on the sale of the Crowne Plaza Hampton Marina to Marina Hotels, LLC for a price of \$5.6 million.

On June 1, 2017, we entered into an agreement to purchase the commercial unit of the planned Hyde Beach House Resort & Residences, a condominium hotel under development in Hollywood, Florida, for a price of \$5.1 million from 4000 South Ocean Property Owner, LLLP. In connection with the agreement, we also entered into a pre-opening services agreement whereby the seller has agreed to pay us approximately \$0.8 million in connection with certain pre-opening activities to be undertaken prior to the closing. We have agreed to purchase inventories at closing consistent with the management and operation of the planned hotel and the related condominium association for an additional amount and have further agreed to enter into a lease agreement for the parking garage and poolside cabanas associated with the planned hotel and to enter into a management agreement relating to the operation and management of the planned hotel's condominium association. We anticipate that the closing of the transaction and the execution of related agreements will take place by the end of 2019, once construction of the planned hotel has been substantially completed. The closing of the transaction is subject to various closing conditions as described in the purchase agreement.

On June 29, 2017, we entered into a promissory note and other loan documents to secure a \$35.5 million mortgage on the DoubleTree by Hilton Jacksonville Riverfront with Wells Fargo Bank, N.A. Pursuant to the loan documents, the loan has a maturity date of July 11, 2024, bears a fixed interest rate of 4.88%, amortizes on a 30-year schedule, and is subject to a prepayment premium following a prepayment lockout period. We used a portion of the proceeds to repay the existing first mortgage on the DoubleTree by Hilton Jacksonville Riverfront, to pay closing costs and for general corporate purposes.

On October 11, 2017, the Company closed a sale and issuance of 1,200,000 shares of its newly authorized 7.875% Series C Cumulative Redeemable Perpetual Preferred Stock (the "Series C Preferred Stock"), for net proceeds after all estimated expenses of approximately \$28.0 million. On October 17, 2017, the Company closed a sale and issuance of an additional 100,000 shares of its Series C Preferred Stock, for net proceeds of approximately \$2.5 million, pursuant to the underwriters' partial exercise of an option granted by the Company to purchase additional shares. The Company contributed the net proceeds from the offering to its Operating Partnership for an equivalent number of Series C Cumulative Redeemable Perpetual Preferred Units (the "Series C Preferred Units"). We used the net proceeds to redeem in full the Operating Partnership's 7.0% senior unsecured notes (the "7% Notes") and for working capital.

On November 15, 2017, the Operating Partnership redeemed the entire \$25.3 million principal amount of the 7% Notes, at a redemption price equal to 101% of the principal amount of the 7% Notes, plus any accrued and unpaid interest to, but not including, the redemption date.

On February 1, 2018, we received proceeds of \$5.0 million on the Hotel Ballast Wilmington, Tapestry Collection by Hilton mortgage loan after meeting certain requirements, per the mortgage documents.

On February 12, 2018, the Company and the Operating Partnership closed on a sale and issuance by the Operating Partnership of an aggregate \$25.0 million of the 7.25% senior unsecured notes due 2021 (the "7.25% Notes"), unconditionally guaranteed by the Company, for net proceeds after all estimated expenses of approximately \$23.3 million. The Operating Partnership used the net proceeds from this offering, together with existing cash on hand and \$57.0 million of asset-level mortgage indebtedness, to finance the acquisition of the Hyatt Centric Arlington and for working capital.

On February 26, 2018, we entered into a First Amendment to Loan Agreement, Amended and Restated Promissory Note, and other related documents with International Bank of Commerce to amend the terms of the mortgage loan on The Whitehall hotel located in Houston, TX. Pursuant to the amended loan documents, payments of principal and interest on a 25-year amortization schedule have begun and the maturity date was extended until February 26, 2023.

On March 1, 2018, we acquired the 318-room Hyatt Centric Arlington located in Arlington, Virginia at an aggregate purchase price of approximately \$79.7 million, including seller credits (the "Arlington Acquisition"). Concurrently with the closing, we entered into a franchise agreement with an affiliate of Hyatt Hotels Corporation for the hotel to continue operating as the Hyatt Centric Arlington, and a management agreement with Highgate Hotels for the management of the hotel. The management agreement: (i) has an initial term of three years commencing March 1, 2018; (ii) provides for a base management fee equal to 2.50% of gross revenues; and (iii) provides for an incentive management fee equal to 10% of the amount by which gross operating profit, as defined in the management agreement, for a given year exceeds the budgeted gross operating profit for such year; provided, however, that the incentive management fee payable in respect of any year shall not exceed 0.5% of the gross revenues of the hotel. The Hyatt Centric Arlington is subject to a long-term ground lease agreement that covers all of the land underlying the hotel. The ground lease requires us to make rental payments of \$50,000 per year in base rent and percentage rent equal to 3.5% of gross rooms revenues in excess of certain thresholds, as defined in the agreements. The initial term of the ground lease expires in 2025 and may be extended by us for five additional renewal periods of 10 years each.

On March 1, 2018, we entered into a loan agreement, a first and second promissory note ("Note A" and "Note B", respectively), and other loan documents, including a guarantee by the Operating Partnership, to secure an aggregate \$57.0 million mortgage (the

“Mortgage Loan”) on the Hyatt Centric Arlington with Fifth Third Bank. Pursuant to the Mortgage Loan documents, Note A had an original principal balance in the amount of \$50.0 million; had a term of 3 years, with two 1-year extension options, each of which is subject to certain criteria; bore a floating interest rate of one-month LIBOR plus 3.00%, payable monthly; and required monthly principal payments of \$78,650. Pursuant to the Mortgage Loan documents, Note B had an original principal balance in the amount of \$7.0 million; had a term of 1-year, with two 1-year extension options, each of which is subject to certain criteria; bore a floating interest rate of 3-month LIBOR plus 5.00%, payable monthly; and requires monthly principal payments of \$100,000 during the initial 1-year term, \$150,000 during the first 1-year extended term, and \$250,000 during the second 1-year extended term, with interest payments due monthly on the outstanding principal amount during all three terms. The full amount of the loan proceeds, together with proceeds of the 7.25% Notes offering and cash on hand, were used to finance the Arlington Acquisition.

On July 2, 2018, we purchased a portion of the parking lot, previously leased, adjacent to the DoubleTree by Hilton Raleigh Brownstone-University for an aggregate purchase price of \$3.5 million.

On July 27, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the DoubleTree by Hilton Raleigh Brownstone-University with MetLife Commercial Mortgage Originator, LLC. The mortgage has an initial principal balance of \$18.3 million, with an additional \$5.2 million available upon the satisfaction of certain conditions. The mortgage has an initial term of 4 years with a 1-year extension and bears a floating rate of interest equal to the 1-month LIBOR rate plus 4.00%. The mortgage requires monthly interest-only payments and, following a 12-month lockout, can be prepaid with a penalty during its second year and without penalty thereafter. We entered into an interest-rate cap agreement to limit our exposure through August 1, 2022 to increases in LIBOR exceeding 3.25% on a notional amount of \$23.5 million. We used a portion of the proceeds to repay the existing first mortgage on the DoubleTree by Hilton Raleigh Brownstone-University and to pay closing costs and intend to use the balance of the proceeds for general corporate purposes.

On July 31, 2018, we entered into a second amendment to the loan and security agreement; an amended, restated and consolidated mortgage loan note; and other related documents with its existing lender, TD Bank, N.A., to amend the terms of our mortgage loan on the DoubleTree by Hilton Philadelphia Airport. Concurrent with the loan modification, we also entered into a 5-year swap agreement with The Toronto-Dominion Bank. Pursuant to the amended loan documents: (i) the principal balance of the loan was increased from approximately \$30.0 million to \$42.2 million; (ii) the loan’s maturity date was extended to July 31, 2023; (iii) the loan bears a floating interest rate equal to the 1-month LIBOR rate plus 2.27% (the “Loan Rate”); (iv) the loan amortizes on a 30-year schedule with payments of principal and interest beginning immediately; (v) the loan can be prepaid without penalty; and (vi) the loan will no longer be fully guaranteed by the Operating Partnership, but the Operating Partnership has guaranteed certain standard “bad boy” carveouts. Pursuant to the swap agreement: (i) the Loan Rate has been swapped for a fixed interest rate of 5.237%; notional amounts of the swap approximate the declining balance of the loan; and (iii) we are responsible for any potential termination fees associated with early termination of the swap agreement. We used a portion of the proceeds to repay in full the existing Note B to the mortgage loan on our Hyatt Centric Arlington and to pay closing costs associated with the amendment and will use the balance of the proceeds for general corporate purposes.

On August 31, 2018, we entered into a Sales Agency Agreement, with Sandler O’Neill & Partners, L.P. (“Sandler O’Neill”), under which the Company may sell from time to time through Sandler O’Neill, as sales agent, shares of the Company’s common stock, par value \$0.01 per share, having an aggregate gross sales price of up to \$5.0 million and up to 400,000 shares of the Company’s 7.875% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share. Through December 31, 2018, the Company sold 88,297 shares of common stock and 52,141 shares of Series C Preferred Stock, for an aggregate total of approximately \$1.8 million in gross proceeds before recognition of offering costs.

On September 18, 2018, we entered into a loan agreement and other documents, including a promissory note, to secure a mortgage on the Hyatt Centric Arlington with MetLife Real Estate Lending LLC. Pursuant to the loan documents, the Mortgage Loan has an initial principal balance of \$50.0 million; has a term of 10 years; bears a fixed interest rate of 5.25%; amortizes on a 30-year schedule; and following a 5-year lockout, can be prepaid with penalty in years 6-10 and without penalty during the final 4 months of the term. The Company used the proceeds to repay the existing first mortgage on the Hyatt Centric Arlington, to pay closing costs, and for general corporate purposes.

2. Summary of Significant Accounting Policies

Basis of Presentation – The consolidated financial statements of the Company presented herein include all of the accounts of Sotherly Hotels Inc., the Operating Partnership, MHI TRS and subsidiaries. All significant inter-company balances and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The consolidated financial statements of the Operating Partnership presented herein include all of the accounts of Sotherly Hotels LP, MHI TRS and subsidiaries. All significant inter-company balances and transactions have been eliminated. Additionally, all

administrative expenses of the Company and those expenditures made by the Company on behalf of the Operating Partnership are reflected as the administrative expenses, expenditures and obligations thereto of the Operating Partnership, pursuant to the terms of the Partnership Agreement.

Investment in Hotel Properties – Investments in hotel properties include investments in operating properties which are recorded at fair value on acquisition date and allocated to land, property and equipment and identifiable intangible assets. Replacements and improvements are capitalized, while repairs and maintenance are expensed as incurred. Upon the sale or retirement of a fixed asset, the cost and related accumulated depreciation are removed from our accounts and any resulting gain or loss is included in the statements of operations. Expenditures under a renovation project, which constitute additions or improvements that extend the life of the property, are capitalized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 7 to 39 years for buildings and building improvements and 3 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.

We review our 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, adverse permanent 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, management performs an analysis to determine if the estimated undiscounted future cash flows from operations and the proceeds from the ultimate disposition of a hotel property exceeds its carrying value. If the estimated undiscounted future cash flows are found to be less than the carrying amount of the asset, an adjustment to reduce the carrying amount to the related hotel property's estimated fair market value would be recorded and an impairment loss recognized.

Assets Held For Sale – The Company records assets as held for sale when management has committed to a plan to sell the assets, actively seeks a buyer for the assets, and the consummation of the sale is considered probable and is expected within one year.

Cash and Cash Equivalents – We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Concentration of Credit Risk – We hold cash accounts at several institutions in excess of the Federal Deposit Insurance Corporation (the "FDIC") protection limits of \$250,000. Our exposure to credit loss in the event of the failure of these institutions is represented by the difference between the FDIC protection limit and the total amounts on deposit. Management monitors, on a regular basis, the financial condition of the financial institutions along with the balances there on deposit to minimize our potential risk.

Restricted Cash – Restricted cash includes real estate tax escrows, insurance escrows and reserves for replacements of furniture, fixtures and equipment pursuant to certain requirements in our various mortgage agreements.

Accounts Receivable – Accounts receivable consists primarily of hotel guest, banqueting and credit card receivables. Ongoing evaluations of collectability are performed and an allowance for potential credit losses is provided against the portion of accounts receivable that is estimated to be uncollectible.

Inventories – Inventories, consisting primarily of food and beverages, are stated at the lower of cost or net realizable value, with cost determined on a method that approximates first-in, first-out basis.

Franchise License Fees – Fees expended to obtain or renew a franchise license are amortized over the life of the license or renewal. The unamortized franchise fees as of December 31, 2018 and 2017 were approximately \$471,996 and \$532,070, respectively. Amortization expense for the years ended December 31, 2018, 2017, and 2016 was \$60,073, \$46,209 and \$52,330, respectively.

Favorable Lease Assets, Net – Favorable lease assets are recorded on non-market contracts assumed as part of the acquisition of certain hotels. We review the terms of agreements assumed in conjunction with the purchase of a hotel to determine if the terms are favorable or unfavorable compared to an estimated market agreement at the acquisition date. Favorable lease assets are recorded at the acquisition date and amortized using straight-line method over the term of the remaining agreement. Amortization expense for the twelve-month periods ended December 31, 2018, 2017 and 2016 totaled \$316,080, \$0 and \$0, respectively.

Deferred Financing and Offering Costs – Deferred financing costs are recorded at cost and consist of loan fees and other costs incurred in issuing debt and are reflected in mortgage loans, net and unsecured notes, net on the consolidated balance sheets. Deferred offering costs are recorded at cost and consist of offering fees and other costs incurred in advance of issuing equity and are reflected in prepaid expenses, inventory and other assets on the consolidated balance sheets. Amortization of deferred financing costs is computed

using a method that approximates the effective interest method over the term of the related debt and is included in interest expense in the consolidated statements of operations.

Our deferred offering costs are applied pro-rata against the minimum anticipated proceeds of an equity offering. If the offering does not generate the minimum anticipated proceeds or is aborted then the excess will be included in corporate general and administrative expenses in the consolidated statements of operations. During the twelve months ended December 31, 2018, 2017 and 2016, the Company wrote off \$0, approximately \$0.5 million and \$0 of deferred offering costs, respectively. As of December 31, 2018, there were no deferred offering costs included in prepaid expenses, inventory and other assets.

Derivative Instruments – Our derivative instruments are reflected as assets or liabilities on the consolidated balance sheet and measured at fair value. Derivative instruments used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as an interest rate risk, are considered fair value hedges. Derivative instruments used to hedge exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. For a derivative instrument designated as a cash flow hedge, the change in fair value each period is reported in accumulated other comprehensive income in stockholders' equity and partners' capital to the extent the hedge is effective. For a derivative instrument designated as a fair value hedge, the change in fair value each period is reported in earnings along with the change in fair value of the hedged item attributable to the risk being hedged. For a derivative instrument that does not qualify for hedge accounting or is not designated as a hedge, the change in fair value each period is reported in earnings.

We use derivative instruments to add stability to interest expense and to manage our exposure to interest-rate movements. To accomplish this objective, we currently use interest rate caps and an interest rate swap which act as cash flow hedges and are not designated as hedges. We value our interest-rate caps and interest rate swap at fair value, which we define as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We also have used derivative instruments in the Company's stock to obtain more favorable terms on our financing. We do not enter into contracts to purchase or sell derivative instruments for speculative trading purposes.

Fair Value Measurements –

We classify the inputs used to measure fair value into the following hierarchy:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3 Unobservable inputs for the asset or liability.

We endeavor to utilize the best available information in measuring fair value. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The following table represents our assets and liabilities measured at fair value and the basis for that measurement (our interest rate caps and interest rate swap are the only assets or liabilities measured at fair value on a recurring basis and there were no non-recurring asset and liability fair value measurements as of December 31, 2018 and 2017, respectively):

	Level 1	Level 2	Level 3
December 31, 2017			
Interest Rate Cap ⁽¹⁾	\$ —	\$ 5,213	\$ —
Interest Rate Swap ⁽²⁾	\$ —	\$ —	\$ —
Mortgage loans ⁽³⁾	\$ —	\$(292,368,370)	\$ —
Unsecured notes ⁽⁴⁾	\$ —	\$ —	\$ —
December 31, 2018			
Interest Rate Caps ⁽¹⁾	\$ —	\$ 94,697	\$ —
Interest Rate Swap ⁽²⁾	\$ —	\$ (984,677)	\$ —
Mortgage loans ⁽³⁾	\$ —	\$(357,279,949)	\$ —
Unsecured notes ⁽⁴⁾	\$(25,390,000)	\$ —	\$ —

(1) Interest rate caps, which caps the 1-month LIBOR rates between 2.5% and 3.25%.

- (2) Interest rate swap, which takes the Loan Rate and swaps it for a fixed interest rate of 5.237%; notional amounts of the swap approximate the declining balance of the loan.
- (3) Mortgage loans are reflected at carrying value on our Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017.
- (4) Unsecured notes are recorded at historical cost on our Consolidated Balance Sheet as of December 31, 2018.

Noncontrolling Interest in Operating Partnership – Certain hotel properties have been acquired, in part, by the Operating Partnership through the issuance of limited partnership units of the Operating Partnership. The noncontrolling interest in the Operating Partnership is: (i) increased or decreased by the limited partners’ pro-rata share of the Operating Partnership’s net income or net loss, respectively; (ii) decreased by distributions; (iii) decreased by redemption of partnership units for the Company’s common stock; and (iv) adjusted to equal the net equity of the Operating Partnership multiplied by the limited partners’ ownership percentage immediately after each issuance of units of the Operating Partnership and/or the Company’s common stock through an adjustment to additional paid-in capital. Net income or net loss is allocated to the noncontrolling interest in the Operating Partnership based on the weighted average percentage ownership throughout the period.

Revenue Recognition – Revenue consists of amounts derived from hotel operations, including the sales of rooms, food and beverage, and other ancillary services. Room revenue is recognized over a customer’s hotel stay. Revenue from food and beverage and other ancillary services is generated when a customer chooses to purchase goods or services separately from a hotel room and revenue is recognized on these distinct goods and services at the point in time or over the time period that goods or services are provided to the customer. Certain ancillary services are provided by third parties and the Company assesses whether it is the principal or agent in these arrangements. If the Company is the agent, revenue is recognized based upon the commission earned from the third party. If the Company is the principal, the Company recognizes revenue based upon the gross sales price. Some contracts for rooms or food and beverage services require an upfront deposit which is recorded as advanced deposits (or contract liabilities) and recognized once the performance obligations are satisfied and shown on our consolidated balance sheets.

Certain of the Company’s hotels have retail spaces, restaurants or other spaces which the Company leases to third parties. Lease revenue is recognized on a straight-line basis over the life of the lease and included in other operating revenues in the Company’s consolidated statements of operations.

The Company collects sales, use, occupancy and similar taxes at its hotels which are presented on a net basis on the consolidated statements of operations. Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. The Company maintains an allowance for doubtful accounts sufficient to cover estimated potential credit losses.

Lease Revenue – Several of our properties generate revenue from leasing commercial space adjacent to the hotel, the restaurant space within the hotel, apartment units and space on the roofs of our hotels for antennas and satellite dishes. We account for the lease income as revenue from other operating departments within the consolidated statement of operations pursuant to the terms of each lease. Lease revenue was \$1,730,015, \$1,780,525 and \$1,785,934, for the years ended December 31, 2018, 2017, and 2016, respectively.

A schedule of minimum future lease payments receivable for the following twelve-month periods is as follows:

December 31, 2019	\$ 1,675,930
December 31, 2020	1,625,491
December 31, 2021	1,566,965
December 31, 2022	1,393,983
December 31, 2023	557,428
December 31, 2024 and thereafter	3,199,781
Total	<u>\$ 10,019,578</u>

Variable Interest Entities – The Operating Partnership is a variable interest entity. The Company’s only significant asset is its investment in the Operating Partnership, and consequently, substantially all of the Company’s assets and liabilities represent those assets and liabilities of the Operating Partnership and its subsidiaries. All of the Company’s debt is an obligation of the Operating Partnership and its subsidiaries.

Income Taxes – The Company has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. As a REIT, the Company generally will not be subject to federal income tax. MHI TRS, our wholly owned

taxable REIT subsidiary which leases our hotels from subsidiaries of the Operating Partnership, is subject to federal and state income taxes.

We account 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. At December 31, 2018, deferred tax assets total approximately \$5.1 million, of which approximately \$4.4 million relates to net operating losses of our TRS Lessee. A valuation allowance is required for deferred tax assets if, based on all available evidence, it is “more-likely-than-not” that all or a portion of the deferred tax asset will or will not be realized due to the inability to generate sufficient taxable income in certain financial statement periods. The “more-likely-than-not” analysis means the likelihood of realization is greater than 50%, that we will or will not be able to fully utilize the deferred tax assets against future taxable income. The net amount of deferred tax assets that are recorded on the financial statements must reflect the tax benefits that are expected to be realized using these criteria. We perform this analysis by evaluating future hotel revenues and expenses, accounting for certain non-recurring costs and expenses during the current and prior two fiscal years, as well as anticipated changes in the lease rental payments from the TRS Lessee to subsidiaries of the Operating Partnership. We have determined that it is more-likely-than-not that we will be able to fully utilize our deferred tax assets for future tax consequences, therefore no valuation allowance is required. As of December 31, 2018, we had no uncertain tax positions. Our policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2018, the tax years that remain subject to examination by the major tax jurisdictions to which the Company is subject generally include 2015 through 2017. In addition, as of December 31, 2018, the tax years that remain subject to examination by the major tax jurisdictions to which MHI TRS is subject, because of open NOL carryforwards, generally include 2014 through 2017.

The Operating Partnership is generally not subject to federal and state income taxes as the unit holders of the Partnership are subject to tax on their respective shares of the Partnership’s taxable income.

Stock-based Compensation – The Company’s 2004 Long Term Incentive Plan (the “2004 Plan”) and its 2013 Long-Term Incentive Plan (the “2013 Plan”), which the Company’s stockholders approved in April 2013, permit the grant of stock options, restricted stock and performance share compensation awards to its employees and directors for up to 350,000 and 750,000 shares of common stock, respectively. The Company believes that stock awards align the interests of its employees with those of its stockholders.

Under the 2004 Plan, the Company has made restricted stock and deferred stock awards totaling 337,438 shares including 255,938 shares issued to certain executives and employees and 81,500 restricted shares issued to its independent directors. All of the 255,938 shares issued to certain of our executives and employees have vested. All of the 81,500 restricted shares issued to the Company’s independent directors have vested. The 2004 plan was terminated in 2013.

As of December 31, 2018, under the 2013 Plan, the Company has made stock awards totaling 163,350 shares, including 77,600 non-restricted shares to certain executives, directors and employees, and 85,750 restricted shares issued to its independent directors and one employee. All awards have vested except for 20,000 shares issued to one employee, which will vest over the next 4 years.

Previously, under the 2004 Plan, and currently, under the 2013 Plan, the Company may issue a variety of performance-based stock awards, including nonqualified stock options. The value of the awards is charged to compensation expense on a straight-line basis over the vesting or service period based on the value of the award as determined by the Company’s stock price on the date of grant or issuance. As of December 31, 2018, no performance-based stock awards have been granted. Consequently, stock-based compensation as determined under the fair-value method would be the same under the intrinsic-value method.

Total stock based compensation cost recognized under the 2004 Plan and 2013 Plan for the years ended December 31, 2018, 2017, and 2016 was \$135,428, \$109,080 and \$211,682, respectively. The 2004 Plan was terminated in April 2013.

Additionally, the Company sponsors and maintains an ESOP and related trust for the benefit of its eligible employees. We reflect unearned ESOP shares as a reduction of stockholders’ equity. Dividends on unearned ESOP shares, when paid, are considered compensation expense. The Company recognizes compensation expense equal to the fair value of the Company’s ESOP shares during the periods in which they are committed to be released. For the years ended December 31, 2018, 2017, and 2016 the ESOP compensation cost was \$253,370, \$238,307 and \$0, respectively. To the extent that the fair value of the Company’s ESOP shares differs from the cost of such shares, the differential is recognized as additional paid in capital. Because the ESOP is internally leveraged through a loan from the Company to the ESOP, the loan receivable by the Company from the ESOP is not reported as an asset nor is the debt of the ESOP shown as a liability in the Company’s consolidated financial statements.

Advertising – Advertising costs were \$432,754, \$357,379 and \$452,665 for the years ended December 31, 2018, 2017, and 2016, respectively and are expensed as incurred.

Business Interruption Proceeds – Insurance recoveries for business interruption were recognized during the years ended December 31, 2018 and 2017, for approximately \$0.8 million and \$0.6 million, respectively. The events that resulted in these recoveries during the year ending December 31, 2018, were caused by an electrical outage at our property in Houston, Texas and by Hurricane Florence at our property in Wilmington, North Carolina. Business interruption recoveries during the year ended December 31, 2017, were caused by the electrical outage at our property in Houston, Texas and by hurricanes Irma and Matthew at our properties in Savannah, Georgia and Tampa, Florida, respectively. The insurance proceeds were reflected in the statement of operations in other operating departments revenues.

Involuntary Conversion of Assets – We record gains or losses on involuntary conversions of assets due to recovered insurance proceeds to the extent the undepreciated cost of a nonmonetary asset differs from the amount of monetary proceeds received. During the years ending December 31, 2018, 2017, and 2016, we recognized approximately \$0.9 million, approximately \$2.2 million and \$0, respectively, for gain on involuntary conversion of assets, which is reflected in the consolidated statements of operations.

Comprehensive Income (Loss) – Comprehensive income (loss), as defined, includes all changes in equity (net assets) during a period from non-owner sources. We do not have any items of comprehensive income (loss) other than net income (loss).

Segment Information – We have determined that our business is conducted in one reportable segment: hotel ownership.

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

Reclassifications – Certain reclassifications have been made to the prior period’s financial statements to conform to the current year presentation. We have adopted ASU 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash, whereby the restricted cash balances are reflected in the total Cash, Cash Equivalents and Restricted Cash for both current and prior year presentation. We have also reclassified gain (loss) on disposal of assets in the prior period’s consolidated statements of operations, to separate disposals related to changes in estimated useful lives of assets, from assets which were disposed of by sale in the respective periods. Certain other reclassifications in the amount of approximately \$0.6 million for the twelve-month period ending December 31, 2016, from rooms expense to indirect expense balances on the consolidated statements of operations have been made to conform to the current period presentation. We also reclassified approximately \$0.3 million for the twelve-month period ending December 31, 2016 on the statement of cash flows into line item, loss on early extinguishments of debt, and out of line item, payments of deferred financing costs, in order to conform to the current period presentation.

New Accounting Pronouncements – In July 2018, Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, The FASB decided to provide another transition method and practical expedients in addition to the existing transition method (a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements) by allowing entities to initially apply the new leases standard at the adoption date (such as January 1, 2019, for calendar year-end public business entities) and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Upon adoption, we currently expect to elect the practical expedients allowed under the guidance and retain the original lease classification and historical accounting for initial direct costs for leases existing prior to the adoption date. We also expect that we will elect not to restate prior periods for the impact of the adoption of the new standard and will instead recognize a cumulative-effect adjustment to beginning retained earnings in the period of adoption. These standards are expected to result in the recognition of right-to-use assets and related liabilities to account for our future obligations under the ground lease arrangements for which we are the lessee. We expect to recognize right of use assets and corresponding liabilities of approximately \$2.0 million to approximately \$5.0 million during the first quarter of 2019.

In August 2017, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements and simplifies the application of hedge accounting. This standard will be effective for the first annual period beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted. We adopted this ASU on January 1, 2018 and aside from minor presentation changes in its disclosure on derivative and hedging activities it has not had a material effect on our consolidated financial statements, however this ASU may have a significant impact on future transactions.

In February 2017, the FASB issued ASU 2017-05, *Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20)*. The FASB issued this update to clarify the scope of Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets, and to add guidance for partial sales of nonfinancial assets. Subtopic 610-20, which was issued in May 2014 as a part of Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606),

provides guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. The amendments in this update also simplify GAAP by eliminating several accounting differences between transactions involving assets and transactions involving businesses in many transactions related to: a partial sale of real estate; a transfer of a nonfinancial asset within the scope of FASB ASC Topic 845, *Nonmonetary Transactions*; a contribution of a nonfinancial asset to form a joint venture; and a transfer of a nonfinancial asset to an equity method investee. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. We adopted this ASU as of January 1, 2018. This ASU has not had a material impact on our current consolidated balance sheets, statements of operations or cash flows, however this ASU may have a significant impact on future transactions.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations – Clarifying the Definition of a Business (Topic 805)*. This ASU clarifies the definition of a business and adds further guidance in evaluating whether a transaction should be accounted for as an acquisition of an asset or a business. This standard will be effective for the first annual period beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted. We adopted this ASU on January 1, 2018 and expect certain future hotel acquisitions will be considered asset purchases instead of business combinations. The effects are mainly in regard to acquisition costs treatment, which in the case of asset purchases, are capitalized on the consolidated balance sheets, and in the case of business combinations are typically expensed into the consolidated statements of operations.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. This ASU addresses the diversity within entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows under Topic 230. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early application of this ASU is permitted for all entities. We adopted this ASU on January 1, 2018 and aside from minor presentation changes in its disclosure on restricted cash, it did not have a material effect on our consolidated balance sheets, statements of operations or cash flows.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. Current GAAP either is unclear or does not include specific guidance on the eight cash flow classification issues included in the amendments in this update. The amendments are an improvement to GAAP because they provide guidance for each of the eight issues, thereby reducing the current and potential future diversity in practice. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early application of this ASU is permitted for all entities. We adopted this ASU as of January 1, 2018. The adoption of this ASU did not have a material impact on our current consolidated balance sheets, statements of operations or cash flows.

In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers – Narrow-Scope Improvements and Practical Expedients (Topic 606)*. The amendments in this ASU provide clarification to certain core recognition principles related to ASU No. 2014-09 including collectability, sales tax presentation, noncash consideration, contract modifications and completed contracts at transition and disclosures no longer required if the full retrospective transition method is adopted. The amendments do not change the core principle of the guidance. We adopted this ASU as of January 1, 2018. We evaluated all of our revenue related to contracts with customers and determined how to transition these requirements into our consolidated financial statements. Refer to “New Accounting Pronouncements - ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*,” below for further discussion of revenue recognition.

In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing (Topic 606)*. This update clarifies guidance related to identifying performance obligations and licensing implementation contained in ASU No. 2014-09. The amendments do not change the core principle of the guidance. We have analyzed all of our revenue related to contracts with customers and have determined how to transition these requirements into our consolidated financial statements. We adopted this ASU as of January 1, 2018. The adoption of this ASU did not have a material impact on our consolidated balance sheets, statements of operations or cash flows. Refer to “New Accounting Pronouncements - ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*,” below for further discussion of revenue recognition.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current GAAP and disclosing key information about leasing arrangements. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early application of this ASU is permitted for all entities. We have created an inventory of our leases and are analyzing our current ground lease, office lease, other right-of-use assets and lease liabilities, and parking garage lease obligations that exist. The standard requires a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. In July 2018, Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*. The FASB decided to provide another transition method and practical expedients in addition to the existing transition method (a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest

comparative period in the financial statements) by allowing entities to initially apply the new leases standard at the adoption date (such as January 1, 2019, for calendar year-end public business entities) and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Upon adoption, we currently expect to elect the practical expedients allowed under the guidance and retain the original lease classification and historical accounting for initial direct costs for leases existing prior to the adoption date. We also expect that we will elect not to restate prior periods for the impact of the adoption of the new standard and will instead recognize a cumulative-effect adjustment to beginning retained earnings in the period of adoption. These standards are expected to result in the recognition of right-to-use assets and related liabilities to account for our future obligations under the ground lease arrangements for which we are the lessee. We expect to recognize right of use assets and corresponding liabilities of approximately \$2.0 million to approximately \$5.0 million during the first quarter of 2019.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, 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. ASU No. 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for us on January 1, 2018. Early adoption is permitted. The standard permits the use of either the retrospective or cumulative effect transition method. By working in conjunction with our hotel operators, we completed our evaluation of the effect that ASU No. 2014-09 will have on our consolidated financial statements and our evaluation of each of our revenue streams under the new standard. Because of the short-term, day-to-day nature of our hotel revenues, we determined that the pattern of revenue recognition will not change significantly. Under ASU No. 2014-09, there will be a recharacterization of certain revenue streams affecting both gross and net revenue reporting due to changes in principal versus agent guidance, which presentation is deemed immaterial for us and will not affect net income. Additionally, we do not sell hotel properties to customers as defined by FASB, but have historically disposed of hotel properties for cash sales with no contingencies and no future involvement in the hotel operations, and therefore, ASU No. 2014-09 will not impact the recognition of hotel sales. We finalized our expanded disclosure for the notes to the consolidated financial statements pursuant to the new requirements. We adopted this ASU on January 1, 2018 under the cumulative effect transition method. No adjustment was recorded to our opening balance of retained earnings on January 1, 2018 as there was no impact for us. Additionally, comparative information beginning in 2018 will not be restated and will continue to be reported under Revenue Recognition (Topic 605). We also expect that the effect of ASU No. 2014-09 will be immaterial on an on-going basis.

3. Acquisition of Hotel Properties

Hyde Resort & Residences. On March 1, 2018, we acquired the Hyatt Centric Arlington hotel, for a total fair value of consideration transferred including inventory and other assets of approximately \$79.7 million (after amendment of the initial purchase price of \$81.0 million). We considered this acquisition to be an asset acquisition as opposed to a business combination, applying the screen test, as discussed in the Accounting Standards Update 2017-01 – Business Combinations – Clarifying the Definition of a Business (Topic 805).

The results of operations of the hotels are included in our consolidated financial statements from the date of acquisition. The total revenue and net income related to the Hyatt Centric Arlington acquisition for the period March 1, 2018 to December 31, 2018 are approximately \$18.1 million and \$0.8 million, respectively.

Hyde Resort & Residences. On January 30, 2017, we acquired the hotel commercial condominium unit of the Hyde Resort & Residences condominium hotel, for a total fair value of consideration transferred including inventory and other assets of approximately \$4.8 million.

The total revenue and net income related to the Hyde Resort & Residences acquisition for the period January 1, 2018 to December 31, 2018 are approximately \$6.7 million and \$0.1 million, respectively and total revenue and net loss for the period January 30, 2017 to December 31, 2017 are approximately \$4.0 million and \$(0.7) million, respectively.

The allocation of the purchase price based on their fair values was as follows:

	Hyatt Centric Arlington	Hyde Resort & Residences
Land and land improvements	\$ 190,916	\$ 500
Buildings and improvements	70,369,046	4,309,500
Furniture, fixtures and equipment	6,229,888	72,616
Favorable lease and other intangible assets	3,054,812	—
Investment in hotel properties	79,844,662	4,382,616
Accrued liabilities and other costs	(111,946)	(866,142)
Prepaid expenses, inventory and other assets	—	470,375
Net cash	<u><u>\$ 79,732,716</u></u>	<u><u>\$ 3,986,849</u></u>

4. Investment in Hotel Properties, Net

Investment in hotel properties as of December 31, 2018 and 2017 consisted of the following:

	December 31, 2018	December 31, 2017
Land and land improvements	\$ 64,409,730	\$ 59,504,625
Buildings and improvements	424,657,327	348,532,577
Furniture, fixtures and equipment	57,830,987	48,467,956
	546,898,044	456,505,158
Less: accumulated depreciation and impairment	(111,172,230)	(98,705,646)
Investment in Hotel Properties, Net	<u><u>\$ 435,725,814</u></u>	<u><u>\$ 357,799,512</u></u>

Our review of possible impairment during the years ended December 31, 2018, 2017 and 2016, resulted in no impairment on our investment in hotel properties, respectively.

5. Debt

Mortgage Loans, Net. As of December 31, 2018 and 2017, we had approximately \$364.8 million and approximately \$297.3 million of outstanding mortgage debt, respectively. The following table sets forth our mortgage debt obligations on our hotels.

Property	Balance Outstanding as of		Prepayment Penalties	Maturity Date	Amortization Provisions	Interest Rate
	December 31, 2018	December 31, 2017				
Crowne Plaza Tampa Westshore ⁽¹⁾	\$ 18,307,000	\$ 15,284,200	None	6/30/2019	⁽¹⁾	LIBOR plus 3.75 %
The DeSoto ⁽²⁾	33,824,350	34,645,929	Yes	7/1/2026	25 years	4.25%
DoubleTree by Hilton Jacksonville Riverfront ⁽³⁾	34,773,546	35,294,741	Yes	7/11/2024	30 years	4.88%
DoubleTree by Hilton Laurel ⁽⁴⁾	8,845,299	9,132,558	Yes	8/5/2021	25 years	5.25%
DoubleTree by Hilton Philadelphia Airport ⁽⁵⁾	42,026,986	30,432,260	None	7/31/2023	30 years	LIBOR plus 2.27 %
DoubleTree by Hilton Raleigh-Brownstone University ⁽⁶⁾	18,300,000	14,503,925	Yes	7/27/2022	⁽⁶⁾	LIBOR plus 4.00 %
DoubleTree Resort by Hilton Hollywood Beach ⁽⁷⁾	57,064,824	58,023,567	n/a	10/1/2025	30 years	4.913%
Georgian Terrace ⁽⁸⁾	44,202,968	45,032,662	n/a	6/1/2025	30 years	4.42%
Hotel Ballast Wilmington, Tapestry Collection by Hilton ⁽⁹⁾	34,236,104	30,000,000	Yes	1/1/2027	25 years	4.25%
Hyatt Centric Arlington ⁽¹⁰⁾	49,885,045	—	Yes	9/18/2028	30 years	5.25%
Sheraton Louisville Riverside ⁽¹¹⁾	11,414,300	11,701,930	Yes	12/1/2026	25 years	4.27%
The Whitehall ⁽¹²⁾	\$ 14,733,458	15,000,000	Yes	2/26/2023	25 years	LIBOR plus 3.50 %
Total Mortgage Principal Balance	\$367,613,880	\$299,051,772				
Deferred financing costs, net	(2,951,327)	(1,923,928)				
Unamortized premium on loan	\$ 166,292	190,972				
Total Mortgage Loans, Net	\$364,828,845	\$297,318,816				

- (1) The note bears a floating interest rate of 1-month LIBOR plus 3.75% subject to a floor rate of 3.75%; with monthly principal payments of \$23,100; the note provides that the mortgage can be extended for two additional periods of one year each, subject to certain conditions.
- (2) The note amortizes on a 25-year schedule after an initial 1-year interest-only period (which expired in August 2017), and is subject to a pre-payment penalty except for any pre-payments made within 120 days of the maturity date.
- (3) The note may not be prepaid until August 2019, after which it is subject to a pre-payment penalty until March 2024. Prepayment can be made without penalty thereafter.
- (4) The note is subject to a pre-payment penalty until April 2021. Prepayment can be made without penalty thereafter.
- (5) The note bears a floating interest rate of 1-month LIBOR plus 2.27%, but we entered into a swap agreement to fix to the rate at 5.237%. Under the swap agreement, notional amounts approximate the declining balance of the loan and we are responsible for any potential termination fees associated with early termination of the swap agreement.
- (6) The note provides initial proceeds of \$18.3 million, with an additional \$5.2 million available upon the satisfaction of certain conditions; has an initial term of 4 years with a 1-year extension; bears a floating interest rate of the 1-month LIBOR plus 4.00%; requires interest only monthly payments; and following a 12-month lockout, can be prepaid with penalty in year 2 and without penalty thereafter. We entered into an interest-rate cap agreement to limit our exposure through August 1, 2022 to increases in LIBOR exceeding 3.25% on a notional amount of \$23,500,000.
- (7) With limited exception, the note may not be prepaid until June 2025.
- (8) With limited exception, the note may not be prepaid until February 2025.
- (9) The note amortizes on a 25-year schedule after an initial 1-year interest-only period, and is subject to a pre-payment penalty except for any pre-payments made within 120 days of the maturity date.
- (10) Following a 5-year lockout, the note can be prepaid with penalty in years 6-10 and without penalty during the final 4 months of the term.
- (11) The note bears a fixed interest rate of 4.27% for the first 5 years of the loan, with an option for the lender to reset the interest rate after 5 years.
- (12) The note bears a floating interest rate of the 1-month LIBOR plus 3.5%, subject to a floor rate of 4.0% and is subject to prepayment penalties subject to a declining scale from 3.0% penalty on or before the first anniversary date, a 2.0% penalty during the second anniversary year and a 1.0% penalty after the third anniversary date.

At December 31, 2018, we were in compliance with all debt covenants, current on all loan payments and not otherwise in default under any of our mortgage loans, with the exception of the mortgage on the Crowne Plaza Tampa Westshore. At December 31,

2018, we failed to meet the Debt Service Coverage Ratio (“DSCR”) covenant under the mortgage of the Crowne Plaza Tampa Westshore. We are currently in discussions with the existing lender to modify or refinance the mortgage on similar terms, with an extension of the maturity date and a reduced DSCR requirement. Notwithstanding the modification discussions, the existing loan agreement contains a balancing provision that allows us to either pay down the principal balance of the loan or offer cash collateral sufficient to meet the DSCR requirement with which we will comply in the event a modification or refinance cannot be executed.

Total future mortgage debt maturities, without respect to any extension of loan maturity, as of December 31, 2018 were as follows:

December 31, 2019	\$ 24,301,062
December 31, 2020	6,161,782
December 31, 2021	14,362,532
December 31, 2022	24,752,732
December 31, 2023	60,594,053
December 31, 2024 and thereafter	237,441,719
Total future maturities	<u>\$ 367,613,880</u>

Unsecured Notes

7.0% Unsecured Notes. On November 21, 2014, the Operating Partnership issued its 7% Notes in the aggregate amount of \$25.3 million. The indenture required quarterly payments of interest and was to mature on November 15, 2019. The 7% Notes were redeemed on November 15, 2017 at 101% of face value.

7.25% Unsecured Notes. On February 12, 2018, the Company and the Operating Partnership closed on a sale and issuance by the Operating Partnership of an aggregate \$25.0 million of the 7.25% Notes, unconditionally guaranteed by the Company, for net proceeds after all estimated expenses of approximately \$23.3 million. The Operating Partnership used the net proceeds from this offering, together with existing cash on hand and \$57.0 million of asset-level mortgage indebtedness, to finance the Arlington Acquisition and for working capital.

6. Commitments and Contingencies

Ground, Building and Submerged Land Leases – We lease 2,086 square feet of commercial space next to the Hilton Savannah DeSoto for use as an office, retail or conference space, or for any related or ancillary purposes for the hotel and/or atrium space. In December 2007, we signed an amendment to the lease to include rights to the outdoor esplanade adjacent to the leased commercial space. The areas are leased under a six-year operating lease, which expired October 31, 2006 and has been renewed for the third of three optional five-year renewal periods expiring October 31, 2011, October 31, 2016 and October 31, 2021, respectively. Rent expense for this operating lease for the years ended December 31, 2018, 2017, and 2016 was each \$72,984, respectively.

We lease, as landlord, the entire fourteenth floor of the Savannah hotel property to The Chatham Club, Inc. under a ninety-nine year lease expiring July 31, 2086. This lease was assumed upon the purchase of the building under the terms and conditions agreed to by the previous owner of the property. No rental income is recognized under the terms of this lease as the original lump sum rent payment of \$990 was received by the previous owner and not prorated over the life of the lease.

We lease land adjacent to the Crowne Plaza Tampa Westshore for use as parking under a five-year renewable agreement with the Florida Department of Transportation that commenced in July 2009 and expires in July 2019. The agreement requires annual payments of \$2,432, plus tax, and may be renewed for an additional five years. Rent expense for each of the years ended December 31, 2018, 2017, and 2016 was \$2,602, respectively.

We lease 5,216 square feet of commercial office space in Williamsburg, Virginia under an agreement, as amended, that commenced September 1, 2009 and extended to August 31, 2019. Rent expense for the years ended December 31, 2018, 2017, and 2016 was \$96,117, \$90,208 and \$91,003, respectively.

We lease the parking garage adjacent to the Hyde Resort & Residences, along with meeting and office space, in Hollywood Beach, Florida. The parking garage and meeting space is leased under a 20-year operating lease requiring monthly payments of \$20,000, which expires in February 2037. Rent expense for the years ending December 31, 2018 and 2017 totaled \$240,000 and \$220,000, respectively.

We lease the land underlying all of the Hyatt Centric Arlington hotel pursuant to a ground lease. The ground lease requires us to make rental payments of \$50,000 per year in base rent and percentage rent equal to 3.5% of gross room revenue in excess of certain thresholds, as defined in the ground lease agreement. The initial term of the ground lease expires in 2025 and may be extended by us for five additional renewal periods of 10 years each. Rent expense for the twelve months ended December 31, 2018 was \$524,490.

We also lease certain furniture and equipment under financing arrangements expiring by October 2019.

A schedule of minimum future lease payments for the following twelve-month periods is as follows:

December 31, 2019	475,343
December 31, 2020	364,163
December 31, 2021	354,639
December 31, 2022	351,464
December 31, 2023	351,464
December 31, 2024 and thereafter	3,568,701
Total	\$ 5,465,774

Employment Agreements— The Company has entered into various employment contracts with employees that could result in obligations to us in the event of a change in control or termination without cause.

Management Agreements – As of December 31, 2018, the Hyatt Centric Arlington hotel operated under a management agreement with Highgate Hotels L.P. The management agreement has an initial term of three years expiring March 1, 2021.

As of December 31, 2018, each of our wholly-owned hotels and the rental program and condominium association of the Hyde Resort & Residences operated under a management agreement with Chesapeake Hospitality (see Note 9). The management agreements expire between January 1, 2020 and January 30, 2022, and may be extended for up to two additional periods of five years each subject to the approval of both parties. Each of the individual hotel management agreements may be terminated earlier than the stated term upon the sale of the hotel covered by the respective management agreement, in which case we may incur early termination fees.

Franchise Agreements – As of December 31, 2018, most of our hotels operate under franchise licenses from national hotel companies. Under the franchise agreements, we are required to pay a franchise fee generally between 3.0% and 5.0% of room revenues, plus additional fees for marketing, central reservation systems, and other franchisor programs and services that amount to between 3.0% and 4.0% of gross revenues from the hotels. The franchise agreements currently expire between June 2019 and October 2030. On April 12, 2016 we allowed the franchise agreement on the Crowne Plaza Houston Downtown to expire. The property has been rebranded as The Whitehall. On July 31, 2017, we allowed the franchise agreement on the Hilton Savannah DeSoto to expire. The property has been rebranded as The DeSoto and operates as an independent hotel. Each of our franchise agreements provides for early termination fees in the event the agreement is terminated before the stated term.

Restricted Cash Reserves – Each month, we are required to escrow with the lenders on the Hotel Ballast Wilmington, Tapestry Collection by Hilton, The DeSoto, the DoubleTree by Hilton Raleigh Brownstone-University, the DoubleTree by Hilton Jacksonville Riverside, the DoubleTree Resort by Hilton Hollywood Beach and the Georgian Terrace an amount equal to 1 / 12 of the annual real estate taxes due for the properties. We are also required by several of our lenders to establish individual property improvement funds to cover the cost of replacing capital assets at our properties. Each month, those contributions equal 4.0% of gross revenues for The DeSoto, the Hotel Ballast Wilmington, Tapestry Collection by Hilton, the DoubleTree by Hilton Jacksonville Riverside, the DoubleTree Resort by Hilton Hollywood Beach, DoubleTree by Hilton Raleigh Brownstone-University, the Whitehall and the Georgian Terrace and equal 4.0% of room revenues for the DoubleTree by Hilton Philadelphia Airport and the Hyatt Centric Arlington.

ESOP Loan Commitment – The Company’s board of directors approved the ESOP on November 29, 2016, which was adopted by the Company in December 2016 and effective January 1, 2016. The ESOP is a non-contributory defined contribution plan covering all employees of the Company. The ESOP is a leveraged ESOP, meaning the contributed funds are loaned to the ESOP from the Company. The Company entered into a loan agreement with the ESOP on December 29, 2016, pursuant to which the ESOP may borrow up to \$5.0 million to purchase shares of the Company’s common stock on the open market. Under the loan agreement, the aggregate principal amount outstanding at any time may not exceed \$5.0 million and the ESOP may borrow additional funds up to that limit in the future, until December 29, 2036.

Litigation – We are not involved in any material litigation, nor, to our knowledge, is any material litigation threatened against us. We have settled, during the period covered by this report, all significant claims made during the same period. We are involved in routine litigation arising out of the ordinary course of business, all of which we expect to be covered by insurance and we believe it is not reasonably possible such matters will have a material impact on our financial condition or results of operations.

7. Preferred Stock and Units

Preferred Stock - The Company is authorized to issue up to 11,000,000 shares of preferred stock. As of December 31, 2018 and 2017, there were each 1,610,000 shares of the Series B Preferred Stock issued and outstanding. As of December 31, 2018 and 2017, there were 1,352,141 and 1,300,000 shares, respectively, of the Series C Preferred Stock issued and outstanding.

On August 31, 2018, we entered into a Sales Agency Agreement, with Sandler O’Neill, under which the Company may sell from time to time through Sandler O’Neill, as sales agent, up to 400,000 shares of the Company’s 7.875% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share. Through the twelve months ended December 31, 2018, the Company sold 52,141 shares of Series C Preferred Stock, for net proceeds of approximately \$1.0 million.

In October 2017, the Company issued 1,300,000 shares of Series C Preferred Stock, for net proceeds after all estimated expenses of approximately \$30.5 million. The Company contributed the net proceeds from the offering to its Operating Partnership for an equivalent number of Series C Preferred Units. Holders of the Company’s Series C Preferred Stock are entitled to receive distributions when authorized by the Company’s board of directors out of assets legally available for the payment of distributions. The Company pays cumulative cash distributions on the Series C Preferred Stock at a rate of 7.875% per annum of the \$25.00 liquidation preference per share. The Series C Preferred Stock is not redeemable by the holders, has no maturity date and is not convertible into any other security of the Company or its affiliates.

On August 23, 2016, the Company issued 1,610,000 shares, \$0.01 par value per share, of its Series B Preferred Stock for net proceeds after all expenses of approximately \$37.8 million, which it contributed to the Operating Partnership for an equivalent number of preferred partnership units. Holders of the Company’s Series B Preferred Stock are entitled to receive distributions when authorized by the Company’s board of directors out of assets legally available for the payment of distributions. The Company pays cumulative cash distributions on the Series B Preferred Stock at a rate of 8.00% per annum of the \$25.00 liquidation preference per share. The Series B Preferred Stock is not redeemable by the holders, has no maturity date and is not convertible into any other security of the Company or its affiliates.

Preferred Units – The Company is the holder of the Operating Partnership’s preferred partnership units and is entitled to receive distributions when authorized by our board of directors out of assets legally available for the payment of distributions.

In September and December 2018, the Operating Partnership issued 52,141 units of 7.875% Series C Preferred Units, for net proceeds after all estimated expenses of approximately \$1.0 million.

In October 2017, the Operating Partnership issued 1,300,000 units of 7.875% Series C Preferred Units, for net proceeds after all estimated expenses of approximately \$30.5 million. The Operating Partnership used the net proceeds to redeem in full the Operating Partnership’s 7% Notes and for working capital.

On August 23, 2016, the Operating Partnership issued 1,610,000 units, \$0.01 par value per unit, of its 8% Series B Cumulative Redeemable Perpetual Preferred Units (the “Series B Preferred Units”) for net proceeds after all expenses of approximately \$37.8 million. The Operating Partnership used the net proceeds to redeem in full the Operating Partnership’s 8% Notes and for working capital.

The Operating Partnership pays cumulative cash dividends on the Series B Preferred Units and Series C Preferred Units at a rate of 8.00% and 7.875%, respectively per annum for each of the \$25.00 liquidation preferences per unit. The Operating Partnership declared and paid per Series B Preferred Units and Series C Preferred Units as follows:

The following table presents the quarterly distributions by the Operating Partnership declared and payable per Series Preferred B Unit and dividends by the Company declared and payable per share of Series B Preferred Stock, for the years ended December 31, 2018, 2017, and 2016:

Quarter Ended	2016	2017	2018
March 31,	\$ —	\$ 0.50	\$ 0.50
June 30,	\$ —	\$ 0.50	\$ 0.50
September 30,	\$ 0.2111 ⁽¹⁾	\$ 0.50	\$ 0.50
December 31,	\$ 0.50	\$ 0.50	\$ 0.50

(1) For the short period from August 23, 2016 to September 30, 2016.

The following table presents the quarterly distributions by the Operating Partnership declared and payable per Series C Preferred Unit and dividends by the Company declared and payable per share of Series C Preferred Stock, for the years ended December 31, 2018, 2017, and 2016:

Quarter Ended	2016	2017	2018
March 31,	\$ —	\$ —	\$ 0.4922
June 30,	\$ —	\$ —	\$ 0.4922
September 30,	\$ —	\$ —	\$ 0.4922
December 31,	\$ —	\$ 0.4430 ⁽²⁾	\$ 0.4922

(2) For the short period from October 11, 2017 to December 31, 2017.

8. Common Stock and Units

Common Stock – The Company is authorized to issue up to 49,000,000 shares of common stock, \$0.01 par value per share. Each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of stockholders. Holders of the Company’s common stock are entitled to receive distributions when authorized by the Company’s board of directors out of assets legally available for the payment of distributions. On December 2, 2016, the Company’s Board of Directors authorized a stock repurchase program under which the Company may purchase up to \$10.0 million of its outstanding common stock, par value \$0.01 per share, at prevailing prices on the open market or in privately negotiated transactions, at the discretion of management. The Company has and expects to continue to use available working capital to fund purchases under the stock repurchase program and intends to complete the repurchase program prior to December 31, 2019, unless extended by the Board of Directors. For the years ended December 31, 2018, 2017 and 2016 the Company repurchased zero, 401,720 and 481,100 shares of common stock, respectively, for approximately \$2.7 million and \$3.2 million, respectively, and the repurchased shares have been returned to the status of authorized but unissued shares of common stock.

The following is a list of issuances during the years ended December 31, 2018, 2017, and 2016 of the Company’s common stock:

On August 31, 2018, we entered into a Sales Agency Agreement, with Sandler O’Neill, under which the Company may sell from time to time through Sandler O’Neill, as sales agent, shares of the Company’s common stock, par value \$0.01 per share, having an aggregate gross sales price of up to \$5,000,000. Through December 31, 2018, the Company sold 88,297 shares of common stock, for net proceeds of approximately \$0.6 million.

On February 5, 2018, the Company was issued 17,250 units in the Operating Partnership and awarded 15,000 shares of restricted stock and 2,250 shares of unrestricted stock to its independent directors.

On January 1, 2018, the Company was issued 25,000 units in the Operating Partnership and awarded 25,000 shares of restricted stock to one of its employees.

On February 15, 2017, the Company was issued 12,000 units in the Operating Partnership and awarded 12,000 shares of restricted stock to its independent directors.

On February 2, 2016, the Company was issued 36,250 units in the Operating Partnership and awarded an aggregate of 22,000 shares of unrestricted stock to certain executives and employees as well as 12,000 shares of restricted stock and 2,250 shares of unrestricted stock to certain of its independent directors.

On February 1, 2016, two holders of units in the Operating Partnership redeemed 422,687 units for an equivalent number of shares of the Company's common stock.

As of December 31, 2018 and 2017, the Company had 14,209,378 and 14,078,831 shares of common stock outstanding, respectively.

Operating Partnership Units – Holders of Operating Partnership units, other than the Company as general partner, have certain redemption rights, which enable them to cause the Operating Partnership to redeem their units in exchange for shares of the Company's common stock on a one-for-one basis or, at the option of the Company, cash per unit equal to the average of the market price of the Company's common stock for the 10 trading days immediately preceding the notice date of such redemption. The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of stock splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of the limited partners or the stockholders of the Company.

For the years ended December 31, 2018, 2017 and 2016, the Operating Partnership repurchased zero, 401,720 and 481,100 units, respectively, for approximately \$0, \$2.7 million and \$3.2 million, respectively, and the repurchased units have been returned to the status of authorized but unissued units.

As of December 31, 2018 and 2017, the total number of Operating Partnership units outstanding was 15,987,518 and 15,856,971, respectively.

As of December 31, 2018 and 2017, the total number of outstanding units in the Operating Partnership not owned by the Company was 1,778,140 and 1,778,140, respectively, with a fair market value of approximately \$10.0 million and approximately \$11.5 million, respectively, based on the price per share of the common stock on such respective dates.

Common Stock Dividends and Unit Distributions – The following table presents the quarterly stock dividends and unit distributions by us declared and payable per common stock/unit for the years ended December 31, 2018, 2017, and 2016:

Quarter Ended	2016	2017	2018
March 31,	\$ 0.085	\$ 0.100	\$ 0.115
June 30,	\$ 0.090	\$ 0.105	\$ 0.120
September 30,	\$ 0.095	\$ 0.110	\$ 0.125
December 31,	\$ 0.095	\$ 0.110	\$ 0.125

9. Related Party Transactions

Chesapeake Hospitality. Chesapeake Hospitality is owned and controlled by individuals including Andrew M. Sims, our chairman and chief executive officer, and Kim E. Sims and Christopher L. Sims, each a former director of Sotherly and immediate family member of our chairman and chief executive officer. As of December 31, 2018, Andrew M. Sims, Kim E. Sims and Christopher L. Sims, beneficially owned, directly or indirectly, approximately 19.3375%, 20.0%, and 20.0%, respectively, of the total outstanding ownership interests of Chesapeake Hospitality. Kim E. Sims and Christopher L. Sims are currently officers and employees of Chesapeake Hospitality. The following is a summary of the transactions between Chesapeake Hospitality and us:

Accounts Receivable – At December 31, 2018 and 2017, we were due \$91,987 and \$113,669, respectively, from Chesapeake Hospitality.

Management Agreements – Each of the hotels and the hotel condominium unit, except for the Hyatt Centric Arlington, that we wholly-owned at December 31, 2018 and 2017, are operated by Chesapeake Hospitality under various management agreements.

On December 15, 2014, we entered into a new master agreement and a series of individual hotel management agreements that became effective on January 1, 2015. The master agreement has a five-year term, but may be extended for such additional periods as long as an individual management agreement remains in effect. The base management fee for the Whitehall and the Georgian Terrace remained at 2.00% through 2015, increased to 2.25% in 2016 and increased to 2.50% thereafter. The base management fees for the remaining properties in the current portfolio were 2.65% through 2017 and decreased to 2.50%

thereafter. For new individual hotel management agreements, Chesapeake Hospitality will receive a base management fee of 2.00% of gross revenues for the first full year from the commencement date through the anniversary date, 2.25% of gross revenues the second full year, and 2.50% of gross revenues for every year thereafter.

Base management fees earned by Chesapeake Hospitality totaled \$4,617,471, \$4,044,059 and \$3,828,896 for the years ended December 31, 2018, 2017, and 2016, respectively. In addition, incentive management fees of \$168,231, \$126,918 and \$36,466 were accrued for the years ended December 31, 2018, 2017, and 2016, respectively.

Employee Medical Benefits – We purchase employee medical benefits through Maryland Hospitality, Inc. (d/b/a MHI Health), an affiliate of Chesapeake Hospitality for those employees that are employed by Chesapeake Hospitality that work exclusively for our hotel properties. Gross premiums for employee medical benefits paid by the Company (before offset of employee co-payments) were \$5,050,304, \$4,801,599 and \$4,606,967 for the years ended December 31, 2018, 2017, and 2016, respectively.

Workers' Compensation Insurance – Pursuant to our management agreements with Chesapeake Hospitality, we pay the premiums for workers' compensation insurance under a self-insured policy owned by Chesapeake Hospitality or its affiliates, and which covers those employees of Chesapeake Hospitality that work exclusively for the properties managed by Chesapeake Hospitality. For the years ended December 31, 2018, 2017, and 2016, we paid \$919,642, \$1,017,294 and \$0, respectively, in premiums for the portion of the plan covering those employees that work exclusively for our properties under our management agreements with Chesapeake Hospitality.

Sotherly Foundation – During 2015, the Company loaned \$180,000 to the Sotherly Foundation, a non-profit organization to benefit wounded warriors. As of December 31, 2018 and 2017, the balance of the loan was \$0 and \$40,000, respectively.

Other Related Parties – On June 24, 2013 we hired Ashley S. Kirkland, the daughter of our Chief Executive Officer as a legal analyst and Robert E. Kirkland IV, her husband, as our compliance officer. On October 2, 2014, we hired Andrew M. Sims Jr., the son of our Chief Executive Officer, as a manager. Compensation for the years ended December 31, 2018, 2017, and 2016 totaled \$386,456, \$304,737 and \$291,508, respectively, for the three individuals.

On February 1, 2016, one current member of our Board of Directors redeemed 322,687 units for an equivalent number of shares of the Company's common stock, and one previous member of our Board of Directors redeemed 100,000 units for an equivalent number of shares of the Company's common stock, pursuant to the terms of the partnership agreement.

During the years ending December 31, 2018, 2017, and 2016, the Company reimbursed \$146,105, \$178,345 and \$123,866, respectively, to a partnership controlled by the Chief Executive Officer for business-related air travel pursuant to the Company's travel reimbursement policy.

10. Retirement Plans

We began a 401(k) plan for qualified employees on April 1, 2006. The plan is subject to "safe harbor" provisions which require that we match 100.0% of the first 3.0% of employee contributions and 50.0% of the next 2.0% of employee contributions. All employer matching funds vest immediately in accordance with the "safe harbor" provisions. Contributions to the plan for the years ended December 31, 2018, 2017, and 2016 were \$71,623, \$67,273 and \$63,944, respectively.

The Company adopted an ESOP in December 2016, effective January 1, 2016. The ESOP is a non-contributory defined contribution plan covering all employees of the Company. The Company sponsors and maintains the ESOP and related trust for the benefit of its eligible employees. The ESOP is a leveraged ESOP, meaning funds are loaned to the ESOP from the Company. The Company entered into a loan agreement with the ESOP on December 29, 2016, pursuant to which the ESOP may borrow up to \$5.0 million to purchase shares of the Company's common stock on the open market, which serve as collateral for the loan. Between January 3, 2017 and February 28, 2017, the Company's ESOP purchased 682,500 shares of the Company's common stock of an aggregate cost of \$4.9 million. Shares purchased by the ESOP are held in a suspense account for allocation among participants. Dividends on allocated shares are paid to the participants of the ESOP, while dividends on unallocated shares are used to pay down the ESOP loan from the Operating Partnership. The share allocations are accounted for at fair value on the date of allocation as follows:

	December 31, 2018		December 31, 2017	
	Number of Shares	Fair Value	Number of Shares	Fair Value
Allocated shares	33,832	\$ 189,798	9,473	\$ 64,321
Committed to be released shares	35,474	199,007	24,359	157,117
Total Allocated and Committed-to-be-Released	69,306	\$ 388,805	33,832	\$ 221,438
Unallocated shares	613,194	3,440,020	648,668	4,183,908
Total ESOP Shares	<u>682,500</u>	<u>\$ 3,828,825</u>	<u>682,500</u>	<u>\$ 4,405,346</u>

11. Indirect Hotel Operating Expenses

Indirect hotel operating expenses consists of the following expenses incurred by the hotels:

	2018	2017	2016
Sales and marketing	\$ 15,998,281	\$ 13,843,578	\$ 13,537,887
General and administrative	14,581,707	12,949,596	12,135,835
Repairs and maintenance	7,624,031	6,828,963	7,314,178
Utilities	6,266,192	5,820,589	6,429,686
Property taxes	6,225,508	5,729,464	5,983,280
Management fees, including incentive	4,785,702	4,170,977	3,865,362
Franchise fees	4,308,065	3,877,231	4,091,729
Insurance	2,894,708	2,446,269	2,594,783
Information and telecommunications	2,142,698	1,647,728	1,679,603
Other	818,608	297,808	104,594
Total indirect hotel operating expenses	\$ 65,645,500	\$ 57,612,203	\$ 57,736,937

12. Income Taxes

The components of the provision for (benefit from) income taxes for the years ended December 31, 2018, 2017, and 2016 are as follows:

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Current:			
Federal	\$ —	\$ —	\$ —
State	149,410	239,582	191,332
	<u>149,410</u>	<u>239,582</u>	<u>191,332</u>
Deferred:			
Federal	351,663	1,661,153	(1,294,408)
State	(31,724)	(162,931)	(264,558)
	<u>319,939</u>	<u>1,498,222</u>	<u>(1,558,966)</u>
	\$ 469,349	\$ 1,737,804	\$ (1,367,634)

A reconciliation of the statutory federal income tax provision (benefit) to the Company's provision for (benefit from) income tax is as follows:

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Statutory federal income tax provision (benefit)	\$ (29,150)	\$ 600,880	\$ (158,859)
Effect of non-taxable REIT loss	380,813	(1,621,526)	(1,135,549)
Effect of change in federal income tax rate on net deferred tax assets	-	2,681,800	-
State income tax provision (benefit)	117,686	76,650	(73,226)
	<u>\$ 469,349</u>	<u>\$ 1,737,804</u>	<u>\$ (1,367,634)</u>

As of December 31, 2018 and 2017, we had a net deferred tax asset of approximately \$5.1 million and \$5.5 million, respectively, of which, approximately \$4.4 million and \$4.9 million, respectively, are due to accumulated net operating losses of our TRS Lessee. These loss carryforwards will begin to expire in 2028 if not utilized. As of December 31, 2018 and 2017, the remainder of the deferred tax asset is attributable to year-to-year timing differences of approximately \$0.7 and \$0.6 million for accrued, but not deductible, employee performance awards, vacation and sick pay, bad debt allowance and depreciation. At the end of the 2017 fiscal year, there was a one-time loss effect resulting from a change in the federal income tax rate, due to the TCJA, on the net deferred tax assets which resulted in lowering deferred tax assets in the amount of approximately \$2.7 million.

We record a valuation allowance to reduce deferred tax assets to an amount that we believe is more likely than not to be realized. Because of expected future taxable income of our TRS Lessee, we have not recorded a valuation allowance to reduce our net deferred tax asset as of December 31, 2018. We regularly evaluate the likelihood that our TRS Lessee will be able to realize its deferred tax assets and the continuing need for a valuation allowance. At December 31, 2018, we determined, based on all available positive and negative evidence, that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward of our TRS Lessee. A number of factors played a critical role in this determination, including:

- a demonstrated track record of past profitability and utilization of past NOL carryforwards,
- reasonable forecasts of future taxable income, and
- anticipated changes in the lease rental payments from the TRS Lessee to subsidiaries of the Operating Partnership.

At December 31, 2018, we determined, based on all available positive and negative evidence, that it is more-likely-than-not that future taxable income will be available during the carryforward periods to absorb all of the consolidated federal and state net operating loss carryforward.

13. Loss per Share and per Unit

Loss Per Share. The limited partners' outstanding limited partnership units in the Operating Partnership (which may be redeemed for common stock upon notice from the limited partner and following our election to redeem the units for stock rather than cash) have been excluded from the diluted earnings per share calculation as there would be no effect on the amounts since the limited partners' share of income would also be added back to net loss. The shares of the Series B Preferred Stock and Series C Preferred Stock are not convertible into or exchangeable for any other property or securities of the Company, except upon the occurrence of a change of control and have been excluded from the diluted earnings per share calculation as there would be no impact on the current controlling stockholders. The 613,194 and 648,668 non-committed, unearned ESOP shares are treated as reducing the number of issued and outstanding common shares and similarly reducing the weighted average number of common shares outstanding, for the years ended December 31, 2018 and 2017, respectively. The effect of allocated and committed to be released shares during the years ended December 31, 2018 and 2017, have not been included in the weighted average diluted earnings per share calculation, since there would be an anti-dilutive effect from the dilution by these shares, although the amount of compensation for allocated shares is reflected in net loss available to common stockholders for basic computation. There are no ESOP units, therefore there is no dilution on the calculation of earnings per unit. The computation of basic net loss per share is presented below.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Numerator			
Net loss available to common stockholders for basic and diluted computation	\$ (5,719,978)	\$ (3,339,136)	\$ (218,173)
Denominator			
Weighted average number of common shares outstanding	14,145,838	14,445,865	14,896,994
Weighted average number of Unearned ESOP Shares	(628,350)	(616,765)	-
Total weighted average number of common shares outstanding for basic computation	13,517,488	13,829,100	14,896,994
Basic net loss per share	\$ (0.42)	\$ (0.24)	\$ (0.01)

Income (Loss) Per Unit. The computation of basic and diluted income (loss) per unit is presented below.

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Numerator			
Net loss available to common unitholders for basic computation	\$ (6,438,071)	\$ (3,752,150)	\$ (244,740)
Denominator			
Weighted average number of units outstanding	15,923,978	16,224,005	16,710,935
Basic net loss per unit	\$ (0.40)	\$ (0.23)	\$ (0.01)

14. Quarterly Operating Results - Unaudited

	Quarters Ended 2018			
	March 31	June 30	September 30	December 31
Total revenue	\$41,735,556	\$51,553,527	\$41,418,062	\$43,465,976
Total operating expenses	37,041,269	42,275,569	38,298,919	40,451,053
Net operating income	4,694,287	9,277,958	3,119,143	3,014,923
Net income (loss)	1,176,488	2,967,589	(1,981,780)	(2,770,454)
Net income (loss) attributable to common shareholders	(238,343)	1,352,414	(3,065,883)	(3,768,166)
Earnings (loss) per share attributable to common shareholders— basic and diluted	\$ (0.02)	\$ 0.10	\$ (0.23)	\$ (0.28)
Net income (loss) available to operating partnership unitholders	(268,356)	1,522,745	(3,451,499)	(4,240,961)
	\$			

Earnings (loss) per unit attributable to operating partnership unitholders— basic and diluted (0.02) \$ 0.10 \$ (0.22) \$ (0.27)

	Quarters Ended 2017			
	March 31	June 30	September 30	December 31
Total revenue	\$38,694,886	\$40,642,632	\$36,769,471	\$38,159,704
Total operating expenses	32,989,182	35,178,717	34,595,193	35,339,712
Net operating income	5,705,704	5,463,915	2,174,278	2,819,992
Net income (loss)	2,886,032	1,135,719	(936,000)	(3,056,262)
Net income (loss) attributable to common shareholders	1,851,090	296,850	(1,550,555)	(3,936,522)
Earnings (loss) per share attributable to common shareholders— basic and diluted	\$ 0.13	\$ 0.02	\$ (0.11)	\$ (0.29)
Net income (loss) available to operating partnership unitholders	2,100,958	310,795	(1,741,000)	(4,422,903)
Earnings (loss) per unit attributable to operating partnership unitholders— basic and diluted	\$ 0.13	\$ 0.02	\$ (0.11)	\$ (0.27)

15. Subsequent Events

On January 11, 2019, we paid a quarterly dividend (distribution) of \$0.125 per common share (and unit) to those stockholders (and unitholders of the Operating Partnership) of record on December 14, 2018.

On January 15, 2019, we paid a quarterly dividend (distribution) of \$0.50 per Series B Preferred Stock (and unit) to the preferred stockholders (and unitholders of the Operating Partnership) of record on December 31, 2018.

On January 15, 2019, we paid a quarterly dividend (distribution) of \$0.4922 per Series C Preferred Stock (and unit) to the preferred stockholders (and unitholders of the Operating Partnership) of record on December 31, 2018.

On January 28, 2019, we authorized payment of a quarterly dividend (distribution) of \$0.125 per common share (and unit) to the stockholders (and unitholders of the Operating Partnership) of record as of March 15, 2019. The dividend (distribution) is to be paid on April 11, 2019.

On January 28, 2019, we authorized payment of a quarterly dividend of \$0.50 per Series B Preferred Share (and unit) to the preferred stockholders (and unitholders of the Operating Partnership) of record as of April 1, 2019. The dividend is to be paid on April 15, 2019.

On January 28, 2019, we authorized payment of a quarterly dividend of \$0.4922 per Series C Preferred Share (and unit) to the preferred stockholders (and unitholders of the Operating Partnership) of record as of April 1, 2019. The dividend is to be paid on April 15, 2019.

**SOTHERLY HOTELS INC.
SOTHERLY HOTELS LP**

**SCHEDULE III—REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 2018
(in thousands)**

Description	Initial Costs		Costs Capitalized Subsequent to Acquisition		Gross Amount At End of Year		Accumulated Depreciation & Impairment	Date of Construction Acquired	Life on Which Depreciation is Computed	
	Encumbrances	Land	Building & Improvements		Land	Building & Improvements				Total
			Land	Building & Improvements						
Crowne Plaza Tampa Westshore – Tampa, Florida	18,307	\$ 4,153	\$ 9,670	\$ 654	\$ 26,553	\$ 4,807	\$ 41,030	1973	2007	3-39 years
The DeSoto – Savannah, Georgia	33,824	600	13,562	668	17,656	1,268	32,486	1968	2004	3-39 years
DoubleTree by Hilton Jacksonville Riverfront – Jacksonville, Florida	34,774	7,090	14,604	157	7,378	7,247	29,229	1970	2005	3-39 years
DoubleTree by Hilton Laurel – Laurel, Maryland	8,845	900	9,443	65	5,695	965	16,103	1985	2004	3-39 years
DoubleTree by Hilton Philadelphia Airport – Philadelphia, Pennsylvania	42,027	2,100	22,031	390	6,118	2,490	30,639	1972	2004	3-39 years
DoubleTree by Hilton Raleigh Brownstone – University – Raleigh, North Carolina	18,300	815	7,416	3,814	6,265	4,629	18,310	1971	2004	3-39 years
DoubleTree Resort by Hilton Hollywood Beach – Hollywood Beach, Florida	57,065	22,865	67,660	439	3,117	23,304	94,081	1972	2015	3-39 years
Georgian Terrace – Atlanta, Georgia	44,203	10,128	45,386	(1,305)	5,641	8,823	59,850	1911	2014	3-39 years
Hilton Wilmington Riverside – Wilmington, North Carolina	34,236	785	16,829	1,124	14,278	1,909	33,016	1970	2004	3-39 years
Hyatt Centric Arlington - Arlington, Virginia	49,885	191	70,369	—	477	191	71,037	2018	2018	3-39 years
Sheraton Louisville Riverside – Jeffersonville, Indiana	11,414	782	6,891	289	14,738	1,071	22,700	1972	2006	3-39 years
The Whitehall – Houston, Texas	14,734	7,374	22,185	106	6,405	7,480	36,070	1963	2013	3-39 years
The Hyde Resort	-	226	4,290	-	-	226	4,516	2016	2017	3-39 years
	\$ 367,614	\$ 58,009	\$ 310,336	\$ 6,401	\$ 114,321	\$ 64,410	\$ 489,067		\$ (85,655)	

(1) For the year ending December 31, 2018, the aggregate cost of our real estate assets for federal income tax purposes was approximately \$478.5 million.

RECONCILIATION OF REAL ESTATE AND ACCUMULATED DEPRECIATION

RECONCILIATION OF REAL ESTATE

Balance at December 31, 2016	\$	402,189
Acquisitions		4,516
Improvements		13,713
Disposal of Assets		(12,381)
Balance at December 31, 2017	\$	408,037
Acquisitions		71,037
Improvements		14,355
Disposal of Assets		(4,362)
Balance at December 31, 2018	\$	<u>489,067</u>

RECONCILIATION OF ACCUMULATED DEPRECIATION

Balance at December 31, 2016	\$	68,506
Current Expense		9,933
Impairment		—
Disposal of Assets		(3,328)
Balance at December 31, 2017	\$	75,111
Current Expense		14,787
Impairment		—
Disposal of Assets		(4,243)
Balance at December 31, 2018	\$	<u>85,655</u>