

HERSHA HOSPITALITY TRUST  
Form S-2  
September 25, 2003  
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As filed with the Securities and Exchange Commission on September 25, 2003

Registration No. 333-

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# SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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## FORM S-2

### REGISTRATION STATEMENT

*UNDER*

*THE SECURITIES ACT OF 1933*

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## HERSHA HOSPITALITY TRUST

(Exact Name of Registrant as Specified in its Governing Instruments)

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148 Sheraton Drive, Box A

New Cumberland, PA 17070

(717) 770-2405

(Address, Including Zip Code, and Telephone Number, including Area Code, of Registrant's Principal Executive Offices)

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Ashish R. Parikh

Chief Financial Officer

Hersha Hospitality Trust

148 Sheraton Drive, Box A

New Cumberland, PA 17070

(717) 770-2405

(717) 774-7383 (Telecopy)

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If the registrant elects to deliver its latest annual report to security holders, or a complete and legible facsimile thereof, pursuant to Item 11(a)(1) of this form, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

### CALCULATION OF REGISTRATION FEE

<b>Title of Shares To Be Registered</b>	<b>Amount To Be Registered (2)</b>	<b>Proposed Maximum Offering Price Per Share (1)</b>	<b>Proposed Maximum Aggregate Offering Price (1)</b>	<b>Amount of Registration Fee</b>
Class A Common Shares	8,625,000	\$8.98	\$77,452,500	\$6,266

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457 under the Securities Act of 1933, based upon the average of the high and low prices on September 19, 2003, as reported by the American Stock Exchange.

(2) Includes 1,125,000 Class A Common Shares which the underwriters have the option to purchase to cover over-allotments, if any.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to Section 8(a) of the Securities Act, may determine.**

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**The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION DATED SEPTEMBER 24, 2003**

PRELIMINARY PROSPECTUS

**7,500,000 Shares**

**Hersha Hospitality Trust**  
**Class A Common Shares**

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We are offering 7,500,000 of our Class A common shares. We will receive all of the net proceeds from the sale of the Class A common shares.

Our Class A common shares are listed on the American Stock Exchange under the symbol HT . The last reported sale price of our Class A common shares on the American Stock Exchange on September 23, 2003 was \$9.04 per share.

**Investing in our Class A common shares involves a high degree of risk. Before buying any shares, you should carefully read the discussion of material risks of investing in our Class A common shares under the heading Risk Factors beginning on page 13.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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	<b>Per</b>	
	<b>Share</b>	<b>Total</b>
	<hr/>	<hr/>
Public offering price	\$	\$
Underwriting discounts and commissions	\$	\$

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Proceeds, before expenses, to us \$ \$

The underwriters may also purchase from us up to an additional 1,125,000 Class A common shares at the public offering price less underwriting discounts and commissions, to cover over-allotments, if any, within 30 days of the date of this prospectus. The underwriters may exercise this option only to cover any over-allotments.

The underwriters are offering the Class A common shares as described under Underwriting. Delivery of the Class A common shares will be made on or about , 2003.

*Joint Book-Running Managers*

**Citigroup**

**UBS Investment Bank**

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You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with information different from that contained or incorporated by reference in this prospectus. Neither the delivery of this prospectus nor the sale of Class A common shares means that information contained or incorporated by reference in this prospectus is correct after the date of this prospectus. This prospectus does not constitute an offer to sell or solicitation of an offer to buy these Class A common shares in any circumstance under which the offer or solicitation is unlawful.

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In this prospectus, references to our company, we, and our mean Hersha Hospitality Trust, including, unless the context otherwise requires, our operating partnership and other direct and indirect subsidiaries. Our operating partnership refers to Hersha Hospitality Limited Partnership, a Virginia limited partnership. HHMLP refers to Hersha Hospitality Management, L.P. and its subsidiaries, which are the entities that lease or manage all of our hotels. Class A common shares means our Priority Class A common shares of Beneficial Interest, par value \$0.01 per share.

CNL means CNL Hospitality Partners, L.P., a Delaware limited partnership, CNL Hospitality GP Corp., a Delaware corporation and general partner of CNL Hospitality Partners, L.P., and CNL Hospitality Properties, Inc., a Maryland real estate investment trust and sole shareholder of CNL Hospitality GP Corp.

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**PROSPECTUS SUMMARY**

The following summary highlights information contained elsewhere in this prospectus. We encourage you to read carefully the entire prospectus and the other documents that it refers to as incorporated in this prospectus. The statements that we make about the contents of those documents are not necessarily complete and are qualified in their entirety by the contents of those documents, which are filed as exhibits to the registration statement of which this prospectus is a part.

**Our Company**

Hersha Hospitality Trust is a self-advised Maryland real estate investment trust that was organized in 1998 and completed its initial public offering in January of 1999. We focus primarily on owning and operating high quality, mid-scale limited service hotels in established markets in the Eastern United States. Our primary strategy is to continue to acquire high quality, mid-scale hotels in metropolitan markets with high barriers to entry in the Northeastern United States. Our portfolio currently consists of 19 hotels with a total of 1,738 rooms located in Pennsylvania, New York, Maryland and Georgia, which operate under leading brands, such as Hampton Inn®, Hilton Garden Inn®, Holiday Inn®, Holiday Inn Express®, DoubleTree®, and Comfort Suites®.

We are structured as an umbrella partnership REIT, or UPREIT, and we own our hotels through our operating partnership, Hersha Hospitality Limited Partnership, for which we serve as general partner. All of our hotels are managed by Hersha Hospitality Management, L.P., or HHMLP, a private management company owned by certain of our trustees, officers and other third party investors. In response to tax law changes, we recently formed a wholly-owned taxable REIT subsidiary, or TRS, to which we currently lease four hotels and to which we intend to lease all of our hotels, including hotels we may acquire in the future and hotels currently leased to HHMLP as those leases expire. We believe that transitioning to this TRS structure positions us to participate more directly in the operating efficiencies and revenue gains at our hotels.

In April of 2003, we entered into a strategic alliance with CNL Hospitality Partners, L.P., a subsidiary of CNL Hospitality Properties, Inc. CNL is a public company which has been one of the most active investors in lodging properties over the past several years. Since its inception in 1996, CNL has invested over \$2.2 billion in hotel properties. The strategic alliance positions us as one of CNL's preferred partners for investing in mid-scale hotels. Our agreement with CNL provides that it will invest up to \$25 million in our operating partnership and up to \$40 million in a newly formed hotel acquisition joint venture. CNL has currently invested \$19 million in our operating partnership and \$8 million in the joint venture, which acquired its first hotel, the Hampton Inn Chelsea, New York, New York, on August 29, 2003.

Our address is 148 Sheraton Drive, Box A, New Cumberland, Pennsylvania 17070. Our telephone number is (717) 770-2405.

**Market Opportunity**

We believe that it is an opportune time in the business cycle to acquire mid-scale hotels. Industry forecasts and historical data lead us to believe that we are at the bottom of the economic and lodging cycle. The Federal Reserve's August 22, 2003 Beige Book predicts 5.7% and 5.6% nominal GDP growth in the fourth quarter of 2003 and full year 2004, respectively. In addition, as of June 2003, the Americas Hospitality & Leisure Consulting Practice at PricewaterhouseCoopers, L.L.P. predicts 4.0% and 4.2% annual growth in revenue per available room, or RevPAR, for the mid-scale limited service segment in 2004 and 2005, respectively. Accordingly, we believe that investments in hotels at this point in the cycle will benefit from the improving fundamentals in the lodging sector.



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Furthermore, we believe that we will have ample acquisition opportunities in the mid-scale limited service hotel market. First, we believe that many small private owners are competitively disadvantaged by their limited access to market information and capital, and may therefore explore asset dispositions as a means to address their illiquidity. In addition, we believe that larger hotel portfolios will be available for sale as public lodging companies seek to sell non-core assets and improve their overall liquidity. We also believe that improving lodging fundamentals will help facilitate agreement between buyers and sellers on hotel valuations, resulting in an increased volume of sales transactions.

As a result of our competitive strengths, described below, we believe that we are well positioned to take advantage of opportunities created by these market characteristics.

## **Competitive Strengths**

### *Our Existing Portfolio*

**High Quality Hotels.** We own and operate high quality hotels operating under popular mid-scale brands such as Hampton Inn<sup>®</sup>, Hilton Garden Inn<sup>®</sup>, Holiday Inn<sup>®</sup>, Holiday Inn Express<sup>®</sup>, Double Tree<sup>®</sup> and Comfort Suites<sup>®</sup>. Since we acquire primarily newly constructed hotels, the median age of our hotels is only five years. In addition, we invest substantially to maintain the quality and appeal of our portfolio. We reserve approximately 4% or more of the gross revenues of each hotel for maintenance capital expenditures, and in order to strengthen the appeal of our hotels, we have actually invested approximately 5.4%, 6.3%, and 2.9% of revenue in maintenance capital expenditures in 2002, 2001 and 2000.

**Proven Operator.** Based on Smith Travel Research, our hotels have outperformed those of our competitors, as evidenced by our weighted average RevPAR indexed against comparable hotels in our markets of 108.6% for the twelve months ended June 30, 2003. We and our affiliated management company have been successful in reducing operating expenses and realizing the benefits of shared marketing efforts by clustering our hotels in geographic areas, such as metropolitan New York, Philadelphia, Pennsylvania, Atlanta, Georgia and Central Pennsylvania. Our hotel net operating margin for our mid-scale limited service hotels managed by our affiliated management company for all of 2002 was 38.6% in 2002 compared to the industry average for mid-scale limited service hotels of 33.0% as reported by Smith Travel Research. In addition, we are positioning ourselves to participate more directly in the operating efficiencies and revenue gains at our hotels through our transition to a TRS structure.

**Stable Performance.** We operate in the mid-scale, limited service segment of the lodging industry, which we believe is less vulnerable to demand swings and offers more consistent operating performance. According to PricewaterhouseCoopers, L.L.P., in 2002, lodging industry RevPAR declined 2.4% while mid-scale without food and beverage RevPAR declined only 0.8%. In addition, we believe the quality of our management and our focus on higher barrier to entry markets further insulate our performance from economic downturns. Accordingly, our same hotel RevPAR increased 3.3% in 2002 for our 16 hotels that were open for all of 2001 and 2002.

### *Growth Platform*

**Acquisition Experience.** We acquire high quality mid-scale limited service hotels in the Northeastern United States clustered in targeted metropolitan markets with high barriers to entry. We believe that this market segment has attractive fundamental investment characteristics and that our familiarity with our target markets has enabled, and will continue to enable, us to effectively identify opportunities and close acquisitions in those markets. The portfolio we owned for all of 2002 yielded a 10.3% unleveraged return based on 2002 net operating income after reserves for furniture, fixtures and equipment, or FF&E, divided by historical purchase



price.

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**Strategic Relationship with CNL.** We have entered into a strategic relationship with CNL, a leading lodging investor which has acquired over \$2.2 billion in hotel investments since its inception in 1996. We expect our acquisition program to benefit from access to CNL's established network of owners, developers, brokers and other contacts. We also have additional access to capital through CNL, which enhances our ability to take advantage of acquisition opportunities. Under the terms of our relationship, CNL has committed up to \$65 million of capital, which includes unfunded amounts of up to \$6 million to our operating partnership and up to \$32 million to our hotel acquisition joint venture with CNL.

**Active Portfolio Management.** We continuously evaluate and adjust our hotel portfolio to achieve our investment criteria for size, brand affiliation and strategic fit. We monitor the cash flow potential for each hotel and its ability to remain accretive to our portfolio. Our decision to sell an asset is often predicated upon market dynamics, asset potential and long term strategic goals. Since our IPO in 1999, we have sold eight hotels and redeployed that capital to purchase additional hotels consistent with our long-term growth strategy.

### *Experienced Leadership*

**Management and Board.** Our management team has an average of 11 years of industry experience and has worked together building our company since 1999. Our CEO, Hasu Shah, purchased his first hotel in 1984 and together with our management team assembled the assets which comprise our portfolio today. In addition, five of our seven trustees are independent and have significant industry experience. Our independent trustees include Michael Leven, former President of Holiday Inn Worldwide and Days Inn, Don Landry, former CEO of Sunburst Hospitality, and John Sabin, former CFO and Treasurer of Vistana and Vice President Finance of Choice Hotels.

**Aligned Incentives.** We believe the economic interests of management and our shareholders are well aligned through managements substantial ownership interest in our operating partnership. Upon completion of this offering and the application of the net offering proceeds, our officers and trustees will own limited partnership units in our operating partnership representing approximately 18.1% of our common shares on a fully-diluted basis.

### *Consistent Dividends*

Since our initial public offering in January of 1999, we have made 17 consecutive quarterly distributions to holders of the Class A common shares of \$0.18 per share, which annualizes to \$0.72 per share. We have also paid an equivalent distribution to holders of common limited partnership units in our operating partnership for the same periods. While it is the current policy of our Board of Trustees to maintain our dividend at this level, future distributions will be authorized by our Board of Trustees based upon a number of factors, including the amount of funds from operations and such other factors as the trustees deem relevant. Our ability to make distributions will depend on our receipt of distributions from our operating partnership and lease payments from our lessees with respect to our hotels.

## **Business Strategy**

### *Increase Same Hotel Growth*

Our operating strategy focuses on increasing same hotel performance for our portfolio. The key elements of this strategy are:

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increasing occupancy levels and RevPAR through active property-level management by HHMLP, including (i) intensive marketing efforts to tour groups, corporate and government extended stay customers and other wholesale customers, and (ii) expanded yield management programs, which are calculated to better match rates to periods of high demand; and

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positioning our hotels to capitalize on increased demand in the mid-scale lodging segment due to the expected economic recovery by managing costs and thereby maximizing earnings.

### *Acquisition Platform*

Our primary strategy is to continue to acquire high-quality, mid-scale hotels in metropolitan markets with high barriers to entry in the Northeastern United States. We believe that current market conditions are creating opportunities to acquire hotels at attractive prices. In executing our disciplined acquisition program, we intend to acquire hotels that meet the following additional criteria:

nationally-franchised hotels operating under popular brands, such as Hampton Inn<sup>®</sup>, Hilton Garden Inn<sup>®</sup>, Embassy Suites<sup>®</sup>, Marriott Courtyard<sup>®</sup>, Residence Inn<sup>®</sup> and Holiday Inn Express<sup>®</sup> hotels;

hotels in locations with significant barriers to entry, such as high development costs, limited availability of land and lengthy entitlement processes; and

hotels in our target markets where we can create clusters and realize economies of scale.

In addition to the recent acquisition and two proposed acquisitions described below, in the ordinary course of our business, we are actively considering hotel acquisition opportunities. We are currently reviewing hotel acquisition opportunities located in our target markets with an aggregate purchase price in excess of \$200 million, including hotels being developed by entities controlled by some of our officers and trustees, which hotels we have an option to acquire. However, each of these acquisitions is subject to due diligence, financing and negotiation of the purchase price and other key terms. There can be no assurance that we will be able to consummate any of these acquisition opportunities.

### *Prudent Use of Leverage*

The relative stability of the mid-scale segment of the lodging industry allows us to increase returns to our shareholders through the prudent application of leverage. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis, and our Board of Trustees' policy is to limit indebtedness to no more than 67% of the total purchase price of all our hotels on an aggregate basis. We may employ a higher amount of leverage at a specific hotel to achieve a desired return when warranted by that hotel's historical operating performance and may use modestly greater leverage across our portfolio if and when warranted by prevailing market conditions.

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Set forth below is tabular information regarding our hotels as of and for the twelve months ended June 30, 2003. Since June 30, 2003, we have also acquired an interest in the Chelsea Hampton Inn in New York City.

**Twelve Months Ended June 30, 2003**

Hotels	Year Opened	Number of Rooms	Room Revenue	Other Revenue(1)	Occupancy	Average Daily Rate	RevPAR(2)	Non-TRS
								Lease Expiration(3)
<b>Metropolitan New York</b>								
Doubletree Jamaica, NY	2002	110	\$ 2,895,846	\$ 476,295	71.1%	\$ 101.47	\$ 72.13	10/01/07
<b>Holiday Inn Express Long Island City, NY</b>								
	2001	79	\$ 1,952,664	\$ 34,147	71.9%	\$ 94.21	\$ 67.72	11/01/06
<b>Philadelphia</b>								
Mainstay Suites King of Prussia, PA	2000	69	\$ 1,221,617	\$ 93,792	59.0%	\$ 82.24	\$ 48.51	06/01/06
Sleep Inn King of Prussia, PA	2000	87	\$ 1,111,120	\$ 21,768	57.4%	\$ 67.10	\$ 38.53	01/26/04
<b>Harrisburg/Hershey</b>								
Comfort Inn Harrisburg, PA	1998	81	\$ 1,509,689	\$ 37,076	67.6%	\$ 77.46	\$ 52.36	01/26/04
<b>Holiday Inn Express &amp; Suites Harrisburg, PA</b>								
	1997	77	\$ 1,546,552	\$ 17,589	67.5%	\$ 81.55	\$ 55.03	09/01/04
Hampton Inn Hershey, PA	1999	110	\$ 2,755,054	\$ 59,342	55.1%	\$ 124.44	\$ 68.62	12/31/05
Holiday Inn Harrisburg, PA	1970	196	\$ 3,056,789	\$ 2,297,847	57.8%	\$ 73.59	\$ 42.51	01/26/04
Holiday Inn Express Hershey, PA	1997	85	\$ 2,007,905	\$ 26,994	60.7%	\$ 106.65	\$ 64.72	01/26/04
Hampton Inn Carlisle, PA	1997	95	\$ 2,022,082	\$ 23,564	67.8%	\$ 84.25	\$ 57.11	01/26/04
<b>Central Pennsylvania</b>								
Hampton Inn Selinsgrove, PA	1996	75	\$ 1,799,220	\$ 27,349	73.6%	\$ 90.54	\$ 66.61	01/26/04
Hampton Inn Danville, PA	1998	72	\$ 1,488,351	\$ 21,015	72.7%	\$ 77.94	\$ 56.63	09/01/04
<b>Holiday Inn Express New Columbia, PA</b>								
	1997	81	\$ 1,427,049	\$ 16,863	61.8%	\$ 79.10	\$ 48.87	01/26/04
<b>Metropolitan Atlanta</b>								
Comfort Suites Duluth, GA	1996	85	\$ 1,127,341	\$ 31,097	60.6%	\$ 59.95	\$ 36.34	(4)
Hampton Inn Peachtree City, GA	1994	61	\$ 1,111,918	\$ 29,496	73.4%	\$ 68.00	\$ 49.94	(4)
Hampton Inn Newnan, GA	1996	91	\$ 1,366,229	\$ 25,625	65.5%	\$ 62.82	\$ 41.13	(4)
Holiday Inn Express Duluth, GA	1996	68	\$ 1,031,186	\$ 22,501	61.4%	\$ 67.68	\$ 41.55	(4)
Mainstay Suites Frederick, MD	2000	72	\$ 1,044,116	\$ 31,082	62.8%	\$ 63.26	\$ 39.73	12/31/06
<b>Total</b>		<b>1,594</b>	<b>\$ 30,474,728</b>	<b>\$ 3,293,442</b>				
<b>Weighted Average</b>					<b>61.3%</b>	<b>\$ 79.19</b>	<b>\$ 50.82</b>	

(1) Represents restaurant revenue, telephone revenue and other revenue.

(2) RevPAR is determined by dividing room revenue by available rooms for the applicable period.

(3) HHMLP has waived all of its rights to extend the terms of its 14 leases. We intend to re-lease these hotels to our wholly-owned TRS upon expiration.

(4) Leased to our wholly-owned TRS.

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### *Recent and Proposed Acquisitions*

In August 2003, we completed the following addition to our portfolio:

*Hampton Inn Chelsea, New York, New York.* On August 29, 2003, our joint venture with CNL acquired the newly-constructed, modern 20-story, 144-room Hampton Inn Chelsea for approximately \$28 million. The hotel is located in the trendy Chelsea district of Manhattan, bordering the West Village and Midtown Manhattan in New York City. The Chelsea Hampton Inn is the first and only Hampton Inn in New York City.

In addition, we are currently negotiating the acquisition of the following two hotel properties for an expected \$30 million, which we expect will close prior to the closing of this offering.

*Hampton Inn, Linden, New Jersey.* This hotel is located five miles from Newark Liberty International Airport, adjacent to Linden Airport and 25 minutes from New York City. The hotel offers 148 rooms equipped with both refrigerator and microwave. The property also has an Executive Boardroom and meeting room facilities. This hotel is attractive due to its close proximity to the two airports and the number of companies with a local presence, including Merck and other pharmaceutical companies as well as General Motors.

*Hilton Garden Inn, Edison, New Jersey.* This 132 room hotel is located in Edison, New Jersey, in the Raritan Center Business Park and one half mile from the New Jersey Convention and Exhibition Center (approximately 20 minutes from downtown Newark, 25 minutes from Newark Liberty International Airport and 30 minutes from Manhattan). In addition to the New Jersey Convention Center, we expect that guest traffic will be generated by nearby business parks, including the Raritan Center, which is comprised of 108 buildings with over 350 companies in operation.

These two acquisitions remain subject to negotiation, financing and due diligence, and we can give no assurance that these acquisitions will be consummated in the expected timeframe or at all.

### **Tax Status and Structure**

We are taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their taxable income (excluding net capital gains). See Federal Income Tax Consequences of Our Status as REIT.

In order to comply with the REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must lease our hotels. Fourteen of our hotels are leased to an independent management company, HHMLP, as required by the REIT qualification rules in effect at the time we acquired those hotels. The REIT qualification rules were recently modified, allowing a hotel REIT to lease its hotels to a taxable REIT subsidiary, or TRS, provided that the TRS engages an eligible independent contractor to manage the hotels. Accordingly, we have leased four of our hotels to a wholly-owned TRS, which will pay qualifying rent to us, and the TRS has in turn entered into management contracts with HHMLP with respect to those hotels. In addition, the hotel owned by our joint venture with CNL is leased to a TRS that is wholly owned by the joint venture. We intend to eventually lease all our hotels to a TRS, whether upon acquisition of new hotels or upon expiration of the leases for the 14 hotels currently leased to HHMLP. HHMLP has agreed not to exercise its option to extend the current lease term with respect to any of

the 14 hotels it currently leases, all of which expire prior to October 2007.

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The following chart shows the structure of our company as of August 31, 2003 on a pro forma basis to give effect to this offering and the application of the net proceeds as described under Use of Proceeds.

1. We currently have two classes of common shares, Class A shares and Class B shares. Class A common shares are held by our public shareholders and Class B shares may be issued to holders of common limited partnership units of our operating partnership. The Class A shares are entitled to certain priorities with respect to distributions; however, as of January 26, 2004 these priorities will expire and we will only have one class of common shares. Upon consummation of this offering our public shareholders will own 10,078,703 Class A common shares. There are no Class B common shares outstanding.
2. CNL owns 190,266 Series A Convertible Preferred Units in our operating partnership, which are currently exchangeable for 2,816,460 common limited partnership units of our operating partnership or 2,816,460 Class A common shares.
3. Represents the general partner interest in our operating partnership.
4. Upon completion of this offering and the application of the net proceeds therefrom, our officers and trustees will own in the aggregate 2,929,242 common limited partnership units of our operating partnership, which are redeemable for an equal number of Class B common shares. K.D. Patel, one of our trustees, subject to the closing of this offering, has committed to exercise his redemption rights with respect to 501,504 common limited partnership units, the redemption price of which will be funded from the net proceeds of this offering.
5. Upon completion of this offering and the application of the net proceeds therefrom, third party investors in our operating partnership will own 370,481 common limited partnership units, which are redeemable for an equal number of Class B common shares.
6. CNL's interest in our joint venture is exchangeable for 1,192,141 common limited partnership units in our operating partnership or the same number of Class A common shares.
7. The lessee is HHM Leasehold Interests, Inc., a TRS in which HHMLP owns a 99% equity interest and our operating partnership owns a 1% equity interest.



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### **Portfolio Formation Transactions**

*Acquisitions.* Since our initial public offering in 1999, we have acquired a total of 17 hotels, including 13 hotels acquired from entities controlled by our officers or trustees. Of the 13 acquisitions from these entities, 12 were newly-constructed or newly-renovated by these entities prior to our acquisition. Since we do not develop properties, we take advantage of our relationships with these development entities to identify development and renovation projects that may be attractive to us. While these entities bear all the risks of development, we maintain an option to purchase the hotel upon completion. Historically we have purchased hotels from these entities subject to a re-pricing mechanism which adjusts the purchase price based on the operating performance of the hotel in the year or two subsequent to closing. While we intend to continue to acquire hotels from these entities if approved by our independent trustees, future acquisitions from these entities will not be subject to these re-pricing adjustments.

*Dispositions.* Since our initial public offering in 1999, we have sold a total of eight hotels, including four hotels sold back to entities controlled by our officers or trustees at the same purchase price we acquired the hotels from those entities. All sales to these entities were in situations where we believed an independent buyer would demand seller financing, which we were not willing to provide. We do not intend to sell hotels to such entities in the future.

*Lease and Management Agreements with HHMLP.* Fourteen of our hotels are leased to HHMLP, and HHMLP manages all of our hotels. We do not operate our own hotels because we are not permitted to do so by the REIT qualification rules. The reason we lease 14 hotels to HHMLP is that the REIT qualification rules in effect at the time we acquired these hotels required us to do so. As a result of changes in the REIT qualification rules, we may now lease our hotels to a TRS. Four of our hotels are currently leased to our TRS and we intend to lease all of our hotels to our TRS, including hotels we may acquire in the future and the hotels currently leased to HHMLP as those leases expire. In accordance with the REIT qualification rules, HHMLP or another third party operator will continue to manage our hotels.

*Loans and Guarantees.* We have loaned money to, borrowed money from, and had our loans guaranteed by our officers, trustees or entities controlled by them. While we intend to make similar hotel development loans in the future to the extent our independent trustees deem appropriate to support our acquisition pipeline, we do not intend to borrow from or have our loans guaranteed by our officers, trustees or entities controlled by them in the future.

See *Certain Relationships and Transactions* for a more detailed discussion of these transactions.

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**THE OFFERING**

Class A common shares offered by us in this offering	7,500,000(1)
Class A common shares to be outstanding after this offering	10,078,703(1)(2)
American Stock Exchange Symbol	HT
Use of Proceeds	We expect that the net proceeds from this offering will be approximately \$62.9 million after deducting underwriting discounts and commissions and offering expenses payable by us (or approximately \$72.4 million if the underwriters exercise the over-allotment option in full). We intend to use the net proceeds from this offering as follows:

\$8.0 million to fund our proposed acquisitions,

\$17.0 million to reduce debt,

\$15.3 million to fund the redemption of approximately 1.8 million of common limited partnership units in our operating partnership at a price per unit equal to the net offering price in this offering, and

the remainder for future acquisitions and for general corporate purposes. See Use of Proceeds.

- (1) Does not include up to 1,125,000 Class A common shares that may be issued by us upon exercise of the underwriters' over-allotment option.
- (2) Does not include:

2,816,460 Class A common shares issuable upon conversion of 190,266 Series A Convertible Preferred Units in our operating partnership currently owned by CNL;

1,192,141 Class A common shares issuable upon exchange of CNL's interest in our joint venture;

5,099,723 Class B common shares issuable upon redemption of outstanding common limited partnership units in our operating partnership which are currently redeemable;

433,333 Class A common shares issuable upon exercise of certain warrants issued in connection with our initial public offering with an exercise price of \$9.90 per share (which warrants expire on January 26, 2004); and

500,000 Class B common shares issuable upon exercise of certain options and SARs held by our trustees, officers and employees of HHMLP which are exercisable at a price of \$6.00 per share only if our Class A common shares have a closing price in excess of \$9.00

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per share for twenty consecutive trading days and which expire on January 26, 2004.

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The following tables set forth certain summary consolidated historical financial data for Hersha Hospitality Trust and its subsidiaries. The financial data as of and for periods ended December 31, 1999, 2000, 2001 and 2002 are derived from our audited consolidated financial statements audited by Moore Stephens, P.C., our former auditors. We appointed Reznick Fedder & Silverman, CPAs, PC, as our new auditors in April 2003. The summary financial data as of and for the periods ended June 30, 2003 and 2002 are derived from our unaudited consolidated financial statements. In the opinion of management, the unaudited consolidated financial statements include all adjustments necessary to present fairly the data for such periods. You should read this summary consolidated financial data along with our consolidated financial statements and the accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operation included elsewhere in this prospectus. The summary data provided below is not necessarily indicative of future performance, and results for the six-months ended June 30, 2003, are not necessarily indicative of results for the full year.

	Year Ended December 31,				Six Months Ended June 30,	
	1999(1)	2000	2001	2002	(unaudited)	
					2002	2003
<b>Statement of Operations Data</b>						
(in thousands, except per share data)						
<b>Revenue:</b>						
Percentage Lease Revenues HHMLP(2)	\$ 7,264	\$ 9,723	\$ 9,558	\$ 11,433	\$ 5,494	\$ 6,336
Percentage Lease Revenues Other(3)		1,850	2,801	2,801	1,400	960
Hotel Operating Revenues						772
Interest	78	50	165	207		
Interest Related Party	28	1	21	7	113	210
Other Revenue					4	4
<b>Total Revenue</b>	<b>7,370</b>	<b>11,624</b>	<b>12,545</b>	<b>14,448</b>	<b>7,011</b>	<b>8,282</b>
<b>Expenses:</b>						
Interest expense	1,428	4,142	4,769	4,826	2,477	2,457
Hotel Operating Expenses						888
Land Lease Related Party	20	15	13			
Taxes and Property Insurance	450	632	812	1,021	513	542
General and Administrative	363	578	534	567	359	389
Early Payment Penalty		107				
Depreciation and Amortization	2,064	3,507	3,897	3,994	2,076	2,196
<b>Total Expenses</b>	<b>4,325</b>	<b>8,981</b>	<b>10,025</b>	<b>10,408</b>	<b>5,425</b>	<b>6,472</b>
<b>Income Before Distribution to Preferred Unitholders, Minority Interest and discontinued operations</b>	<b>3,045</b>	<b>2,643</b>	<b>2,520</b>	<b>4,040</b>	<b>1,586</b>	<b>1,810</b>
Distribution to Preferred Unitholders						(264)
Income Allocated to Minority Interest	(1,707)	(1,908)	(2,342)	(3,238)	(968)	(1,208)
<b>Discontinued Operations:</b>						
Gain on Sale of Discontinued Operations			598	449		
Income from Discontinued Operations		112	58	41		
<b>Net income</b>	<b>\$ 1,338</b>	<b>\$ 847</b>	<b>\$ 834</b>	<b>\$ 1,292</b>	<b>\$ 618</b>	<b>\$ 338</b>
<b>Basic Earnings Per Common Share(5)</b>	<b>\$ 0.59</b>	<b>\$ 0.37</b>	<b>\$ 0.37</b>	<b>\$ 0.51</b>	<b>\$ 0.25</b>	<b>\$ 0.13</b>

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Diluted Earnings Per Common Share(5)	\$ 0.48	\$ 0.37	\$ 0.37	\$ 0.51	\$ 0.21	
Dividends declared per Common Share	\$ 0.67	\$ 0.72	\$ 0.72	\$ 0.72	\$ 0.36	\$ 0.36

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	Six Months Ended	
	June 30, 2003	
	(unaudited)	
	Actual	As Adjusted(4)
(in thousands)		
Cash	\$ 513	\$ 31,110
Net investment in hotel properties	\$ 92,379	\$ 92,379
Minority interest in Partnership	\$ 32,858	\$ 32,469
Shareholder's equity	\$ 10,799	\$ 58,785
Total assets	\$ 109,195	\$ 139,792
Total debt	\$ 61,798	\$ 44,798

**Balance Sheet Data**

	Year Ended December 31,				Six Months Ended June 30,	
	(unaudited)				(unaudited)	
	1999(1)	2000	2001	2002	2002	2003
(in thousands, except share data)						
Same Hotels RevPAR(6)(7)	\$ 43.97	\$ 50.22	\$ 49.76	\$ 51.51	\$ 47.15	\$ 48.44
Same Hotels average occupancy rate(7)	61.8%	63.6%	64.5%	63.7%	62.3%	63.4%
Funds from operations(8)	\$ 5,109	\$ 6,647	\$ 7,054	\$ 8,293	\$ 3,662	\$ 4,006
EBITDA(9)	\$ 6,537	\$ 10,677	\$ 11,765	\$ 13,078	\$ 6,139	\$ 6,463
Net cash provided by operating activities	\$ 3,075	\$ 5,032	\$ 6,828	\$ 7,977	\$ 2,620	\$ 1,851
Net cash provided by (used in) investing activities	\$ (9,149)	\$ (14,895)	\$ 5,513	\$ (145)	\$ (3,241)	\$ (8,410)
Net cash provided by (used in) financing activities	\$ 6,198	\$ 9,739	\$ (12,174)	\$ (7,859)	\$ 626	\$ 6,932
Weighted average shares outstanding						
Basic	2,275,000	2,275,000	2,275,000	2,519,820	2,462,220	2,578,247
Diluted	6,326,690	6,715,996	7,296,596	7,619,542	7,561,942	8,426,285

(dollars in thousands)

- (1) Our company commenced operations on January 26, 1999.
- (2) Represents initial fixed rent plus aggregate percentage rent paid by HHMLP to our operating partnership pursuant to percentage leases, which payments are calculated by applying the rent provisions in the respective percentage leases to the historical room revenues.
- (3) Represents initial fixed rent paid by a third party lessee to our operating partnership pursuant to percentage leases, which payments are calculated by applying the rent provisions in the respective percentage leases to the historical room revenues.
- (4) As adjusted to reflect (a) the sale of 7.5 million Class A common shares in this offering at an assumed offering price of \$9.04 per share, net of underwriting discounts and commissions and offering expenses payable by us, and (b) the application of the net proceeds to pay down \$17.0 million of indebtedness and to redeem 1.8 million common limited partnership units for an aggregate of \$15.3 million. Does not reflect an increase in minority interest in our operating partnership resulting from CNL's acquisition of 40,266 additional Series A Preferred Units on August 29, 2003.
- (5) Represents basic and diluted earnings per share computed in accordance with FAS No. 128.
- (6) Calculated by dividing total revenue by the number of available rooms for the 13 hotels owned by us for all of the periods shown.

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- (7) For the 13 hotels owned by us for all of the periods shown.
- (8) The National Association of Real Estate Investment Trusts (NAREIT) developed Funds from Operations ( FFO ) as a relative non-GAAP financial measure of performance and liquidity of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO, as defined under the definition adopted by NAREIT in April 2002 and as presented by us, is net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from debt restructuring or sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. We further adjust FFO for preferred stock distributions. FFO does not represent cash flows from operating activities in accordance with GAAP (which, unlike FFO,

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generally reflects all cash effects of transactions and other events in the determination of net income) and should not be considered an alternative to net income as an indication of our performance or to cash flow as a measure of liquidity or ability to make distributions. We consider FFO a meaningful, additional measure of operating performance because it primarily excludes the effects of the assumption that the value of real estate assets diminishes predictably over time, and because it is widely used by industry analysts as a performance measure. Comparison of our presentation of FFO to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs or the use of other definitions of that term. See Management's Discussion and Analysis of Financial Condition and Results of Operations Funds From Operations.

The following table reconciles FFO to the most directly comparable GAAP measure, net income applicable to common shares:

	Year Ended December 31,				Six Months Ended June 30,	
	1999	2000	2001	2002	2002	2003
<b>FFO Reconciliation</b>						
	(in thousands)					
Net income applicable to common shares	\$ 1,338	\$ 847	\$ 834	\$ 1,292	\$ 618	\$ 338
Less: Gain on Sale of Assets			(598)	(449)		
Add:						
Minority interest	1,707	1,908	2,342	3,238	968	1,208
Distributions to Preferred Unitholders						264
Depreciation and amortization	2,064	3,892	4,476	4,212	2,076	2,196
<b>Funds From Operations</b>	<b>\$ 5,109</b>	<b>\$ 6,647</b>	<b>\$ 7,054</b>	<b>\$ 8,293</b>	<b>\$ 3,662</b>	<b>\$ 4,006</b>

- (9) EBITDA represents income before discontinued operations and minority interest plus interest, taxes, depreciation and amortization. EBITDA is presented because we believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. However, other companies in our industry may calculate EBITDA differently than we do. EBITDA is not a measurement of financial performance under GAAP and should not be considered as an alternative to cash flow from operating activities or as a measure of liquidity or an alternative to net income as indicators of our operating performance or any other measures of performance derived in accordance with GAAP. See the Statements of Cash Flow included in our financial statements.

The following table reconciles EBITDA, which is not a measure under GAAP, to net income for the periods ended as indicated.

	Year Ended December 31,				Six Months Ended June 30,	
	1999	2000	2001	2002	2002	2003
<b>EBITDA Reconciliation</b>						
	(in thousands)					
Income before discontinued operations and minority interest	\$ 3,045	\$ 2,643	\$ 2,520	\$ 4,040	\$ 1,586	\$ 1,810
Income tax benefit (expense)						
Interest and financing expense	1,428	4,142	4,769	4,826	2,477	2,457
Depreciation and amortization	2,064	3,892	4,476	4,212	2,076	2,196
<b>EBITDA</b>	<b>\$ 6,537</b>	<b>\$ 10,677</b>	<b>\$ 11,765</b>	<b>\$ 13,078</b>	<b>\$ 6,139</b>	<b>\$ 6,463</b>





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**RISK FACTORS**

An investment in our Class A common shares involves significant risks, including the risk of losing your entire investment. In evaluating our business, prospective investors should carefully consider the following risk factors in addition to the other information contained in this prospectus.

**RISKS RELATING TO OUR BUSINESS AND OPERATIONS**

**We may be unable to integrate acquired hotels into our operations or otherwise manage our planned growth, which may adversely affect our operating results.**

We expect to use the net proceeds from this offering to acquire a substantial number of hotels. If we are successful in making these acquisitions, we cannot assure you that we (or HHMLP) will be able to adapt our management, administrative, accounting and operational systems and arrangements, or hire and retain sufficient operational staff to integrate these investments into our portfolio and manage any future acquisitions of additional assets without operating disruptions or unanticipated costs. Acquisition of hotels would generate additional operating expenses that we would be required to pay. As we acquire additional hotels, we will be subject to the operational risks associated with owning new lodging properties. Our failure to integrate successfully any future acquisitions into our portfolio could have a material adverse effect on our results of operations and financial condition and our ability to pay dividends to shareholders.

**Acquisition of hotels with limited operating history may not achieve desired results.**

We seek to acquire a substantial number of new hotels, including hotels that may be acquired with the net proceeds of this offering. Many of our acquisitions are likely to be newly developed hotels. Newly-developed or newly-renovated hotels do not have the operating history that would allow our management to make pricing decisions in acquiring these hotels based on historical performance. The purchase prices of these hotels are typically based upon management's expectations as to the operating results of such hotels, subjecting us to risks that such hotels may not achieve anticipated operating results or may not achieve these results within anticipated time frames. As a result, we may not be able to generate enough cash flow from these hotels to make debt payments or pay operating expenses. In addition, room revenues may be less than that required to provide us with our anticipated return on investment. In either case, the amounts available for distribution to our shareholders could be reduced.

**Our acquisitions may not achieve expected performance, which may harm our financial condition and operating results.**

We anticipate that acquisitions will largely be financed with the net proceeds of this offering and through externally generated funds such as borrowings under credit facilities and other secured and unsecured debt financing. Acquisitions entail risks that investments will fail to perform in accordance with expectations and that estimates of the cost of improvements necessary to acquire and market properties will prove inaccurate, as well as general investment risks associated with any new real estate investment. Because we must distribute at least 90% of our taxable income to maintain our qualification as a REIT, our ability to rely upon income or cash flow from operations to finance our growth and acquisition activities will be limited. Accordingly, were we unable to obtain funds from borrowings or the capital markets to finance our growth and acquisition activities, our ability to grow could be curtailed, amounts available for distribution to shareholders could be adversely affected and we could be required to reduce distributions.

**We own a limited number of hotels and significant adverse changes at one may impact our lessees ability to pay rent and our ability to make distributions to shareholders.**

We own only 19 hotels. Significant adverse changes in the operations of any one hotel could have a material adverse effect on our lessees ability to make rent payments and, accordingly, on our ability to make expected distributions to our shareholders.

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**We focus on acquiring hotels operating under a limited number of franchise brands, which creates greater risk as the investments are more concentrated.**

We intend to place particular emphasis in our acquisition strategy on hotels similar to our current hotels. We invest in hotels operating under a few select franchises and therefore will be subject to risks inherent in concentrating investments in a particular franchise brand, which could have an adverse effect on our lease revenues and amounts available for distribution to shareholders. These risks include, among others, the risk of a reduction in hotel revenues following any adverse publicity related to a specific franchise brand.

**Many of our hotels are located in Pennsylvania, which may increase the effect of any local economic conditions.**

Eleven of our 19 hotels are located in Pennsylvania. Some of our other hotels are clustered in metropolitan areas, such as Atlanta. As a result, localized adverse events or conditions, such as an economic recession around these hotels, could have a significant adverse effect on our operations, and ultimately on the amounts available for distribution to shareholders.

**We face risks associated with the use of debt, including refinancing risk.**

At June 30, 2003, we had debt outstanding of \$61.8 million. We may borrow additional amounts from the same or other lenders in the future, or may issue corporate debt securities in public or private offerings. Some of these additional borrowings may be secured by our hotels. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis, and our Board of Trustees' policy is to limit indebtedness to no more than 67% of the total purchase price of all our hotels on an aggregate basis. However our declaration of trust (as amended and restated, our Declaration of Trust ) does not limit the amount of indebtedness we may incur. We cannot assure you that we will be able to meet our debt service obligations and, to the extent that we cannot, we risk the loss of some or all of our hotels to foreclosure. There is also a risk that we may not be able to refinance existing debt or that the terms of any refinancing will not be as favorable as the terms of the existing debt. If principal payments due at maturity cannot be refinanced, extended or repaid with proceeds from other sources, such as new equity capital or sales of properties, our cash flow may not be sufficient to repay all maturing debt in years when significant balloon payments come due.

**We do not operate our hotels and, as a result, we do not have complete control over implementation of our strategic decisions.**

In order for us to satisfy certain REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must lease our hotels. Fourteen of our hotels are leased to an independent management company, HHMLP, as required by the REIT qualification rules in effect at the time we acquired those hotels. In addition, four other hotels are managed by HHMLP under management agreements with our wholly-owned TRS who leases those hotels from us. HHMLP makes and implements strategic business decisions with respect to our hotels, such as decisions with respect to the repositioning of a franchise or food and beverage operations and other similar decisions. Decisions made by HHMLP or any other hotel operator to whom we may lease our hotels may not be in the best interests of a particular hotel or of our company. Accordingly, we cannot assure you that our lessees or HHMLP will operate our hotels in a manner that is in our best interests.

**Dependence on our lessees for rent may impact distributions to shareholders.**

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We rely on our lessees to make rent payments in order to make distributions to shareholders. Obligations under the percentage leases, including the obligation to make rent payments, are unsecured. HHMLP, the lessee of 14 of our hotels, incurred a net loss of \$671,000 for the year ended December 31, 2002, a net loss of \$1,104,000 for the year ended December 31, 2001, and a net loss of \$147,000 for the year ended December 31, 2000, and HHMLP had a partners' deficit of \$3,351,000 as of June 30, 2003. Reductions in revenues from our hotels or in the net operating income of our lessees may adversely affect the ability of our lessees to make these rent payments and thus our ability to make anticipated distributions to our shareholders.

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### **We depend on key personnel.**

We depend on the services of our existing senior management to carry out our business and investment strategies. As we expand, we will continue to need to attract and retain qualified additional senior management. We do not have employment contracts with any of our senior management and they may cease to provide services to us at any time. The loss of the services of any of our key management personnel, or our inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

### **We face increasing competition for the acquisition of hotel properties and other assets, which may impede our ability to make future acquisitions or may increase the cost of these acquisitions.**

We face competition for investment opportunities in mid-scale hotels from entities organized for purposes substantially similar to our objectives, as well as other purchasers of hotels. We compete for such investment opportunities with entities that have substantially greater financial resources than we do, including access to capital or better relationships with franchisors, sellers or lenders. Our competitors may generally be able to accept more risk than we can manage prudently and may be able to borrow the funds needed to acquire hotels. Competition may generally reduce the number of suitable investment opportunities offered to us and increase the bargaining power of property owners seeking to sell.

## **RISKS RELATING TO CONFLICTS OF INTEREST**

### **Due to conflicts of interest, many of our existing agreements may not have been negotiated on an arm's-length basis and may not be in our best interest.**

Some of our officers and trustees have ownership interests in HHMLP and in entities with which we have entered into transactions, including hotel acquisitions and dispositions and certain financings. Consequently, the terms of our agreements with those entities, including hotel contribution or purchase agreements, percentage leases, the Administrative Services Agreement between us and HHMLP pursuant to which HHMLP provides certain administrative services, the Option Agreement between the operating partnership and some of the trustees and officers and our property management agreements with HHMLP may not have been negotiated on an arm's-length basis and may not be in the best interest of all our shareholders.

### **Conflicts of interest with other entities may result in decisions that do not reflect our best interests.**

The following officers and trustees own collectively approximately 81% of HHMLP: Hasu P. Shah, Jay H. Shah, Neil H. Shah, David L. Desfor and Kiran P. Patel. The following officers and trustees serve as officers of HHMLP: David L. Desfor, Kiran P. Patel and K.D. Patel. Conflicts of interest may arise in respect of the ongoing leasing, acquisition, disposition and operation of our hotels including, but not limited to, the percentage leases and enforcement of the contribution and purchase agreements, the Administrative Services Agreement, the Option Agreement and our property management agreements with HHMLP. Consequently, the interests of shareholders may not be fully represented in all decisions made or actions taken by our officers and trustees.

**Conflicts of interest relating to sales or refinancing of hotels acquired from some of our trustees and officers may lead to decisions that are not in our best interest.**

Some of our trustees and officers have unrealized gains associated with their interests in the hotels we have acquired from them and, as a result, any sale of the these hotels or refinancing or prepayment of principal on the indebtedness assumed by us in purchasing these hotels may cause adverse tax consequences to such of our trustees and officers. Therefore, our interests and the interests of these individuals may be different in connection with the disposition or refinancing of these hotels.

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### **Competing hotels owned or acquired by some of our trustees and officers may hinder these individuals from spending adequate time on our business.**

Some of our trustees and officers own hotels and may develop or acquire new hotels, subject to certain limitations. Such ownership, development or acquisition activities may materially affect the amount of time these officers and trustees devote to our affairs. Some of our trustees and officers operate hotels that are not owned by us, which may materially affect the amount of time that they devote to managing our hotels. Pursuant to the Option Agreement, as amended, we have an option to acquire any hotels developed by our officers and trustees.

### **The bankruptcy of an affiliated guarantor of the indebtedness relating to some of our hotels could trigger a default under our loan documents.**

Mr. Hasu P. Shah, Chairman of our Board of Trustees and CEO, guarantees the indebtedness of four of our hotels. Mr. Shah's bankruptcy would constitute a default under the related loan documents, and such default would cause some or all of the assumed indebtedness to become immediately due and payable. In the event that the lender accelerates the payment, such acceleration could adversely affect our cash available for distribution. If we are unable to make such payment, we may be forced to sell the hotels that serve as collateral for the indebtedness in order to make such payment. In addition, if the hotels that serve as collateral for the guarantees by Mr. Hasu Shah experience financial difficulty, we may be more likely to invest in those hotels with income from other hotels so that Mr. Shah will not be required to fund his guarantees.

### **Need for certain consents from the limited partners may not result in decisions advantageous to shareholders.**

Under our operating partnership's amended and restated partnership agreement, the holders of at least two-thirds of the interests in the partnership must approve a sale of all or substantially all of the assets of the partnership or a merger or consolidation of the partnership. Upon completion of this offering, some of our officers and trustees will own an approximately 18.1% interest in the operating partnership on a fully-diluted basis. Their large ownership percentage may make it less likely that a merger or sale of our company that would be in the best interests of our shareholders will be approved.

## **RISKS RELATING TO OUR CORPORATE STRUCTURE**

### **A major shareholder has significant influence over our affairs.**

CNL, through its ownership of Series A Preferred Units of our limited partnership, upon completion of this offering and the application of the net proceeds thereof, will own approximately 17.39% of our common shares on a fully-diluted basis. In addition, CNL would be able to acquire an additional 5.77% of our common shares on a fully-diluted basis upon exchange of its interest in our joint venture. CNL may also purchase additional Series A Preferred Units and joint venture interests. Pursuant to the terms of the Series A Convertible Preferred Units owned by CNL, and the Series A Preferred Shares into which they are exchangeable, it has a number of special rights, including, but not limited to:

certain preemptive rights with respect to any issuance by us prior to April 2006 of Class A common shares;



certain rights to elect members of our Board of Trustees; and

certain approval rights including with respect to:

mergers;

the sale of all or substantially all of our assets;

the issuance of equity securities;

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the payment of dividends while in arrears with respect to dividends relating to CNL's securities;

certain amendments to our Declaration of Trust;

filing for bankruptcy; and

terminating our REIT status.

In addition, for so long as the holders of the Series A Convertible Preferred Units hold in the aggregate that number of Series A Convertible Preferred Units, Class A common shares and any other class of our equity that represent on an as-converted or as-exchanged basis at least five percent of the issued and outstanding Class A common shares on a fully diluted basis, a majority of the Series A Convertible Preferred Units must approve a sale of all or substantially all of the assets of the operating partnership or a merger or consolidation of the operating partnership. CNL therefore holds veto power over such extraordinary transactions, which could result in the disapproval of a transaction that would be beneficial to our shareholders.

In addition, pursuant to the terms of our joint venture with CNL, until April 21, 2004, we must present all of our proposed acquisitions to the investment committee of the joint venture, and we may only acquire such acquisition directly if the investment committee or CNL fails to approve that acquisition for the joint venture. This arrangement may make it more difficult for us to acquire suitable hotels other than through the joint venture.

As a result of its ownership of our securities and the rights described above, CNL may have significant influence over our affairs. This could potentially be disadvantageous to other shareholders' interests, which may not be aligned with the interests of CNL. For a more detailed description of CNL's rights, see the sections entitled "CNL Strategic Alliance."

**Our ownership limitation may restrict business combination opportunities.**

To qualify as a REIT under the Code, no more than 50% of our outstanding shares of beneficial interest may be owned, directly or indirectly, by five or fewer individuals during the last half of each taxable year. To preserve our REIT qualification, our Declaration of Trust generally prohibits direct or indirect ownership of more than 9.9% of the number of outstanding shares of any class of our securities, including the Class A common shares, by any person. Generally, Class A common shares owned by affiliated owners will be aggregated for purposes of the ownership limitation. The ownership limitation could have the effect of delaying, deferring or preventing a change in control or other transaction in which holders of Class A common shares might receive a premium for their Class A common shares over the then prevailing market price or which such holders might believe to be otherwise in their best interests.

**The Declaration of Trust contains a provision that creates staggered terms for our Board of Trustees.**

Our Board of Trustees is divided into two classes. The terms of the first and second classes expire in 2004 and 2005, respectively. Trustees of each class are elected for two-year terms upon the expiration of their current terms and each year one class of trustees will be elected by the shareholders. The staggered terms of trustees may delay, defer or prevent a tender offer, a change in control of us or other transaction, even

though such a transaction might be in the best interest of the shareholders.

**Maryland Business Combination Law may discourage a third party from acquiring us.**

Under the Maryland General Corporation Law, as amended (MGCL), as applicable to real estate investment trusts, certain business combinations (including certain issuances of equity securities) between a Maryland real estate investment trust and any person who beneficially owns ten percent or more of the voting power of the trust's shares or an affiliate thereof or any person who is an affiliate or associate of the trust and was the beneficial owner of ten percent or more of the voting shares of the trust within the two year period immediately prior to the date in question, are prohibited for five years after the most recent date on which this shareholder

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acquired at least ten percent of the voting power of the trust's shares. Thereafter, any such business combination must be approved by two super-majority shareholder votes unless, among other conditions, the trust's common shareholders receive a minimum price (as defined in the MGCL) for their shares and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its common shares. These provisions could delay, defer or prevent a transaction or change of control of our company in which our shareholders might otherwise receive a premium for their shares above then-current market prices or might otherwise deem to be in their best interests. CNL and some of our trustees and officers may control a sufficient percentage of the voting power to block a proposal respecting a business combination under these provisions. As part of the transaction with CNL, we exempted CNL from the application of these provisions, which could make us more vulnerable to an unsolicited acquisition attempt by CNL that would not be advantageous for all shareholders.

### **The Board of Trustees may change our investment and operational policies without a vote of the Class A common shareholders.**

Our major policies, including our policies with respect to acquisitions, financing, growth, operations, debt limitation and distributions, are determined by our Board of Trustees. The Trustees may amend or revise these and other policies from time to time without a vote of the holders of the Class A common shares.

### **Our Board of Trustees may issue additional shares that may cause dilution or prevent a transaction that is in the best interests of our shareholders.**

Our Declaration of Trust authorizes the Board of Trustees, without shareholder approval, to:

amend the Declaration of Trust to increase or decrease the aggregate number of shares of beneficial interest or the number of shares of beneficial interest of any class that we have the authority to issue,

cause us to issue additional authorized but unissued Class A common shares, Class B common shares or preferred shares and

classify or reclassify any unissued common or preferred shares and to set the preferences, rights and other terms of such classified or reclassified shares, including the issuance of additional Class A common shares or preferred shares that have preference rights over the Class A common shares with respect to dividends, liquidation, voting and other matters.

Any one of these events could cause dilution to our common shareholders, delay, defer or prevent a transaction or a change in control that might involve a premium price for the Class A common shares or otherwise not be in the best interest of holders of Class A common shares.

## **RISKS RELATED TO OUR TAX STATUS**

**If we fail to qualify as a REIT, our dividends will not be deductible to us, and our income will be subject to taxation.**

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We have operated and intend to continue to operate so as to qualify as a REIT for federal income tax purposes. Our continued qualification as a REIT will depend on our continuing ability to meet various requirements concerning, among other things, the ownership of our outstanding shares of beneficial interest, the nature of our assets, the sources of our income, and the amount of our distributions to our shareholders. If we were to fail to qualify as a REIT in any taxable year, we would not be allowed a deduction for distributions to our shareholders in computing our taxable income and would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Unless entitled to relief under certain Code provisions, we also would be disqualified from treatment as a REIT for the four taxable years following the year during which qualification was lost. As a result, amounts available for distribution to shareholders would be reduced for each of the years involved. Although we currently intend to operate in a

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manner designed to qualify as a REIT, it is possible that future economic, market, legal, tax or other considerations may cause the trustees, with the consent of holders of two-thirds of the outstanding shares, to revoke the REIT election.

### **Failure to make required distributions would subject us to tax.**

In order to qualify as a REIT, each year we must distribute to our shareholders at least 90% of our taxable income, other than any net capital gain. To the extent that we satisfy the distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any year are less than the sum of:

85% of our ordinary income for that year;

95% of our capital gain net income for that year; and

100% of our undistributed taxable income from prior years.

We have paid out, and intend to continue to pay out, our income to our shareholders in a manner intended to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax. Differences in timing between the recognition of income and the related cash receipts or the effect of required debt amortization payments could require us to borrow money or sell assets to pay out enough of our taxable income to satisfy the distribution requirement and to avoid corporate income tax and the 4% nondeductible excise tax in a particular year. In the past we have borrowed, and in the future we may borrow, to pay distributions to our shareholders and the limited partners of our operating partnership. Such borrowings subject us to risks from borrowing as described herein.

### **Recent changes in taxation of corporate dividends may adversely affect the value of our Class A common shares.**

The Jobs and Growth Tax Relief Reconciliation Act of 2003, which was enacted into law on May 28, 2003, among other things, generally reduces to 15% the maximum marginal rate of tax payable by domestic noncorporate taxpayers on dividends received from a regular C corporation. This reduced tax rate, however, will not apply to dividends paid to domestic noncorporate taxpayers by a REIT on its stock, except for certain limited amounts. Although the earnings of a REIT that are distributed to its shareholders still generally will be subject to less federal income taxation than earnings of a non-REIT C corporation that are distributed to its shareholders net of corporate-level income tax, this legislation could cause domestic noncorporate investors to view the stock of regular C corporations as more attractive relative to the stock of a REIT than was the case prior to the enactment of the legislation, because the dividends from regular C corporations will generally be taxed at a lower rate while dividends from REITs will generally be taxed at the same rate as the individual's other ordinary income. We cannot predict what effect, if any, the enactment of this legislation may have on the value of the stock of REITs in general or on our Class A common shares in particular, either in terms of price or relative to other investments.

## **RISKS RELATED TO THE HOTEL INDUSTRY**

**The value of our hotels depends on conditions beyond our control.**

Our hotels are subject to varying degrees of risk generally incident to the ownership of hotels. The underlying value of our hotels, our income and ability to make distributions to our shareholders are dependent upon the ability of our lessees to operate the hotels in a manner sufficient to maintain or increase revenues in excess of operating expenses to enable our lessees to make rent payments. Hotel revenues may be adversely affected by adverse changes in national economic conditions, adverse changes in local market conditions due to changes in general or local economic conditions and neighborhood characteristics, competition from other hotels, changes in interest rates and in the availability, cost and terms of mortgage funds, the impact of present or future

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environmental legislation and compliance with environmental laws, the ongoing need for capital improvements, particularly in older structures, changes in real estate tax rates and other operating expenses, adverse changes in governmental rules and fiscal policies, civil unrest, acts of terrorism, acts of God, including earthquakes, hurricanes and other natural disasters, acts of war, adverse changes in zoning laws, and other factors that are beyond our control. In particular, general and local economic conditions may be adversely affected by the recent terrorist incidents in New York and Washington, D.C. Our management is unable to determine the long-term impact, if any, of these incidents or of any acts of war or terrorism in the United States or worldwide, on the U.S. economy, on us or our hotels or on the market price of our Class A common shares.

**Our hotels are subject to general hotel industry operating risks, which may impact lessees' ability to make rent payments and on our ability to make distributions to shareholders.**

Our hotels are subject to all operating risks common to the hotel industry. The hotel industry has experienced volatility in the past, as have our hotels, and there can be no assurance that such volatility will not occur in the future. These risks include, among other things, competition from other hotels; over-building in the hotel industry that could adversely affect hotel revenues; increases in operating costs due to inflation and other factors, which may not be offset by increased room rates; reduction in business and commercial travel and tourism; strikes and other labor disturbances of hotel employees; increases in energy costs and other expenses of travel; adverse effects of general and local economic conditions; and adverse political conditions. These factors could reduce revenues of the hotels and adversely affect the lessees' ability to make rent payments, and therefore, our ability to make distributions to our shareholders.

**Competition for guests is highly competitive.**

The hotel industry is highly competitive. Our hotels compete with other existing and new hotels in their geographic markets. Many of our competitors have substantially greater marketing and financial resources than we do. If their marketing strategies are effective, our lessees may be unable to make rent payments and we may be unable to make distributions to our shareholders.

**Our investments are concentrated in a single segment of the hotel industry.**

Our current business strategy is to own and acquire hotels primarily in the mid-scale segment of the hotel industry. We are subject to risks inherent in concentrating investments in a single industry and in a specific market segment within that industry. The adverse effect on rent under the percentage leases and amounts available for distribution to shareholders resulting from a downturn in the hotel industry in general or the mid-scale segment in particular could be more pronounced than if we had diversified our investments outside of the hotel industry or in additional hotel market segments.

**The hotel industry is seasonal in nature.**

The hotel industry is seasonal in nature. Generally, hotel revenues are greater in the second and third quarters than in the first and fourth quarters. Our hotels' operations historically reflect this trend. We believe that we will be able to make distributions necessary to maintain REIT status through cash flow from operations; but if we are unable to do so, we may not be able to make the necessary distributions or we may have to generate cash by a sale of assets, increasing indebtedness or sales of securities to make the distributions.



**Risks of operating hotels under franchise licenses, which may be terminated or not renewed, may impact our lessees' ability to make rent payments and our ability to make distributions to shareholders.**

The continuation of the franchise licenses is subject to specified operating standards and other terms and conditions. All of the franchisors of our hotels periodically inspect our hotels to confirm adherence to their operating standards. The failure of our partnership or our lessees to maintain such standards or to adhere to such other terms and conditions could result in the loss or cancellation of the applicable franchise license. It is possible that a franchisor could condition the continuation of a franchise license on the completion of capital

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improvements that the trustees determine are too expensive or otherwise not economically feasible in light of general economic conditions, the operating results or prospects of the affected hotel. In that event, the trustees may elect to allow the franchise license to lapse or be terminated.

There can be no assurance that a franchisor will renew a franchise license at each option period. If a franchisor terminates a franchise license, we, our partnership and our lessees may be unable to obtain a suitable replacement franchise, or to successfully operate the hotel independent of a franchise license. The loss of a franchise license could have a material adverse effect upon the operations or the underlying value of the related hotel because of the loss of associated name recognition, marketing support and centralized reservation systems provided by the franchisor. Although the percentage leases require our lessees to maintain the franchise licenses for each hotel, our lessees' loss of a franchise license for one or more of the hotels could have a material adverse effect on our partnership's revenues and our amounts available for distribution to shareholders.

**Operating costs and capital expenditures for hotel renovation may be greater than anticipated and may adversely impact rent payments by our lessees and our ability to make distributions to shareholders.**

Hotels generally have an ongoing need for renovations and other capital improvements, particularly in older structures, including periodic replacement of furniture, fixtures and equipment. Under the terms of our leases and management agreements with HHMLP, we are obligated to pay the cost of expenditures for items that are classified as capital items under GAAP that are necessary for the continued operation of our hotels. If these expenses exceed our estimate, the additional cost could have an adverse effect on amounts available for distribution to shareholders. In addition, we may acquire hotels in the future that require significant renovation. Renovation of hotels involves certain risks, including the possibility of environmental problems, construction cost overruns and delays, uncertainties as to market demand or deterioration in market demand after commencement of renovation and the emergence of unanticipated competition from hotels.

## **RISKS RELATED TO REAL ESTATE INVESTMENT GENERALLY**

**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.**

Real estate investments are relatively illiquid. Our ability to vary our portfolio in response to changes in operating, economic and other conditions will be limited. No assurances can be given that the fair market value of any of our hotels will not decrease in the future.

**If we suffer losses that are not covered by insurance or that are in excess of our insurance coverage limits, we could lose investment capital and anticipated profits.**

Each lease specifies comprehensive insurance to be maintained on each of our hotels, including liability and fire and extended coverage in amounts sufficient to permit the replacement of the hotel in the event of a total loss, subject to applicable deductibles. Leases for hotels subsequently acquired by us will contain similar provisions. However, there are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, hurricanes and acts of terrorism, that may be uninsurable or not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations and other factors also might make it impracticable to use insurance proceeds to replace the applicable hotel after such applicable hotel has been damaged or destroyed. Under such circumstances, the insurance proceeds received by us might not be adequate to restore our economic position with respect to the applicable hotel. If any of these or similar events occur, it may reduce

the return from the attached property and the value of our investment.

**REITs are subject to property taxes.**

Each hotel is subject to real and personal property taxes. The real and personal property taxes on hotel properties in which we invest may increase as property tax rates change and as the properties are assessed or reassessed by taxing authorities. Many state and local governments are facing budget deficits which has led many

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of them, and may in the future lead others to, increase assessments and/or taxes. If property taxes increase, our ability to make expected distributions to our shareholders could be adversely affected.

### **Environmental matters could adversely affect our results.**

Operating costs may be affected by the obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of future legislation. Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances on, under or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. The cost of complying with environmental laws could materially adversely affect amounts available for distribution to shareholders. Phase I environmental assessments have been obtained on all of our hotels. Nevertheless, it is possible that these reports do not reveal all environmental liabilities or that there are material environmental liabilities of which we are unaware.

### **Costs associated with complying with the Americans with Disabilities Act may adversely affect our financial condition and operating results.**

Under the Americans with Disabilities Act of 1993 (ADA), all public accommodations are required to meet certain federal requirements related to access and use by disabled persons. While we believe that our hotels are substantially in compliance with these requirements, a determination that we are not in compliance with the ADA could result in imposition of fines or an award of damages to private litigants. In addition, changes in governmental rules and regulations or enforcement policies affecting the use and operation of the hotels, including changes to building codes and fire and life-safety codes, may occur. If we were required to make substantial modifications at the hotels to comply with the ADA or other changes in governmental rules and regulations, our ability to make expected distributions to our shareholders could be adversely affected.

## **RISK RELATED TO THIS OFFERING**

### **Investors in this offering will experience immediate and significant dilution in the book value per share.**

The public offering price of our Class A common shares is substantially higher than what our net tangible book value per share will be immediately after this offering. Purchasers of our Class A common shares in this offering will incur immediate dilution of approximately \$3.21 in net tangible book value per share of Class A common shares from the price payable for our Class A common shares in this offering.

### **The priority and preferences benefiting the holders of Class A common shares will expire no later than January 26, 2004.**

The Class A common shares enjoy the benefit of a priority period during which, subject to the prior rights of the holders of Series A Convertible Preferred Units, the holders of the Class A common shares are entitled to receive, prior to any distributions either to the holders of common limited partnership units or to the holders of the Class B common shares, if any, cumulative dividends in an amount per Class A common share equal to \$0.18 per quarter. The priority period expires on the earlier of (i) January 26, 2004 and (ii) an election by us to end the priority period

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within 15 days if the share price remains over \$7.00 per share for these 15 days. Although our share price has remained over \$7.00 for more than 15 days, we do not intend to elect to terminate the priority period. As a result, the priority period will terminate on January 26, 2004. After the expiration of the priority period, distributions will be made, subject to preference of the Series A Convertible Preferred Units owned by CNL, to holders of the Class A common shares and common limited partnership units in our operating partnership on a pro rata basis. After the termination of the priority period, a significant downturn in our financial results will have a greater chance of impacting the distributions made with respect to the Class A common shares.

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**We may be unable to invest the excess net proceeds raised in this offering on acceptable terms or at all, which would harm our financial condition and operating results.**

The portion of the net proceeds of this offering not used to fund our proposed acquisitions, repay indebtedness or to redeem limited partnership units in our operating partnership, which will be approximately \$22.6 million, will be available for future investments in hotel assets. Until we identify hotel investments consistent with our investment criteria, we intend to invest that portion of the net offering proceeds in money market funds. We cannot assure you that we will be able to identify hotel investments that meet our investment criteria, that we will be successful in completing any investment we identify or that any investment we complete using the net proceeds of this offering will produce a return on our investment. Moreover, because we will not have identified these future investments at the time of our offering, we will have broad authority to invest the excess net proceeds of this offering in any hotel investments that we may identify in the future.

In addition, pursuant to the terms of our joint venture with CNL, until April 21, 2004, we must present all of our proposed acquisitions to the investment committee of the joint venture, and we may only acquire such acquisition directly if the investment committee or CNL fails to approve that acquisition for the joint venture. This arrangement may make it more difficult for us to acquire suitable hotels other than through the joint venture.

**We cannot assure you that an active public market for our Class A common shares will develop.**

The number of Class A common shares proposed to be sold in this offering is more than twice times the number of currently outstanding shares. Prior to this offering, there has been limited trading volume for our Class A common shares, and we cannot assure you that an active trading market for the shares of Class A common shares will develop as a result of this offering or, if developed, that any such market will be sustained. In the absence of an active public trading market, an investor may be unable to liquidate an investment in our Class A common shares at the price or in the time period desired. We cannot assure you that the price at which the shares of Class A common shares will sell in the public market after the closing of this offering will not be lower than the price at which they are sold by the underwriters.

**Adjustments to the purchase price to our hotels may lead to substantial shareholder dilution.**

Five of the hotels currently owned by us were purchased pursuant to agreements that provide for post-closing purchase price adjustments based on the hotel's performance in relation to the purchase price. In the event that any of the purchase prices of these hotels are increased on an adjustment date and the purchase price adjustment is paid in common limited partnership units, owners of the Class A common shares at such time will experience dilution.

**Future offerings of debt securities, which would be senior to our Class A common shares upon liquidation, or equity securities, which would dilute our existing shareholders and may be senior to our Class A common shares for the purposes of dividend distributions, may adversely affect the market price of our Class A common shares.**

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred or common shares. Upon liquidation, holders of our debt securities and shares of preferred shares and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common shares. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of

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our Class A common shares, or both. Our preferred shares, if issued, could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common shares. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our shareholders bear the risk of our future offerings reducing the market price of our common shares and diluting their stock holdings in us.

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**Possible adverse effect of shares available for future sale on price of Class A common shares.**

At any time, CNL may elect to exchange its Series A Convertible Preferred Units for up to 2,816,460 Class A common shares and exchange its interest in their joint venture with us for up to 1,192,141 additional Class A common shares. To the extent CNL funds additional capital to us or our joint venture, the number of Class A common shares issuable upon such exchange will increase. Furthermore, as of August 31, 2003, there are 5,099,723 outstanding limited partnership units in our operating partnership (other than the Series A Convertible Preferred Units) which currently are redeemable for Class B common shares (or 3,299,723 units upon completion of this offering and the application of the net proceeds thereof). Upon the exchange of the Series A Convertible Preferred Units or the redemption of common limited partnership units, the Class B common shares or Class A common shares received therefor may be sold in the public market pursuant to shelf registration statements that we are obligated to file on behalf of CNL and the limited partners of our operating partnership, or pursuant to any available exemptions from registration. Sales of a substantial number of Class A common shares or Class B common shares, or the perception that such sales could occur, could adversely affect prevailing market prices of the Class A common shares. Holders of these shares and units have entered into lock up agreements in connection with this offering that prevent them from selling these shares until 120 days from the date of this prospectus.

**There are no assurances of our ability to make distributions in the future.**

We intend to pay quarterly dividends and to make distributions to our shareholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. However, our ability to pay dividends may be adversely affected by the risk factors described in this prospectus. All distributions will be made at the discretion of our Board of Trustees and will depend upon our earnings, our financial condition, maintenance of our REIT status and such other factors as our board may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, some of our distributions may include a return of capital.

**An increase in market interest rates may have an adverse effect on the market price of our securities.**

One of the factors that investors may consider in deciding whether to buy or sell our securities is our dividend rate as a percentage of our share or unit price, relative to market interest rates. If market interest rates increase, prospective investors may desire a higher dividend or interest rate on our securities or seek securities paying higher dividends or interest. The market price of our Class A common shares likely will be based primarily on the earnings and return that we derive from our investments and income with respect to our properties and our related distributions to shareholders, and not from the market value or underlying appraised value of the properties or investments themselves. As a result, interest rate fluctuations and capital market conditions can affect the market price of our Class A common shares. For instance, if interest rates rise without an increase in our dividend rate, the market price of our Class A common shares could decrease because potential investors may require a higher dividend yield on our Class A common shares as market rates on interest-bearing securities, such as bonds, rise. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby adversely affecting cash flow and our ability to service our indebtedness and pay dividends.



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**FORWARD-LOOKING STATEMENTS**

This prospectus, including the sections entitled Prospectus Summary, Risk factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business and Properties contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors, all of which are difficult to predict and many of which are beyond our control, that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continue, our future success depends, seek to continue or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Important factors that could cause actual results to differ materially from those in our forward looking statements in this prospectus include, but are not limited to, the factors discussed in the section entitled Risk Factors and the filings made by us with the SEC that are incorporated in this prospectus. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

**Table of Contents****USE OF PROCEEDS**

We estimate that the net proceeds to us from the sale of the 7,500,000 Class A common shares offered hereby will be approximately \$62.9 million, after deducting underwriting discounts and commissions and the estimated expenses of this offering payable by us. If the underwriters exercise their over-allotment option in full, we estimate that our net proceeds will be approximately \$72.4 million.

As required by the partnership agreement of our operating partnership, we will contribute all of the net proceeds to our operating partnership in exchange for additional partnership interests. We intend to use the net proceeds of this offering, subject to maintaining our REIT qualification, as follows: \$8.0 million to fund our proposed acquisitions, \$17.0 million to reduce indebtedness, \$15.3 million to redeem 1.8 million common limited partnership units in our operating partnership at a price per unit equal to the net offering price in this offering, and the remainder to fund future acquisitions and for other general corporate purposes.

The terms of the indebtedness we will repay with the net proceeds of this offering are as follows:

<u>Facility</u>	<u>Total Amount</u>	<u>Amount Repaid</u>	<u>Interest Rate</u>	<u>Maturity</u>
Sovereign Bank Credit Line	\$ 4.0 million	\$ 4.0 million	4.00%	1/1/04
Waypoint Bank	\$ 5.5 million	\$ 5.5 million	4.25%	1/1/08
Shreenathji Enterprises, Ltd.	\$ 1.0 million	\$ 1.0 million	6.00%	Demand Note
Royal Bank of Pennsylvania	\$ 6.5 million	\$ 6.5 million	8.86%	6/1/04
<b>Total</b>	<b>\$ 17.0 million</b>	<b>\$ 17.0 million</b>		

Shreenathji Enterprises is owned in part by Hasu P. Shah, Jay H. Shah, Kiran P. Patel and K.D. Patel, who will receive the proceeds of this repayment.

The common limited partnership units in our operating partnership to be redeemed are owned by the following individuals (or family limited partnerships controlled by them):

<u>Owner</u>	<u>Number of Units</u>
Bharat Mehta	671,050
K.D. Patel (Trustee)	501,504
Nayana Gandhi	389,281
Madhu Patni	145,760
Manhar Gandhi	51,434
Manish Patni	40,971

Total	1,800,000
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The amount and timing of our use of the net proceeds of this offering will depend on a number of factors, including the success of locating suitable acquisition properties and the amount of cash we generate from operations. As a result, we will retain broad discretion in the allocation of the net proceeds from this offering. Pending the use of proceeds referenced above, the net proceeds will be invested in interest-bearing, short-term investment grade securities or money market accounts, which are consistent with our intention to qualify as a REIT. Such investments may include, for example, government and government agency securities, certificates of deposit, interest-bearing bank deposits and mortgage loan participations.

**Table of Contents****CAPITALIZATION**

The following table sets forth the capitalization of Hersha Hospitality Trust as of June 30, 2003, on an actual basis and as adjusted to give effect to:

the sale of 7.5 million Class A common shares in this offering at an assumed offering price of \$9.04 per share, net of underwriting discounts and commissions and offering expenses payable by us; and

the use of the net proceeds of this offering to:

pay down \$17.0 million of indebtedness; and

redeem 1.8 million common limited partnership units for an aggregate of \$15.3 million.

This table should be read in conjunction with the section captioned Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes included elsewhere in this prospectus.

	As of June 30, 2003	
	Actual	As adjusted
	(dollars in thousands)	
Cash	\$ 513	\$ 31,110
Debt:		
Lines of credit	\$ 4,431	\$
Mortgages payable	57,367	44,798
Total debt	61,798	44,798
Minority Interest(1)(3)	32,858	32,469
Shareholders' Equity(2):		
Preferred shares, \$0.01 par value, 10,000,000 shares authorized, including 350,000 Series A Preferred Shares, no shares issued and outstanding		
Class A common shares, \$0.01 par value, 50,000,000 shares authorized, 2,578,703 shares issued and outstanding, 10,078,703 shares issued and outstanding, as adjusted	26	101
Class B common shares, \$0.01 par value, 50,000,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital(3)	13,691	61,602
Distributions in excess	(2,918)	(2,918)
Total shareholders' equity	10,799	58,785
Total Capitalization	\$ 105,455	\$ 136,052

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- (1) Does not reflect an increase in minority interest in our operating partnership resulting from CNL's acquisition of 40,266 additional Series A Preferred Units on August 29, 2003.
- (2) Does not include:
- 2,816,460 Class A common shares issuable upon conversion of 190,266 Series A Convertible Preferred Units in our operating partnership currently owned by CNL;
  - 1,192,141 Class A common shares issuable upon exchange of CNL's interest in our joint venture;
  - 5,099,723 Class B common shares issuable upon redemption of outstanding common limited partnership units in our operating partnership which are currently redeemable;
  - 433,333 Class A common shares issuable upon exercise of certain warrants issued in connection with our initial public offering with an exercise price of \$9.90 per share (which warrants expire on January 26, 2004); and
  - 500,000 Class B common shares issuable upon exercise of certain options and SARs held by our trustees, officers and employees of HHMLP which are exercisable at a price of \$6.00 per share only if our Class A common shares have a closing price in excess of \$9.00 per share for twenty consecutive trading days, and which expire on January 26, 2004.
- (3) Includes a \$14,907,000 adjustment to increase minority interest and decrease additional paid-in capital, which results from the accounting treatment for the contribution of the net proceeds of this offering to our operating partnership.

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**DISTRIBUTIONS AND PRICE RANGE OF CLASS A COMMON SHARES**

Since our initial public offering in January of 1999, we have made 17 consecutive quarterly distributions to holders of the Class A common shares of \$0.18 per share, which annualizes to \$0.72 per share. We have also paid an equivalent distribution to holders of our common limited partnership units in our operating partnership for the same periods. While it is the current policy of our Board of Trustees to maintain our dividend at this level, future distributions will be authorized by our Board of Trustees based on a number of factors, including the amount of funds from operations, our partnership's financial condition, debt service requirements, capital expenditure requirements for our hotels, the annual distribution requirements under the REIT provisions of the Code and such other factors as the trustees deem relevant. Our ability to make distributions will depend on our receipt of distributions from our operating partnership and lease payments from our lessees with respect to the hotels. We rely on our lessees to generate sufficient cash flow from the operation of the hotels to meet their rent obligations under the percentage leases.

The Class A common shares enjoy the benefit of a priority period during which, subject to the prior rights of the holders of Series A Convertible Preferred Units, the holders of the Class A common shares are entitled to receive, prior to any distributions either to the holders of common limited partnership units or to the holders of the Class B common shares if any, cumulative dividends in an amount per Class A common share equal to \$0.18 per quarter. The priority period expires on the earlier of (i) January 26, 2004 and (ii) an election by us to end the priority period within 15 days if the share price remains over \$7.00 per share for these 15 days. After the holders of the common limited partnership units and the Class B common shares have received an amount per unit or per share equal to this distribution, the holders of the Class A common shares and the holders of the common limited partnership units and the Class B common shares, if any, are entitled to receive further distributions on a pro rata basis. As of the date of this prospectus, no Class B common shares are outstanding. Thus, the Class A common shares have priority rights only with respect to the outstanding common limited partnership units other than the Series A Convertible Preferred Units issued to CNL as described below. In the future, we may issue additional Class A common shares, securities senior to the Class A common shares and the partnership may issue units that are not subordinated to the Class A common shares.

The Series A Convertible Preferred Units rank senior to all common limited partnership units in our operating partnership, including our general partner units, and all Class A or Class B common shares. Distributions on the Series A Convertible Preferred Units accrue at a rate of 10.5% of the original issue price. Because we derive our revenue from distributions from our operating partnership, the distribution rights of the Class A common shares and the Class B common shares are effectively subordinate to the distribution rights of the Series A Convertible Preferred Units. *See CNL Strategic Alliance.*

The hotel business is seasonal in nature and, therefore, revenues from the hotels in the first and fourth quarters are traditionally lower than those in the second and third quarters and our lease revenue may be lower in these quarters. We expect to use excess cash flow from the second and third quarters to fund distribution shortfalls in the first and fourth quarters. We cannot assure you that we will be able to continue to make quarterly distributions at the current rate.

Our Class A common shares trade on the American Stock Exchange under the symbol HT. As of August 31, 2003, there were 2,578,703 Class A common shares outstanding held by approximately 250 persons of record and 1,500 beneficial owners. The following table sets forth the high and low sale prices of our Class A common shares as reported by the American Stock Exchange and dividends declared on our Class A common shares for each of the quarters indicated.

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	<b>Price Range</b>		<b>Cash Dividend</b>
	<b>High</b>	<b>Low</b>	<b>Per Share</b>
<b>Year ended December 31, 2003</b>			
Third quarter (through September 23, 2003)	\$ 9.05	\$ 7.93	
Second quarter	\$ 8.25	\$ 6.54	\$ 0.18
First quarter	\$ 7.30	\$ 6.31	\$ 0.18
<b>Year ended December 31, 2002</b>			
Fourth quarter	\$ 6.99	\$ 5.40	\$ 0.18
Third quarter	\$ 6.55	\$ 5.75	\$ 0.18
Second quarter	\$ 6.70	\$ 6.00	\$ 0.18
First quarter	\$ 6.70	\$ 5.51	\$ 0.18
<b>Year ended December 31, 2001</b>			
Fourth quarter	\$ 6.25	\$ 5.10	\$ 0.18
Third quarter	\$ 6.90	\$ 4.25	\$ 0.18
Second quarter	\$ 6.09	\$ 4.80	\$ 0.18
First quarter	\$ 6.13	\$ 5.50	\$ 0.18

**Table of Contents****SELECTED CONSOLIDATED FINANCIAL DATA**

The following tables set forth selected consolidated historical financial data for Hersha Hospitality Trust and its subsidiaries and Hersha Hospitality Management, L.P. and its subsidiaries. The financial data as of and for periods ended December 31, 1999, 2000, 2001 and 2002 are derived from our audited consolidated financial statements and those of HHMLP audited by Moore Stephens, P.C., our former auditors. We appointed Reznick Fedder & Silverman, CPAs, PC, as our new auditors in April of 2003. The selected financial data as of and for the periods ended June 30, 2003 and 2002 are derived from our unaudited consolidated financial statements and those of HHMLP. In the opinion of management, the unaudited consolidated financial statements include all adjustments necessary to present fairly the data for such periods. You should read this selected consolidated financial data along with our consolidated financial statements and those of HHMLP and the accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operation included elsewhere in this prospectus. The selected data provided below is not necessarily indicative of future performance, and results for the six-months ended June 30, 2003, are not necessarily indicative of results for the full year.

**Hersha Hospitality Trust**

	Year Ended December 31,				Six Months Ended June 30,	
	1999(1)	2000	2001	2002	(unaudited)	
					2002	2003
<b>Statement of Operations Data</b>						
(in thousands, except per share data)						
<b>Revenue:</b>						
Percentage Lease Revenues HHMLP (2)	\$ 7,264	\$ 9,723	\$ 9,558	\$ 11,433	\$ 5,494	\$ 6,336
Percentage Lease Revenues Other (3)		1,850	2,801	2,801	1,400	960
Hotel Operating Revenues						772
Interest	78	50	165	207		
Interest Related Party	28	1	21	7	113	210
Other Revenue					4	4
<b>Total Revenue</b>	<b>7,370</b>	<b>11,624</b>	<b>12,545</b>	<b>14,448</b>	<b>7,011</b>	<b>8,282</b>
<b>Expenses:</b>						
Interest expense	1,428	4,142	4,769	4,826	2,477	2,457
Hotel Operating Expenses						888
Land Lease Related Party	20	15	13			
Taxes and Property Insurance	450	632	812	1,021	513	542
General and Administrative	363	578	534	567	359	389
Early Payment Penalty		107				
Depreciation and Amortization	2,064	3,507	3,897	3,994	2,076	2,196
<b>Total Expenses</b>	<b>4,325</b>	<b>8,981</b>	<b>10,025</b>	<b>10,408</b>	<b>5,425</b>	<b>6,472</b>
<b>Income Before Distribution to Preferred Unitholders, Minority Interest and discontinued operations</b>	<b>3,045</b>	<b>2,643</b>	<b>2,520</b>	<b>4,040</b>	<b>1,586</b>	<b>1,810</b>
Distribution to Preferred Unitholders						(264)
<b>Income Allocated to Minority Interest</b>	<b>(1,707)</b>	<b>(1,908)</b>	<b>(2,342)</b>	<b>(3,238)</b>	<b>(968)</b>	<b>(1,208)</b>
<b>Discontinued Operations:</b>						
Gain on Sale of Discontinued Operations			598	449		
Income from Discontinued Operations		112	58	41		



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Net income	\$ 1,338	\$ 847	\$ 834	\$ 1,292	\$ 618	\$ 338
Basic Earnings Per Common Share (4)	\$ 0.59	\$ 0.37	\$ 0.37	\$ 0.51	\$ 0.25	\$ 0.13
Diluted Earnings Per Common Share (4)	\$ 0.48	\$ 0.37	\$ 0.37	\$ 0.51	\$ 0.21	
Dividends declared per Common Share	\$ 0.67	\$ 0.72	\$ 0.72	\$ 0.72	\$ 0.36	\$ 0.36

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	Year Ended December 31,				Six Months Ended June 30,	
	1999(1)	2000	2001	2002	2002	2003
<b>Balance Sheet Data</b>						
	(in thousands, except share data)					
Cash	\$ 124		\$ 167	\$ 140	\$ 173	\$ 513
Net investment in hotel properties	\$ 51,908	\$ 87,671	\$ 88,100	\$ 93,814	\$ 89,587	\$ 92,379
Minority interest in Partnership	\$ 18,980	\$ 17,679	\$ 20,436	\$ 20,258	\$ 19,824	\$ 32,593
Shareholder s equity	\$ 11,805	\$ 11,014	\$ 10,210	\$ 11,378	\$ 11,622	\$ 11,064
Total assets	\$ 56,382	\$ 94,531	\$ 96,017	\$ 101,516	\$ 98,235	\$ 109,195
Total debt	\$ 24,754	\$ 61,450	\$ 61,535	\$ 65,341	\$ 62,512	\$ 61,798
<b>Other Data</b>						
Same Hotels RevPAR (5)(6)	\$ 43.97	\$ 50.22	\$ 49.76	\$ 51.51	\$ 47.15	\$ 48.44
Same Hotels average occupancy rate (6)	61.8%	63.6%	64.5%	63.7%	62.3%	63.4%
Funds from operations (7)	\$ 5,109	\$ 6,647	\$ 7,054	\$ 8,293	\$ 3,662	\$ 4,006
EBITDA (8)	\$ 6,537	\$ 10,677	\$ 11,765	\$ 13,078	\$ 6,139	\$ 6,463
Net cash provided by operating activities	\$ 3,075	\$ 5,032	\$ 6,828	\$ 7,977	\$ 2,620	\$ 1,851
Net cash provided by (used in) investing activities	\$ (9,149)	\$ (14,895)	\$ 5,513	\$ (145)	\$ (3,241)	\$ (8,410)
Net cash provided by (used in) financing activities	\$ 6,198	\$ 9,739	\$ (12,174)	\$ (7,859)	\$ 626	\$ 6,932
Weighted average shares outstanding						
Basic	2,275,000	2,275,000	2,275,000	2,519,820	2,462,220	2,578,247
Diluted	6,326,690	6,715,996	7,296,596	7,619,542	7,561,942	8,426,285

(dollars in thousands)

- (1) We commenced operations on January 26, 1999.
- (2) Represents initial fixed rent plus aggregate percentage rent paid by HHMLP to our operating partnership pursuant to percentage leases, which payments are calculated by applying the rent provisions in the respective percentage leases to the historical room revenues.
- (3) Represents initial fixed rent paid by a third party lessee to our operating partnership pursuant to percentage leases, which payments are calculated by applying the rent provisions in the respective percentage leases to the historical room revenues.
- (4) Represents basic and diluted earnings per share computed in accordance with FAS No. 128.
- (5) Calculated by dividing total revenue by the number of available rooms for the 13 hotels owned by us for all of the periods shown.
- (6) For the 13 hotels owned by us for all of the periods shown.
- (7) The National Association of Real Estate Investment Trusts (NAREIT) developed Funds from Operations ( FFO ) as a relative non-GAAP financial measure of performance and liquidity of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO, as defined under the definition adopted by NAREIT in April 2002 and as presented by us, is net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from debt restructuring or sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. We further adjust FFO for preferred stock distributions. FFO does not represent cash flows from operating activities in accordance with GAAP (which, unlike FFO, generally reflects all cash effects of transactions and other events in the determination of net income) and should not be considered an alternative to net income as an indication of our performance or to cash flow as a measure of liquidity or ability to make distributions. We consider FFO a meaningful, additional measure of operating performance because it primarily excludes the effects of the assumption that the value of real estate assets diminishes predictably over time, and because it is widely used by industry analysts as a performance measure. Comparison of our presentation of FFO to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs or the use of other definitions of that term. See Management s Discussion and Analysis of Financial Condition and Results of Operations Funds From Operations.

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The following table reconciles FFO to the most directly comparable GAAP measure, net income applicable to common shares:

	Year Ended December 31,				Six Months Ended June 30,	
	1999	2000	2001	2002	2002	2003
<b>FFO Reconciliation</b>						
(in thousands)						
Net income applicable to common shares	\$ 1,338	\$ 847	\$ 834	\$ 1,292	\$ 618	\$ 338
Less: Gain on Sale of Assets			(598)	(449)		
Add:						
Minority interest	1,707	1,908	2,342	3,238	968	1,208
Distributions to Preferred Unitholders						264
Depreciation and amortization	2,064	3,892	4,476	4,212	2,076	2,196
<b>Funds From Operations</b>	<b>\$ 5,109</b>	<b>\$ 6,647</b>	<b>\$ 7,054</b>	<b>\$ 8,293</b>	<b>\$ 3,662</b>	<b>\$ 4,006</b>

- (8) EBITDA represents income before discontinued operations and minority interest plus interest, taxes, depreciation and amortization. EBITDA is presented because we believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. However, other companies in our industry may calculate EBITDA differently than we do. EBITDA is not a measurement of financial performance under GAAP and should not be considered as an alternative to cash flow from operating activities or as a measure of liquidity or an alternative to net income as indicators of our operating performance or any other measures of performance derived in accordance with GAAP. See the Statements of Cash Flow included in our financial statements.

The following table reconciles EBITDA, which is not a measure under GAAP, to net income for the periods ended as indicated.

	Year Ended December 31,				Six Months Ended June 30,	
	1999	2000	2001	2002	2002	2003
<b>EBITDA Reconciliation</b>						
(in thousands)						
Income before discontinued operations and minority interest	\$ 3,045	\$ 2,643	\$ 2,520	\$ 4,040	\$ 1,586	\$ 1,810
Income tax benefit (expense)						
Interest and financing expense	1,428	4,142	4,769	4,826	2,477	2,457
Depreciation and amortization	2,064	3,892	4,476	4,212	2,076	2,196
<b>EBITDA</b>	<b>6,537</b>	<b>\$ 10,677</b>	<b>\$ 11,765</b>	<b>\$ 13,078</b>	<b>\$ 6,139</b>	<b>\$ 6,463</b>

**Table of Contents****Hersha Hospitality Management, L.P.**

	Year Ended				Six Months Ended	
	December 31,				June 30,	
	1999(1)	2000	2001	2002	2002	2003
<b>Operating Data</b>	(in thousands)					
Revenues from Hotel Operations						
Room Revenue	\$ 21,871	\$ 26,903	\$ 25,560	\$ 24,711	\$ 12,020	\$ 12,165
Restaurant Revenue	2,074	1,875	1,880	2,445	1,269	1,264
Other Revenue	1,354	1,340	1,843	2,782	669	576
<b>Total Revenues from Hotel Operations</b>	<b>25,299</b>	<b>30,118</b>	<b>29,283</b>	<b>29,938</b>	<b>13,958</b>	<b>14,005</b>
Expenses:						
Hotel Operating Expenses	9,788	10,739	10,373	10,061	5,052	5,543
Restaurant Operating Expenses	1,822	1,743	1,593	1,971	949	1,121
Advertising and Marketing	1,228	1,754	2,086	2,061	1,072	1,097
Bad Debts	247	17	124	13		
Depreciation and Amortization	102	192	229	250	129	124
General and Administrative	3,873	4,911	4,708	4,745	2,365	2,397
General and Admin.-Related Parties	45	141	126	21		
Lease Expense-HHLP	7,264	9,933	10,396	11,433	5,952	6,491
Lease Expense-Other Related Parties	1,316	798	703			
<b>Total Expenses</b>	<b>25,685</b>	<b>30,288</b>	<b>30,338</b>	<b>30,555</b>	<b>15,519</b>	<b>16,773</b>
Loss before Discontinued Operations	(386)	(110)	(1,055)	(617)	(1,561)	(2,768)
Loss from Discontinued Operations		(37)	(49)	(54)		
<b>Net Loss</b>	<b>\$ (386)</b>	<b>\$ (147)</b>	<b>\$ (1,104)</b>	<b>\$ (671)</b>	<b>\$ (1,561)</b>	<b>\$ (2,768)</b>

(1) We commenced operations on January 26, 1999.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**General**

As of August 31, 2003, we owned 19 hotels in the eastern United States. For purposes of the REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must lease our hotels. Fourteen of our hotels are leased to an eligible independent contractor, HHMLP, as required by the REIT qualification rules in effect at the time we acquired those hotels. Those rules were recently modified, allowing a hotel REIT to lease its hotels to a taxable REIT subsidiary, or TRS, provided that the TRS engages an eligible independent contractor to manage the hotels. Accordingly, we have leased four of our hotels to a wholly-owned TRS, which will pay qualifying rent, and the TRS has in turn entered into management contracts with HHMLP with respect to those hotels. We intend to eventually lease all our hotels to a TRS, whether upon the acquisition of new hotels or upon expiration of the leases for the 14 hotels currently leased to HHMLP. We also own one hotel through our joint venture with CNL, and that hotel is leased to a TRS that is wholly owned by that joint venture. The joint venture's hotel is managed by HHMLP.

As more of our hotels are leased to our TRS, we will participate more directly in the operating performance of our hotels. Rather than receiving base and percentage lease payments from HHMLP, which funded its own hotel operating expenses, our TRS will directly receive all revenue from, and be required to fund all expenses relating to, hotel operations. Our TRS will also be subject to income tax on its earnings.

Our current revenue is derived from lease payments from HHMLP, lease payments from our TRS and distributions to us from our TRS and from our joint venture with CNL. Because the lease payments from HHMLP comprise a significant portion of our revenue, the following discussion also addresses the performance of HHMLP for the periods presented.

Upon completion of this offering and the application of the net proceeds thereof, we expect to have approximately \$22.6 million in cash available to fund future hotel acquisitions. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis. If and when we are able to identify and close suitable hotel acquisitions, we will own a substantially larger hotel portfolio compared to our existing assets.

*All dollar figures in this section are presented in thousands, except for per share amounts.*

**Results of Operations, Six Months Ended June 30, 2003 Compared to June 30, 2002**

**Hersha Hospitality Trust**

Our revenues for the six months ended June 30, 2003 and 2002, substantially consisted of total lease revenues recognized pursuant to the percentage leases. Total lease revenues during the six month period ended June 30, 2003 were \$7,296 an increase of \$402 or 5.8%, as compared to total lease revenues of \$6,894 for the same period during 2002. The increase in lease revenues is primarily attributable to an increase in fixed

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lease revenue from HHMLP related to several of the properties acquired in prior periods. The increase in total lease revenue was slightly offset by a decrease in the percentage lease revenues from properties previously leased to Noble Investment Group Ltd ( Noble ), an independent third party management company.

Our company had previously entered into leases with Noble to lease and manage four hotels in the metropolitan Atlanta market. Noble elected not to renew these leases upon expiration of the current terms. The leases for the Hampton Inn Newman, Georgia and Hampton Inn Peachtree City, Georgia expired on April 20, 2003 and the leases for the Comfort Suites Duluth, Georgia and Holiday Inn Express Duluth, Georgia expired on May 20, 2003.

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On the respective lease termination dates, we leased the four properties to 44 New England Management Company and engaged HHMLP to operate the hotels under management contracts. Therefore, the consolidated financial statements as of June 30, 2003 include the operating results of these four hotels under the TRS structure. Previously, revenues on the consolidated financial statements were derived primarily from lease payments which were made out of the net operating income of the properties pursuant to the percentage leases. Under the TRS structure, total revenues and related operating expenses from the hotel properties are also being reported under Hotel Operating Revenues and Hotel Operating Expenses in the consolidated statements of operations.

Net income allocated to common shareholders decreased by \$280 for the six months that ended June 30, 2003 to \$338, as compared to net income of \$618 for the same period during 2002. The decrease in net income is primarily attributable to distributions to holders of our Series A Convertible Preferred Units during the six months ended June 30, 2003.

**HHMLP**

HHMLP room revenues from the hotels increased by \$145 or 1.2%, to \$12,165 for the six months that ended June 30, 2003, as compared to \$12,020 for the same period in 2002. This increase in revenues is primarily attributable to the continued stabilization of new assets during the period. The increase in room revenues was also reflective of the higher occupancy percentage, average daily rate, or ADR, and increases in RevPAR for the period. HHMLP increased its net loss by \$1,207 to \$2,768 from \$1,561 in the same period in 2002. This increase is primarily due to additional hotel operating expenses and additional fixed lease payments during the period in addition to the significant start-up expenses absorbed by HHMLP related to newly-built properties that have either commenced operations or are currently in the development state. The primary components of hotel operating expenses that contributed to the increased net loss included additional employee payroll and benefits costs, franchise fees and utilities expenses. During the construction and stabilization of newly built hotel properties, HHMLP incurs significant hotel operating expenses prior to achieving stabilized operating revenues.

HHMLP maintains the ability to borrow funds from related entities, partners and shareholders. Its borrowing costs range from 8.5% on short-term loans to 10.5% on longer term loans.

The following table shows certain hotel operating information for the periods indicated.

	Six Months Ended	
	June 30,	
	2002	2003
Occupancy Rate	59.1%	60.4%
ADR	\$ 74.75	\$ 78.54
RevPar	\$ 44.21	\$ 47.47
Room Revenue	\$ 12,019,948	\$ 12,165,215
Room nights available	271,870	256,296
Room nights occupied	160,807	154,895

**Comparison of Year Ended December 31, 2002 to Year Ended December 31, 2001**

**Hersha Hospitality Trust**

Our total revenues for the year ended December 31, 2002 consisted substantially of percentage lease revenue recognized pursuant to percentage leases with HHMLP and Noble. Our revenue was approximately \$14,448, an increase of 15.2% compared to revenue of \$12,545 for the year ended December 31, 2001. Net income for the period was approximately \$1,292, an increase of 54.9% compared to 2001 net income of approximately \$834. The increase in revenue is primarily attributable to additional percentage lease revenues at several of our existing properties along with a full twelve months of operations at the Mainstay Suites and Sleep



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Inn, King of Prussia, Pennsylvania that was acquired on June 1, 2001 and the Holiday Inn Express, Long Island City, New York that was acquired on November 1, 2001.

Net income increased from the prior year due to an increase in percentage lease revenues, as highlighted above, along with a decrease in interest expense from our floating rate debt and a gain of approximately \$449 on the sale of the Clarion Suites, Philadelphia, Pennsylvania.

## **HHMLP**

HHMLP's revenues increased by approximately \$655 for the year ended December 31, 2002, or 2.2%, to approximately \$29,938 as compared to \$29,283 for the year ended 2001. The increase in revenues was due to additional food and beverage revenues at the Holiday Inn Conference Center, New Cumberland and the increase in third party management fees. HHMLP's revenues were slightly offset by a reduction in total room revenues. HHMLP's net loss for the year ended December 31, 2002 decreased to approximately \$671 from \$1,104 in 2001. The decrease in HHMLP's net loss was primarily a result of increased total revenues in addition to lower operating expenses and related party rent payments. This net loss is primarily due to the significant start-up expenses absorbed by HHMLP related to newly-built properties that have either commenced operations or are currently in the development stage. The primary components of hotel operating expenses are employee payroll and benefits costs, advertising, franchise fees, utilities and recurring maintenance expenses. During the construction and stabilization of newly built hotel properties, HHMLP incurs significant hotel operating expenses prior to achieving stabilized operating revenues.

## **Comparison of Year Ended December 31, 2001 to Year Ended December 31, 2000**

During 2002, we and HHMLP adopted the provisions of FASB No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The previously reported 2001 and 2000 results of operations have been reclassified to reflect the provisions of FASB No. 144.

## **Hersha Hospitality Trust**

Our total revenues for the twelve-month period ended December 31, 2001 consisted substantially of percentage lease revenue recognized pursuant to percentage leases with HHMLP and Noble. Our revenue was approximately \$12,545 an increase of 7.9% compared to revenue of \$11,624 for the year ended December 31, 2000. Net income for the period was approximately \$834 a decrease of 1.5% compared to 2000 net income of approximately \$847. The increase in total lease revenue is primarily attributable to the full year of operations in 2001 from several properties acquired during 2000 along with three additional acquisitions completed during 2001. Total lease revenues were slightly offset by the disposition of six hotels during 2001 and lower percentage lease revenues from several of the hotels owned during 2001.

Net income decreased from the prior year due to an increase in interest expense, property taxes, insurance and depreciation and amortization as a result of the acquisitions during 2000 and 2001, as mentioned above.

## **HHMLP**

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HHMLP's revenues decreased by \$835 for the year ended December 31, 2001, or 2.8%, to approximately \$29,283 as compared to \$30,118 for the year ended 2000. The decrease in revenues was due to the sale of six properties during 2001 along with lower occupancies and average daily rates at several hotels. HHMLP's net loss for the year ended December 31, 2001 increased to approximately \$1,104 from \$147 in 2000. The increase in HHMLP's net loss was a result of lower revenues mentioned above and consequently lower gross operating profits at several of our leased hotels. In addition HHMLP incurred losses due to the start up expenses incurred, such as sales and marketing, at several of the newly-built properties that commenced operations in 2001. Corporate office overhead expenses were also higher in 2001 as HHMLP added personnel and office space in its continuing efforts to ramp up its infrastructure.

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### **Liquidity and Capital Resources**

Our principal source of cash to meet our cash requirements, including distributions to shareholders, is our share of our operating partnership's cash flow. Our operating partnership's principal source of revenue is rent payments under the percentage leases with HHMLP, lease payments from our TRS, and distributions from our TRS and our joint venture with CNL. The lessees' obligations under the leases are unsecured. The lessees' ability to make rent payments, and our liquidity, including our ability to make distributions to common shareholders, is dependent on the lessees' ability to generate sufficient cash flow from the operation of the hotels. Cash flow from the operations of the hotels is subject to risk factors common to the hotel industry, including, but not limited to competition for guest from other hotels, local and national economic trends, seasonality and reaction to geopolitical events. In addition to these sources of cash, we expect to receive \$62.9 million in net proceeds from this offering, approximately \$22.6 million of which has not been allocated for use.

We expect to meet our short-term liquidity requirements generally through net cash provided by operations, existing cash balances and, if necessary, short-term borrowings under a secured line of credit. We believe that our net cash provided by operations will be adequate to fund both operating requirements and payment of dividends by us in accordance with REIT requirements.

We expect to meet our long-term liquidity requirements, such as scheduled debt maturities and property acquisitions, primarily with the unallocated net proceeds from this offering and through long-term secured and unsecured borrowings. In addition, we may issue additional limited partnership units in our operating partnership in connection with acquisitions of hotel properties.

We intend to make additional investments in hotel properties and will likely incur, or cause our operating partnership to incur, indebtedness in connection with such investments, or to meet distribution requirements imposed on a REIT under the Internal Revenue Code to the extent that working capital and cash flow from our investments are insufficient to make such distributions. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis, and our Board of Trustees' policy is to limit indebtedness to no more than 67% of the total purchase price of all our hotels on an aggregate basis. Our organizational documents do not limit the amount of indebtedness that we may incur and our Board of Trustees may modify the debt policy at any time without shareholder approval.

### **Funds From Operations (FFO)**

The National Association of Real Estate Investment Trusts (NAREIT) developed Funds from Operations ( FFO ) as a relative non-GAAP financial measure of performance and liquidity of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO, as defined under the definition adopted by NAREIT in April 2002 and as presented by us, is net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from debt restructuring or sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. We further adjust FFO for preferred stock distributions. FFO does not represent cash flows from operating activities in accordance with GAAP (which, unlike FFO, generally reflects all cash effects of transactions and other events in the determination of net income) and should not be considered an alternative to net income as an indication of our performance or to cash flow as a measure of liquidity or ability to make distributions. We consider FFO a meaningful, additional measure of operating performance because it primarily excludes the effects of the assumption that the value of real estate assets diminishes predictably over time, and because it is widely used by industry analysts as a performance measure. Comparison of our presentation of FFO to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs or the use of other definitions of that term.



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The following table reconciles FFO for the periods presented to the most directly comparable GAAP measure, net income, for the same periods.

FFO reconciliation	Year Ended December 31,				Six Months Ended June 30	
	1999	2000	2001	2002	2002	2003
	(dollars in thousands)					
Net income applicable to common shares	\$ 1,338	\$ 847	\$ 834	\$ 1,292	\$ 618	\$ 338
Less: Gain on Sale of Assets			(598)	(449)		
Add:						
Minority interest	1,707	1,908	2,342	3,238	968	1,208
Distributions to Preferred Unitholders						264
Depreciation and amortization	2,064	3,892	4,476	4,212	2,076	2,196
<b>Funds From Operations</b>	<b>\$ 5,109</b>	<b>\$ 6,647</b>	<b>\$ 7,054</b>	<b>\$ 8,293</b>	<b>\$ 3,662</b>	<b>\$ 4,006</b>

Funds from Operations were \$4,006 for the six months ended June 30, 2003, which was an increase of approximately \$344 or 9.4% over FFO in the comparable period in 2002, which was \$3,662. The increase in FFO for the six months ended June 30, 2003 was primarily a result of increased percentage lease revenues from HHMLP, increased interest revenue from development line funding and lower borrowing costs during the quarter. FFO was partially offset due to the recognition of hotel operating expenses in excess of income from hotel operations. These income and expense items were recognized during the quarter due to the TRS structure implemented to lease the hotels previously leased to Noble.

Funds from Operations were \$8,293 for the year ended December 31, 2002, which was an increase of approximately \$1,239 or 17.6% over FFO in the comparable period in 2001, which was \$7,054. The increase in FFO during the year ended December 31, 2002 was primarily a result of higher percentage lease revenues at several of the Company's properties in addition to lower overall borrowing costs on the Company's floating rate debt.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, all estimates are evaluated by us, including those related to carrying value of investments in hotel properties. All estimates are based upon historical experience and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

*Revenue Recognition.* Percentage lease income is recognized when earned from the lessees under the agreements from the date of acquisition of each hotel property. Lease income is recognized under fixed rent agreements ratably over the lease term. All leases between us and the lessees are operating leases.

*Allowance for Doubtful Accounts.* We have not recorded an allowance for doubtful accounts. Substantially all of our receivables at December 31, 2002 and 2001 were comprised of rent due from our lessees under the

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percentage leases (rent), which were fully paid in January 2003 and 2002, respectively. Historically, we have not experienced any losses on our lessees' receivables. However, the lessees rely primarily on cash flow from their operation of the hotels to pay rent, and collection of future receivables from the lessees, therefore, cannot be assured.

*Impairment of Long-Lived Assets.* We review the carrying value of each hotel property in accordance with Statement of Financial Accounting Standards (SFAS) No. 144 to determine if circumstances exist indicating an impairment in the carrying value of the investment in the hotel property or if depreciation periods should be modified. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We perform undiscounted cash flow analyses to determine if an impairment exists. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Hotel properties held for sale are presented at the lower of carrying amount or fair value less cost to sell.

We would record an impairment charge if we believe an investment in hotel property has been impaired such that future undiscounted cash flows would not recover the book basis of the investment in the hotel property. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's carrying value, thereby possibly requiring an impairment charge in the future. We have reviewed each of our hotel properties at June 30, 2003 for impairment and, based on our estimate of each hotel's future undiscounted cash flows, determined that no impairment existed at any of our hotels.

## **REIT Qualification Tests**

We are subject to numerous operational and organizational requirements to maintain our REIT status. Based on tests performed by management for the years ended December 31, 2002, 2001, 2000 and 1999, we believe that we satisfied the requirements needed to maintain our REIT status. However, we are subject to audit and if the Internal Revenue Service determined that we failed one or more of these tests, we could lose our REIT status. If we did not qualify as a REIT, our income would become subject to federal and state income taxes, which would be substantial, and the resulting adverse effects on our results of operations, liquidity and amounts distributable to shareholders would be material.

## **Inflation**

Operators of hotels in general possess the ability to adjust room rates quickly. However, competitive pressures may limit the lessee's ability to raise room rates in the face of inflation, and annual increases in average daily rates have failed to keep pace with inflation.

## **Seasonality**

Our hotels' operations historically have been seasonal in nature, reflecting higher occupancy rates during the second and third quarters. This seasonality can be expected to cause fluctuations in our quarterly lease revenue to the extent that we receive percentage rent.

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The hotel business is seasonal, with hotel revenue generally greater in the second and third quarters than in the first and fourth quarters. To the extent that cash flow from operating activities is insufficient to provide all of the estimated quarterly distributions, we anticipate that we will be able to fund any such deficit from future working capital.

### **Subsequent Events**

Effective June 30, 2003, HHMLP formed HHM Leasehold Interests, Inc., or HLI, and contributed to it the leases for the 14 hotels leased from us by HHMLP. HLI is owned 99% by HHMLP and 1% by us. At the same time, HHMLP entered into a management agreement with HLI pursuant to which HHMLP will manage the



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hotels. HLI is treated as our taxable REIT subsidiary. The formation of HLI and the related transactions were part of our obligations to CNL in connection with their investment in us and will not have a material effect on us.

The quarterly dividend pertaining to the Class A common shares and operating partnership unitholders distributions for the second quarter of 2003 was paid on July 18, 2003 at the rate of \$0.18 per share, which represents an annualized rate of \$0.72 per annum.

In addition, on September 4, 2003, our Board of Trustees declared a quarterly cash dividend of \$0.18 per Class A common share, relating to the third quarter ending September 30, 2003. This dividend reflects dividend distributions of \$0.72 per share on an annualized basis. This dividend is payable on October 23, 2003 to shareholders of record on September 26, 2003. This is the 18th consecutive common share dividend of \$0.18 per quarter paid by the company since its initial public offering in January 1999.

On July 18, 2003, CNL was paid a distribution of \$264,000 related to its purchase of \$10 million of Series A Convertible Preferred Units on April 21, 2003 and \$5 million of Series A Convertible Preferred Units on May 21, 2003. This quarterly distribution is calculated utilizing a quarterly distribution of 2.625% (10.5% annually) of the original issue price per Series A Convertible Preferred Unit based upon the pro rata number of days that the Series A Convertible Preferred Units were outstanding during the quarter ended June 30, 2003.

## **Recently Issued Accounting Standards**

The Financial Accounting Standards Board ( FASB ) has issued Statement of Financial Accounting Standards ( SFAS ) No. 146, Accounting for Exit or Disposal Activities. SFAS No. 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force ( EITF ) of the FASB has set forth in EITF Issue No 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The scope of SFAS No. 146 also included (1) costs related to terminating a contract that is not a capital lease and (2) termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred compensation contract. SFAS No. 146 will be effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 had no impact on our results of operations or financial position for 2003.

The FASB has issued SFAS No. 147, Acquisitions of Certain Financial Institutions, which is effective for certain transactions arising on or after October 1, 2002. SFAS No. 147 will have no impact on our company.

The FASB has issued SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have adopted the disclosure requirements of SFAS No. 148. We currently account for stock-based employee compensation in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, the alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation mandated by SFAS No. 148 are not applicable to us at this time.

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The FASB has issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which is effective for certain transactions arising on or after June 30, 2003. SFAS No. 149 will have no impact on our Company.

The FASB has issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which is effective for interim financial periods beginning after June 15, 2003. The Company is currently assessing the potential impact of implementing SFAS No. 150.

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FASB Interpretation No. 45 ( FIN 45 ), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34, was issued in November 2002. FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. We have made the disclosures required by FIN 45.

FASB Interpretation No. 46 ( FIN 46 ), Consolidation of Variable Interest Entities an interpretation of ARB No. 51, was issued in January 2003. FIN 46 requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. We will continue to monitor and evaluate the impact of FIN 46 on our financial statements.

**Quantitative and Qualitative Disclosures About Market Risk**

Our primary market risk exposure is to changes in interest rates on our variable rate line of credit and other floating rate debt. At June 30, 2003, we had total outstanding indebtedness under the line of credit of approximately \$4,431 at an interest rate of 4.00% and total floating rate mortgages payable of \$18,106 at a current weighted average interest rate of 4.89%.

Our interest rate risk objectives are to limit the impact of interest rate fluctuations on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, we manage our exposure to fluctuations in market interest rates for a portion of our borrowings through the use of fixed rate debt instruments to the extent that reasonably favorable rates are obtainable with such arrangements. We may enter into derivative financial instruments such as interest rate swaps or caps and treasury options or locks to mitigate our interest rate risk on a related financial instrument or to effectively lock the interest rate on a portion of our variable rate debt. Currently, we have no derivative financial instruments. We do not enter into derivative or interest rate transactions for speculative purposes.

Approximately 68.4% of our outstanding mortgages payable are subject to fixed interest rates while approximately 31.6% of our outstanding mortgages payable are subject to floating rates. We regularly review interest rate exposure on our outstanding borrowings in an effort to minimize the risk of interest rate fluctuations. We periodically review the interest rate environment and seek to proactively manage our fixed and floating rate debt levels in order to minimize financing costs and provide the greatest operating flexibility to manage our portfolio.

For debt obligations outstanding at June 30, 2003, the following table presents principal repayments and related weighted average interest rates by expected maturity dates (in thousands):

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Thereafter</u>
Fixed Rate Debt	\$ 409	\$ 895	\$ 977	\$ 1,068	\$ 1,167	\$ 34,745

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Average Interest Rate	8.90%	8.90%	8.90%	8.90%	8.90%	8.90%
Floating Rate Debt	\$ 233	\$ 492	\$ 524	\$ 560	\$ 597	\$ 15,700
Average Interest Rate	4.41%	4.96%	4.96%	4.96%	4.96%	4.19%

The table incorporates only those exposures that existed as of June 30, 2003 and does not consider exposure or positions that could arise after that date. As a result, our ultimate realized gain or loss with respect to interest rate fluctuations will depend on the exposures that arise during the future period, prevailing interest rates, and our hedging strategies at that time.

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### **BUSINESS AND PROPERTIES**

#### **Our Company**

Hersha Hospitality Trust is a self-advised Maryland real estate investment trust that was organized in 1998 and completed its initial public offering in January of 1999. We focus primarily on owning and operating high quality, mid-scale limited service hotels in established markets in the Eastern United States. Our primary strategy is to continue to acquire high quality, mid-scale hotels in metropolitan markets with high barriers to entry in the Northeastern United States. Our portfolio currently consists of 19 hotels with a total of 1,738 rooms located in Pennsylvania, New York, Maryland and Georgia, which operate under leading brands, such as Hampton Inn®, Hilton Garden Inn®, Holiday Inn®, Holiday Inn Express®, DoubleTree®, and Comfort Suites®.

We are structured as an umbrella partnership REIT, or UPREIT, and we own our hotels through our operating partnership, Hersha Hospitality Limited Partnership, for which we serve as general partner. All of our hotels are managed by Hersha Hospitality Management, L.P., or HHMLP, a private management company owned by certain of our trustees, officers and other third party investors. In response to tax law changes, we recently formed a wholly-owned taxable REIT subsidiary, or TRS, to which we currently lease four hotels and to which we intend to lease all of our hotels, including hotels we may acquire in the future and hotels currently leased to HHMLP as those leases expire. We believe that transitioning to this TRS structure positions us to participate more directly in the operating efficiencies and revenue gains at our hotels.

In April of 2003, we entered into a strategic alliance with CNL Hospitality Partners, L.P., a subsidiary of CNL Hospitality Properties, Inc. CNL is a public company which has been one of the most active investors in lodging properties over the past several years. Since its inception in 1996, CNL has invested over \$2.2 billion in hotel properties. The strategic alliance positions us as one of CNL's preferred partners for investing in mid-scale hotels. Our agreement with CNL provides that it will invest up to \$25 million in our operating partnership and up to \$40 million in a newly formed hotel acquisition joint venture. CNL has currently invested \$19 million in our operating partnership and \$8 million in the joint venture, which acquired its first hotel, the Hampton Inn Chelsea, New York, New York, on August 29, 2003.

#### **Market Opportunity**

We believe that it is an opportune time in the business cycle to acquire mid-scale hotels. Industry forecasts and historical data lead us to believe that we are at the bottom of the economic and lodging cycle. The Federal Reserve's August 22, 2003 Beige Book predicts 5.7% and 5.6% nominal GDP growth in the fourth quarter of 2003 and full year 2004, respectively. In addition, as of June 2003, the Americas Hospitality & Leisure Consulting Practice at PricewaterhouseCoopers, L.L.P. predicts 4.0% and 4.2% annual growth in revenue per available room, or RevPAR, for the mid-scale limited service segment in 2004 and 2005, respectively. Accordingly, we believe that investments in hotels at this point in the cycle will benefit from the improving fundamentals in the lodging sector.

Furthermore, we believe that we will have ample acquisition opportunities in the mid-scale limited service hotel market. First, we believe that many small private owners are competitively disadvantaged by their limited access to market information and capital, and may therefore explore asset dispositions as a means to address their illiquidity. In addition, we believe that larger hotel portfolios will be available for sale as public lodging companies seek to sell non-core assets and improve their overall liquidity. We also believe that improving lodging fundamentals will help facilitate agreement between buyers and sellers on hotel valuations, resulting in an increased volume of sales transactions.

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As a result of our competitive strengths, described below, we believe that we are well positioned to take advantage of opportunities created by these market characteristics.

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### **Competitive Strengths**

#### *Our Existing Portfolio*

**High Quality Hotels.** We own and operate high quality hotels operating under popular mid-scale brands such as Hampton Inn<sup>®</sup>, Hilton Garden Inn<sup>®</sup>, Holiday Inn<sup>®</sup>, Holiday Inn Express<sup>®</sup>, Double Tree<sup>®</sup> and Comfort Suites<sup>®</sup>. Since we acquire primarily newly constructed hotels, the median age of our hotels is only five years. In addition, we invest substantially to maintain the quality and appeal of our portfolio. We reserve approximately 4% or more of the gross revenues of each hotel for maintenance capital expenditures, and in order to strengthen the appeal of our hotels, we have actually invested approximately 5.4%, 6.3%, and 2.9% of revenue in maintenance capital expenditures in 2002, 2001 and 2000.

**Proven Operator.** Based on Smith Travel Research, our hotels have outperformed those of our competitors, as evidenced by our weighted average RevPAR indexed against comparable hotels in our markets of 108.6% for the twelve months ended June 30, 2003. We and our affiliated management company have been successful in reducing operating expenses and realizing the benefits of shared marketing efforts by clustering our hotels in geographic areas, such as metropolitan New York, Philadelphia, Pennsylvania, Atlanta, Georgia and Central Pennsylvania. Our hotel net operating margin for our mid-scale limited service hotels managed by our affiliated management company for all of 2002 was 38.6% in 2002 compared to the industry average for mid-scale limited service hotels of 33.0% as reported by Smith Travel Research. In addition, we are positioning ourselves to participate more directly in the operating efficiencies and revenue gains at our hotels through our transition to a TRS structure.

**Stable Performance.** We operate in the mid-scale, limited service segment of the lodging industry, which we believe is less vulnerable to demand swings and offers more consistent operating performance. According to PricewaterhouseCoopers, L.L.P., in 2002, lodging industry RevPAR declined 2.4% while mid-scale without food and beverage RevPAR declined only 0.8%. In addition, we believe the quality of our management and our focus on higher barrier to entry markets further insulate our performance from economic downturns. Accordingly, our same hotel RevPAR increased 3.3% in 2002 for our 16 hotels that were open for all of 2001 and 2002.

#### *Growth Platform*

**Acquisition Experience.** We acquire high quality mid-scale limited service hotels in the Northeastern United States clustered in targeted metropolitan markets with high barriers to entry. We believe that this market segment has attractive fundamental investment characteristics and that our familiarity with our target markets has enabled, and will continue to enable, us to effectively identify opportunities and close acquisitions in those markets. The portfolio we owned for all of 2002 yielded a 10.3% unleveraged return based on 2002 net operating income after reserves for furniture, fixtures and equipment, or FF&E, divided by historical purchase price.

**Strategic Relationship with CNL.** We have entered into a strategic relationship with CNL, a leading lodging investor which has acquired over \$2.2 billion in hotel investments since its inception in 1996. We expect our acquisition program to benefit from access to CNL's established network of owners, developers, brokers and other contacts. We also have additional access to capital through CNL, which enhances our ability to take advantage of acquisition opportunities. Under the terms of our relationship, CNL has committed up to \$65 million of capital, which includes unfunded amounts of up to \$6 million to our operating partnership and up to \$32 million to our hotel acquisition joint venture with CNL.

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**Active Portfolio Management.** We continuously evaluate and adjust our hotel portfolio to achieve our investment criteria for size, brand affiliation and strategic fit. We monitor the cash flow potential for each hotel and its ability to remain accretive to our portfolio. Our decision to sell an asset is often predicated upon market dynamics, asset potential and long term strategic goals. Since our IPO in 1999, we have sold eight hotels and redeployed that capital to purchase additional hotels consistent with our long-term growth strategy.

### *Experienced Leadership*

**Management and Board.** Our management team has an average of 11 years of industry experience and has worked together building our company since 1999. Our CEO, Hasu Shah, purchased his first hotel in 1984 and together with our management team assembled the assets which comprise our portfolio today. In addition, five of our seven trustees are independent and have significant industry experience. Our independent trustees include Michael Leven, former President of Holiday Inn Worldwide and Days Inn, Don Landry, former CEO of Sunburst Hospitality, and John Sabin, former CFO and Treasurer of Vistana and Vice President Finance of Choice Hotels.

**Aligned Incentives.** We believe the economic interests of management and our shareholders are well aligned through managements substantial ownership interest in our operating partnership. Upon completion of this offering and the application of the net offering proceeds, our officers and trustees will own limited partnership units in our operating partnership representing approximately 18.1% of our common shares on a fully-diluted basis.

### *Consistent Dividends*

Since our initial public offering in January of 1999, we have made 17 consecutive quarterly distributions to holders of the Class A common shares of \$0.18 per share, which annualizes to \$0.72 per share. We have also paid an equivalent distribution to holders of common limited partnership units in our operating partnership for the same periods. While it is the current policy of our Board of Trustees to maintain our dividend at this level, future distributions will be authorized by our Board of Trustees based upon a number of factors, including the amount of funds from operations and such other factors as the trustees deem relevant. Our ability to make distributions will depend on our receipt of distributions from our operating partnership and lease payments from our lessees with respect to our hotels.

## **Business Strategy**

### *Increase Same Hotel Growth*

Our operating strategy focuses on increasing same hotel performance for our portfolio. The key elements of this strategy are:

increasing occupancy levels and RevPAR through active property-level management by HHMLP, including (i) intensive marketing efforts to tour groups, corporate and government extended stay customers and other wholesale customers, and (ii) expanded yield management programs, which are calculated to better match rates to periods of high demand; and



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positioning our hotels to capitalize on increased demand in the mid-scale lodging segment due to the expected economic recovery by managing costs and thereby maximizing earnings.

### *Acquisition Platform*

Our primary strategy is to continue to acquire high-quality, mid-scale hotels in metropolitan markets with high barriers to entry in the Northeastern United States. We believe that current market conditions are creating

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opportunities to acquire hotels at attractive prices. In executing our disciplined acquisition program, we intend to acquire hotels that meet the following additional criteria:

nationally-franchised hotels operating under popular brands, such as Hampton Inn<sup>®</sup>, Hilton Garden Inn<sup>®</sup>, Embassy Suites<sup>®</sup>, Marriott Courtyard<sup>®</sup>, Residence Inn<sup>®</sup> and Holiday Inn Express<sup>®</sup> hotels;

hotels in locations with significant barriers to entry, such as high development costs, limited availability of land and lengthy entitlement processes; and

hotels in our target markets where we can create clusters and realize economies of scale.

In addition to the recent acquisition and two proposed acquisitions described below, in the ordinary course of our business, we are actively considering hotel acquisition opportunities. We are currently reviewing hotel acquisition opportunities located in our target markets with an aggregate purchase price in excess of \$200 million, including hotels being developed by entities controlled by some of our officers and trustees, which hotels we have an option to acquire. However, each of these acquisitions is subject to due diligence, financing and negotiation of the purchase price and other key terms. There can be no assurance that we will be able to consummate any of these acquisition opportunities.

### *Prudent Use of Leverage*

The relative stability of the mid-scale segment of the lodging industry allows us to increase returns to our shareholders through the prudent application of leverage. Our strategy is to maintain target debt levels of approximately 60% of the total purchase price of our hotels both on an individual and aggregate basis, and our Board of Trustees' policy is to limit indebtedness to no more than 67% of the total purchase price of all our hotels on an aggregate basis. We may employ a higher amount of leverage at a specific hotel to achieve a desired return when warranted by that hotel's historical operating performance and may use modestly greater leverage across our portfolio if and when warranted by prevailing market conditions.

### **Tax Status and Structure**

We are taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their taxable income (excluding net capital gains). See *Federal Income Tax Consequences of Our Status as REIT*.

In order to comply with the REIT qualification rules, we cannot directly operate any of our hotels. Instead, we must lease our hotels. Fourteen of our hotels are leased to an independent management company, HHMLP, as required by the REIT qualification rules in effect at the time we acquired those hotels. The REIT qualification rules were recently modified, allowing a hotel REIT to lease its hotels to a taxable REIT subsidiary, or TRS, provided that the TRS engages an eligible independent contractor to manage the hotels. Accordingly, we have leased four of our hotels to a wholly-owned TRS, which will pay qualifying rent to us, and the TRS has in turn entered into management contracts with HHMLP with respect to those hotels. In addition, the hotel owned by our joint venture with CNL is leased to a TRS that is wholly owned by the joint venture. We intend to eventually lease all our hotels to a TRS, whether upon acquisition of new hotels or upon expiration of the leases for the 14 hotels currently leased to HHMLP. HHMLP has agreed not to exercise its option to extend the current lease term with respect to any of the 14 hotels it currently leases, all of which expire prior to October 2007.



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The following chart shows the structure of our company as of August 31, 2003 on a pro forma basis to give effect to this offering and the application of the net proceeds as described under Use of Proceeds.

1. We currently have two classes of common shares, Class A shares and Class B shares. Class A common shares are held by our public shareholders and Class B shares may be issued to holders of common limited partnership units of our operating partnership. The Class A shares are entitled to certain priorities with respect to distributions; however, as of January 26, 2004 these priorities will expire and we will only have one class of common shares. Upon consummation of this offering our public shareholders will own 10,078,703 Class A common shares. There are no Class B common shares outstanding.
2. CNL owns 190,266 Series A Convertible Preferred Units in our operating partnership, which are currently exchangeable for 2,816,460 common limited partnership units of our operating partnership or 2,816,460 Class A common shares.
3. Represents the general partner interest in our operating partnership.
4. Upon completion of this offering and the application of the net proceeds therefrom, our officers and trustees will own in the aggregate 2,929,242 common limited partnership units of our operating partnership, which are redeemable for an equal number of Class B common shares. K.D. Patel, one of our trustees, subject to the closing of this offering, has committed to exercise his redemption rights with respect to 501,504 common limited partnership units, the redemption price of which will be funded from the net proceeds of this offering.
5. Upon completion of this offering and the application of the net proceeds therefrom, third party investors in our operating partnership will own 370,481 common limited partnership units, which are redeemable for an equal number of Class B common shares.
6. CNL's interest in our joint venture is exchangeable for 1,192,141 common limited partnership units in our operating partnership or the same number of Class A common shares.
7. The lessee is HHM Leasehold Interests, Inc., a TRS in which HHMLP owns a 99% equity interest and our operating partnership owns a 1% equity interest.

**Table of Contents****Description of Our Hotels**

Set forth below is tabular information regarding our hotels as of and for the twelve months ended June 30, 2003. Since June 30, 2003, we have acquired an interest in the Chelsea Hampton Inn in New York City. Each of our hotels is owned by subsidiary of our operating partnership, except for the Chelsea Hampton Inn, which is owned by our joint venture with CNL, and each hotel is either leased and managed by HHMLP or leased to a TRS and managed by HHMLP. A summary description of each hotel follows.

**Twelve Months Ended June 30, 2003**

Hotels	Year Opened	Number of Rooms	Room Revenue	Other Revenue(1)	Occupancy	Average Daily Rate	RevPAR(2)	Non-TRS
								Lease Expiration(3)
<b>Metropolitan New York</b>								
Doubletree Jamaica, NY	2002	110	\$ 2,895,846	\$ 476,295	71.1%	\$ 101.47	\$ 72.13	10/01/07
<b>Holiday Inn Express Long Island City, NY</b>								
	2001	79	\$ 1,952,664	\$ 34,147	71.9%	\$ 94.21	\$ 67.72	11/01/06
<b>Philadelphia</b>								
Mainstay Suites King of Prussia, PA	2000	69	\$ 1,221,617	\$ 93,792	59.0%	\$ 82.24	\$ 48.51	06/01/06
Sleep Inn King of Prussia, PA	2000	87	\$ 1,111,120	\$ 21,768	57.4%	\$ 67.10	\$ 38.53	01/26/04
<b>Harrisburg/Hershey</b>								
Comfort Inn Harrisburg, PA	1998	81	\$ 1,509,689	\$ 37,076	67.6%	\$ 77.46	\$ 52.36	01/26/04
<b>Holiday Inn Express &amp; Suites Harrisburg, PA</b>								
	1997	77	\$ 1,546,552	\$ 17,589	67.5%	\$ 81.55	\$ 55.03	09/01/04
Hampton Inn Hershey, PA	1999	110	\$ 2,755,054	\$ 59,342	55.1%	\$ 124.44	\$ 68.62	12/31/05
Holiday Inn Harrisburg, PA	1970	196	\$ 3,056,789	\$ 2,297,847	57.8%	\$ 73.59	\$ 42.51	01/26/04
Holiday Inn Express Hershey, PA	1997	85	\$ 2,007,905	\$ 26,994	60.7%	\$ 106.65	\$ 64.72	01/26/04
Hampton Inn Carlisle, PA	1997	95	\$ 2,022,082	\$ 23,564	67.8%	\$ 84.25	\$ 57.11	01/26/04
<b>Central Pennsylvania</b>								
Hampton Inn Selinsgrove, PA	1996	75	\$ 1,799,220	\$ 27,349	73.6%	\$ 90.54	\$ 66.61	01/26/04
Hampton Inn Danville, PA	1998	72	\$ 1,488,351	\$ 21,015	72.7%	\$ 77.94	\$ 56.63	09/01/04
<b>Holiday Inn Express New Columbia, PA</b>								
	1997	81	\$ 1,427,049	\$ 16,863	61.8%	\$ 79.10	\$ 48.87	01/26/04
<b>Metropolitan Atlanta</b>								
Comfort Suites Duluth, GA	1996	85	\$ 1,127,341	\$ 31,097	60.6%	\$ 59.95	\$ 36.34	(4)
Hampton Inn Peachtree City, GA	1994	61	\$ 1,111,918	\$ 29,496	73.4%	\$ 68.00	\$ 49.94	(4)
Hampton Inn Newnan, GA	1996	91	\$ 1,366,229	\$ 25,625	65.5%	\$ 62.82	\$ 41.13	(4)
Holiday Inn Express Duluth, GA	1996	68	\$ 1,031,186	\$ 22,501	61.4%	\$ 67.68	\$ 41.55	(4)
Mainstay Suites Frederick, MD	2000	72	\$ 1,044,116	\$ 31,082	62.8%	\$ 63.26	\$ 39.73	12/31/06
<b>Total</b>		<b>1,594</b>	<b>\$ 30,474,728</b>	<b>\$ 3,293,442</b>				
<b>Weighted Average</b>					<b>61.3%</b>	<b>\$ 79.19</b>	<b>\$ 50.82</b>	

(1) Represents restaurant revenue, telephone revenue and other revenue.

(2) RevPAR is determined by dividing room revenue by available rooms for the applicable period.

(3) HHMLP has waived all of its rights to extend the terms of its 14 leases. We intend to re-lease these hotels to our wholly-owned TRS upon expiration.

(4) Leased to our wholly-owned TRS.

**Comfort Inn**

***Harrisburg, Pennsylvania***

*Description.* The Comfort Inn, Harrisburg, Pennsylvania is located 8 miles north of Hershey, Pennsylvania at 7744 Linglestown Road off exit 27 of Interstate 81. The hotel opened in May 1998. It is an 81-room limited service hotel. Amenities include an indoor pool, hot tub, fitness center, meeting facilities, complimentary continental breakfast and 24-hour coffee. All rooms have one king bed or two queen beds and some Jacuzzi suites are available.

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*Guest Profile and Local Competition.* Approximately 25% of the hotel's business is related to commercial activity from local businesses. The hotel's group business, which accounts for approximately 5% of its business, is generated from area institutions, local weddings and local social and sporting events. The remainder of the hotel's business consists of transient and recreational travelers generated by its proximity to Hershey, Pennsylvania. We consider our primary competition to be the Comfort Suites and Holiday Inn in Grantville, Pennsylvania.

### ***Comfort Suites***

#### ***Duluth, Georgia***

*Description.* The Comfort Suites, Gwinnett Place Mall is located just off Pleasant Hill Road and Interstate 85 at exit 40. Opened in June 1996, this 85-suite hotel features large spacious guest suites each equipped with a king size bed or two double beds. Amenities include a fitness center, Jacuzzi within a large sunroom, indoor pool and meeting facilities with a 60-person capacity.

*Guest Profile and Local Competition.* Numerous local business parks in Duluth, Norcross and Lawrenceville play a vital role in the hotel's success. Companies such as Scientific Atlanta, Primerica Financial Services, NCR, Motorola, Hitachi, and Lucent Technologies all have major offices in the area and use this hotel frequently for room nights and meeting space. The leisure market is fueled by the Gwinnett Place Mall and many local events. We consider the hotel's primary competitors to be the Holiday Inn Express, the Hampton Inn & Suites, the Courtyard Gwinnett Mall and the Fairfield Inn.

### ***Doubletree***

#### ***JFK International Airport, Jamaica, New York***

*Description.* The Doubletree Club, JFK Airport, Jamaica, New York is located 16 miles from Manhattan, and is adjacent to the JFK International Airport. Opened in January 2002, this 110-room hotel features high-speed internet access in all rooms, a 24-hour business center with printers and computers, a fitness room and a full service restaurant.

*Guest Profile and Local Competition.* Located near JFK Airport and close to Manhattan, this hotel's main source of room nights is business travelers and transient leisure travelers utilizing the JFK Airport. The main competitors in the area are the Ramada Plaza JFK, Hampton Inn, Courtyard by Marriott and the Radisson Hotel JFK Airport.

### ***Hampton Inns***

#### ***Peachtree, Georgia***

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*Description.* This Hampton Inn is located in the Atlanta community of Peachtree City. This 61-room, limited service hotel opened in 1994. A poured concrete structure, this two-story building features the traditional Hampton Inn architecture with metal rooflines and an ample porte-cochere. This hotel features an outdoor pool and has a well equipped fitness facility. The hotel has a meeting room that can accommodate 25 persons.

*Guest Profile and Local Competition.* Peachtree City is home to over ten Fortune 500 companies and boasts a two million square foot industrial park. Several major Japanese companies, including Panasonic, Hoshizaki, TDK and Shinsei, are located in Peachtree City. The hotel's primary competitors are the Holiday Inn, Sleep Inn, and Days Inn located in Peachtree City.



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### ***Newnan, Georgia***

*Description.* The Hampton Inn, Newnan is located in one of Atlanta's fastest growing counties. This 91-room hotel sits adjacent to Interstate I-85 and features traditional Hampton Inn architecture with three floors on poured concrete. This hotel features an outdoor pool, fitness centers, and full-service meeting room.

*Guest Profile and Local Competition.* The primary demand generators for the Hampton Inn, Newnan include several major corporations located in the industrial park, which include Yokogawa, Johnson-Yokogawa, Yamaha, Kawasaki, Ryder, Ritchie Brothers, and Southern States Vehicle Auctions. The industrial park is slated for expansion and Coweta County's population has grown by over 40% since 1991. Leisure demand is generated by weddings, festivals, local racetracks and a tourist base. The main competition for this hotel includes the Jameson Inn, Springhill Suites, Comfort Inn, Best Western and Holiday Inn Express.

### ***Selinsgrove, Pennsylvania***

*Description.* The Hampton Inn, Selinsgrove, Pennsylvania is located on Pennsylvania Routes 11 and 15. The hotel, which opened in September 1996, is a 75-room, three story, limited service hotel. Amenities include an indoor pool, hot tub, fitness center, meeting facilities, complimentary continental breakfast and 24-hour coffee. All rooms have one king bed or two queen beds, some Jacuzzi suites are available and some rooms have refrigerators, coffee makers and microwaves.

*Guest Profile and Local Competition.* Approximately 80% of the hotel's business is related to commercial activity from local businesses. The remainder of the hotel's business consists of leisure travelers, transient guests and demand generated by the hotel's proximity to area universities and Knoebels Amusement Park. We consider our primary competition to be the Best Western near Selinsgrove, Pennsylvania.

### ***Carlisle, Pennsylvania***

*Description.* The Hampton Inn, Carlisle, Pennsylvania is located at the intersection of Route 11 and exit 16 off the Pennsylvania Turnpike. The hotel, which opened in June 1997, is a 95-room limited service hotel. Amenities include an indoor pool, hot tub, fitness center, meeting facilities, complimentary continental breakfast and 24-hour coffee. All rooms have one king bed or two queen beds, some Jacuzzi suites are available and some rooms have refrigerators, coffee makers and microwaves.

*Guest Profile and Local Competition.* Approximately 50% of the hotel's business is related to commercial activity from local businesses. The remainder of the hotel's business consists of overnight travelers and general demand generated by the hotel's proximity to the Carlisle Fairgrounds and the Army War College. We consider our primary competition to be the Holiday Inn in Carlisle, Pennsylvania.

### ***Danville, Pennsylvania***

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*Description.* The Hampton Inn, Danville, Pennsylvania, is located at Exit 33 off Interstate 80. The hotel, which opened in September 1998, is a 72-room, three story, limited service hotel. Amenities include an indoor pool, hot tub, fitness center, meeting facilities, complimentary continental breakfast, and 24-hour coffee service. All rooms offer queen beds or king beds, and coffee makers.

*Guest Profile and Local Competition.* The majority of the hotel guests consist of tourists or overnight business travelers. We consider our primary competition to be several non-franchised hotels located in the surrounding area.

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### ***New York, New York (Chelsea)***

*Description.* The Hampton Inn is a new modern 20 story high rise hotel located in the trendy up-and-coming district of Chelsea in New York City, bordering the West Village and Midtown Manhattan, and is equipped with many modern conveniences. The hotel offers free High-Speed Internet Access, complimentary breakfast and a 100% Satisfaction Guarantee. The grand opening of the hotel was on August 27, 2003.

*Guest Profile and Local Competition.* We expect that the many businesses located in the district of Chelsea between mid-town and lower Manhattan's financial district will generate guest for this hotel. The surrounding area also includes the Fashion Institute of Technology, the Toy & Gift buildings and the nearby garment district. The hotel is also conveniently located near the Jacob Javits Convention Center and the headquarters for Credit Suisse First Boston. The leisure market is also an important segment fed by the nearby theater district and other attractions in Manhattan. Nearby competing hotels include a Comfort Inn, a Clarion, a Courtyard Marriott, the Giraffe and the Chelsea Savoy hotel.

### ***Hampton Inn and Suites***

### ***Hershey, Pennsylvania***

*Description.* The Hampton Inn and Suites is located at 749 East Chocolate Avenue in Hershey, Pennsylvania. The hotel opened in September 1999 and has 110 rooms, 35 of which are suites. The hotel is located near all of the major attractions in Hershey, including the amusement park and the Hershey chocolate factory. Amenities include an indoor pool, exercise room, hot tub, meeting facilities, complimentary continental breakfast and 24-hour coffee.

*Guest Profile and Local Competition.* The majority of the hotel guests consist of tourists and overnight travelers. The hotel's close proximity to all Hershey attractions makes this property especially attractive to leisure travelers. The hotel's primary competitors are the Hilton Garden Inn, Comfort Inn, Holiday Inn Express and Springhill Suites.

### ***Holiday Inn Hotel and Conference Center***

### ***Harrisburg, Pennsylvania***

*Description.* The Holiday Inn Hotel and Conference Center, Harrisburg, Pennsylvania is located at the intersection of the Pennsylvania Turnpike exit 18 and Interstate 83, ten minutes from downtown, Harrisburg International Airport and Hershey Park. The hotel opened in 1970 as a Sheraton Inn and was converted to a Ramada Inn in 1984. It was completely renovated and converted to a Holiday Inn in September 1995. This hotel has 196 deluxe guest units and is a full service hotel, including a full service restaurant as well as a nightclub. Amenities include an indoor tropical courtyard with a pool and Jacuzzi as well as a banquet and conference facility for up to 700 people.

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*Guest Profile and Local Competition.* Approximately 40% of the hotel's business is related to commercial activity from local businesses. The remainder of the hotel's business consists of overnight travelers visiting Hershey and Harrisburg. We consider our primary competition to be the Radisson Penn Harris in Camp Hill, Pennsylvania.

*Additional Information Regarding Depreciation.* This is our only hotel that generates more than 10% of our revenue. The federal tax basis is \$1,238,000. The depreciation method used is Modified Accelerated Recovery System and the depreciation rate is based upon tables issued by the Internal Revenue Service for properties utilizing this depreciation method. The life claimed with respect to this property for purposes of depreciation is 39 years.

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### ***Holiday Inn Express***

#### ***Duluth, Georgia***

*Description.* The Holiday Inn Express, Gwinnett Place Mall is located just off Pleasant Hill Road and Interstate 85 at exit 40. Opened in June 1996, this 68-room hotel features spacious guestrooms equipped with a king size bed or two double beds. This hotel features an outdoor pool along with a well-equipped fitness center. Meeting space is also available and accommodates up to 50 people.

*Guest Profile and Local Competition.* Numerous local business parks in Duluth, Norcross and Lawrenceville play a vital role in the hotel's success. Companies such as Scientific Atlanta, Primerica Financial Services, NCR, Motorola, Hitachi, and Lucent Technologies all have major offices in the area and use this hotel frequently for room nights and meeting space. The Gwinnett Civic and Cultural Center and the millions of Priority Club members worldwide are also solid contributors of room nights throughout the year. We consider the hotel's primary competitors to be the Comfort Suites, the Hampton Inn & Suites, the Courtyard Gwinnett Mall and the Fairfield Inn.

#### ***Hershey, Pennsylvania***

*Description.* The Holiday Inn Express, Hershey, Pennsylvania is located on Walton Avenue, one and one half miles from Hershey Park. The hotel, which opened in October 1997, is an 85-room limited service hotel. Amenities include an indoor pool, hot tub, fitness center, business service center, meeting facility, complimentary continental breakfast and 24-hour coffee. All rooms have one king bed or two queen beds and some rooms have refrigerators, coffee makers and microwaves.

*Guest Profile and Local Competition.* Approximately 30% of the hotel's business is related to commercial activity from local business. The hotel's group business, which accounts for approximately 5% of its business, is generated from area institutions, local weddings and local social and sporting events. The remainder of the hotel's business consists of transient guests, visitors to area residents and demand generated by the hotel's proximity to Hershey Park. We consider our primary competition to be the Comfort Inn in Hershey, Pennsylvania.

#### ***New Columbia, Pennsylvania***

*Description.* The Holiday Inn Express, New Columbia, Pennsylvania is located at the intersection of Interstate 80 and Route 15. The hotel, which opened in December 1997, is an 81-room limited service hotel. Amenities include an indoor pool, hot tub, fitness center, meeting facility, complimentary continental breakfast and 24-hour coffee. All rooms have one king bed or two queen beds, some Jacuzzi suites are available and some rooms have refrigerators, coffee makers and microwaves. The Holiday Inn Express in New Columbia, Pennsylvania is consistently ranked number one in its region for GSTS (Guest Satisfaction Tracking System). This award recognizes the Holiday Inn Express in New Columbia as the leader in guest satisfaction and product service out of 32 other Holiday Inns and Holiday Inns Express in the Eastern region.

*Guest Profile and Local Competition.* Approximately 80% of the hotel's business is related to commercial activity from local business. As a result of its proximity to ski resorts and nearby tourist attractions, recreational travelers generate approximately 10% of the hotel's business. The

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remainder of the hotel's business consists of overnight travelers and visitors to area residents. We consider our primary competition to be the Comfort Inn in New Columbia, Pennsylvania.

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### ***Long Island City (Midtown Tunnel), New York***

*Description.* This Holiday Inn Express is located adjacent to the entrance of the Midtown Tunnel in Long Island City and is within minutes from midtown Manhattan. This 79-room, limited service hotel opened in 2001. A poured concrete structure, this three-story building is conveniently located alongside the Long Island Expressway.

*Guest Profile and Local Competition.* Long Island City is within minutes of midtown Manhattan and is accessible via car or via direct access to the subway line into Times Square. The hotel also serves numerous corporate headquarters and businesses within Queens and is located within six miles of La Guardia airport and within 13 miles of the JFK International Airport. The hotel competes directly with the Best Western and numerous other limited service hotels within Long Island City and Manhattan.

### ***Holiday Inn Express and Suites***

### ***Harrisburg, Pennsylvania***

*Description.* The Holiday Inn Express and Suites, Harrisburg, Pennsylvania is located at 5680 Allentown Boulevard and is easily accessible from Interstates 81 and 83. The hotel, which opened in August 1998 as a Clarion Inn and Suites, is a 77-room limited service hotel. Amenities include an outdoor pool, meeting facilities, complimentary continental breakfast, and 24-hour coffee. All rooms have one king bed or two queen beds. Jacuzzi suites are available and some rooms also have refrigerators and microwaves.

*Guest Profile and Local Competition.* Approximately 40% of the hotel's business is comprised of business travelers, 30% is related to group business, 20% is leisure travelers, and 10% is government business. We consider our primary competition the Best Western and the Baymont Inn, both located in Harrisburg, Pennsylvania.

### ***Mainstay Suites***

### ***Frederick, Maryland***

*Description.* The Mainstay Suites, Frederick, Maryland is an all-suites extended stay hotel located near the office parks of Frederick and convenient to Baltimore and Washington, D.C. Each suite features a separate living area and fully equipped kitchen and dining area. The property also features a fitness room and indoor pool. There are also several suites with computers available in the room.

*Guest Profile and Local Competition.* The Frederick market has experienced significant growth over the past five years due to the development of new office parks and governmental agencies due to its proximity to Baltimore and Washington, D.C. Both governmental agencies and private companies utilize this hotel for long-term accommodations for their employees. Tourist attractions in close proximity to Frederick also attract

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leisure travelers that complement the corporate and governmental business. The primary competition for this hotel comes from the Residence Inn, Frederick and the Courtyard, Frederick.

### ***King of Prussia, Pennsylvania***

*Description.* This Mainstay Suites is located just off the Pennsylvania Turnpike and is part of a unique dual branded hotel, the first to feature a Mainstay Suites and Sleep Inn under one roof. This unique property combines many amenities convenient for both the business and leisure traveler. This 69-room hotel opened in 2000 and the suites include fully-equipped kitchens, a comfortable living room and a spacious work area.

*Guest Profile and Local Competition.* This hotel serves both the nearby corporate market as well as the strong leisure demand generators such as the Valley Forge Historic Park, Valley Forge Convention Center, King



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of Prussia Mall. The hotel is within twenty miles of downtown Philadelphia and serves all of the corporate and leisure demand generators of this market. The hotel's primary competition includes the Fairfield Inn, Best Western, Comfort Inn and McIntosh Inn located within King of Prussia.

### *Sleep Inn*

#### *King of Prussia, Pennsylvania*

*Description.* This Sleep Inn is located just off the Pennsylvania Turnpike and is part of a unique dual branded hotel, the first to feature a Mainstay Suites and Sleep Inn under one roof. This unique property combines many amenities convenient for both the business and leisure traveler. This 87-room limited service hotel opened in 2000.

*Guest Profile and Local Competition.* This hotel serves both the nearby corporate market as well as the strong leisure demand generators such as the Valley Forge Historic Park, Valley Forge Convention Center and King of Prussia Mall. The hotel is within twenty miles of downtown Philadelphia and serves all of the corporate and leisure demand generators of this market. The hotel's primary competition includes the Fairfield Inn, Best Western, Comfort Inn and McIntosh Inn all located within King of Prussia.

## **Dispositions**

We continuously evaluate and adjust our hotel portfolio to achieve our investment criteria for size, brand affiliation and strategic fit. We monitor the cash flow potential for each hotel and its ability to remain accretive to our portfolio. Our decision to sell an asset is often predicated upon market dynamics, asset potential and long term strategic goals. Since our IPO in 1999, we have sold eight hotels and redeployed that capital to purchase additional hotels consistent with our long-term growth strategy.

## **Operating Practices**

HHMLP and our TRS utilize a centralized accounting and data processing system, which facilitates financial statement and budget preparation, payroll management, internal auditing and other support functions for the on-site hotel management team. The lessees provide centralized control over purchasing and project management (which can create economies of scale in purchasing) while emphasizing local discretion within specific guidelines.

## **Capital Improvements, Renovation and Refurbishment**

The percentage leases require the lessees to maintain the hotels in a condition that complies with their respective franchise licenses among other requirements. In addition, we may upgrade the hotels in order to capitalize on opportunities to increase revenue, and as deemed necessary by our management to seek to meet competitive conditions and preserve asset quality. We will also renovate hotels when we believe the investment in

renovations will provide an attractive return to us through increased revenue under the percentage leases or is otherwise in the best interests of our shareholders.

**Franchise Agreements**

HHMLP holds all of the franchise licenses for all of the hotels that it leases from us. We expect to maintain the franchise licenses for hotels leased to our TRSs.

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We anticipate that most of the additional hotels in which we invest will be operated under franchise licenses. We believe that the public's perception of quality associated with a franchisor is an important feature in the operation of a hotel. Franchisors provide a variety of benefits for franchisees, which include national advertising, publicity and other marketing programs designed to increase brand awareness, training of personnel, continuous review of quality standards and centralized reservation systems.

The franchise licenses generally specify certain management, operational, record-keeping, accounting, reporting and marketing standards and procedures with which the franchisee must comply. The franchise licenses obligate our lessees to 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 by our lessees, display of signage, and the type, quality and age of furniture, fixtures and equipment included in guest rooms, lobbies and other common areas.

The following table sets forth certain information in connection with the franchise licenses:

<b>Hotel</b>	<b>Effective Date</b>	<b>Expiration Date</b>
Comfort Inn, Harrisburg, PA	May 15, 1998	May 15, 2018
Comfort Suites, Duluth, GA	May 19, 2000	May 19, 2020
Doubletree, Jamaica, NY	April 25, 2001	April 24, 2023
Hampton Inn, Peachtree, GA	April 20, 2000	April 19, 2021
Hampton Inn, Newnan, GA	April 20, 2000	April 19, 2021
Hampton Inn, Selinsgrove, PA	September 12, 1996	September 11, 2016
Hampton Inn, Carlisle, PA	June 16, 1997	June 15, 2017
Hampton Inn, Danville, PA	March 28, 1997	March 27, 2018
Hampton Inn, New York, NY	August 27, 2003	August 27, 2023
Hampton Inn & Suites, Hershey, PA	September 24, 1998	September 23, 2019
Holiday Inn Hotel and Conference Center, Harrisburg, PA	September 29, 1995	September 29, 2005
Holiday Inn Express, Duluth, GA	May 20, 2000	May 20, 2010
Holiday Inn Express, Hershey, PA	September 30, 1997	September 30, 2007
Holiday Inn Express, New Columbia, PA	December 3, 1997	December 3, 2007
Holiday Inn Express, Long Island City, NY	December 28, 2000	December 28, 2010
Holiday Inn Express and Suites, Harrisburg, PA	December 22, 1999	December 22, 2009
Mainstay Suites, King of Prussia, PA	November 30, 1997	November 30, 2017
Mainstay Suites, Frederick, MD(2)	April 4, 2000	April 3, 2020
Sleep Inn, King of Prussia, PA	November 30, 1997	November 30, 2017

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### **The Percentage Leases**

Our hotels are operated by our lessees, HHMLP and 44 New England Management, pursuant to percentage leases. Each percentage lease with HHMLP has an initial non-cancelable term of five years. All, but not less than all, of these leases may be extended for an additional five-year term at HHMLP's option. At the end of the first extended term, HHMLP, at its option, may extend some or all of the leases for an additional five-year term. HHMLP has agreed not to exercise its option to extend the current lease term with respect to any of the 14 hotels it currently leases. The percentage leases are subject to early termination upon the occurrence of defaults thereunder and certain other events described therein.

The percentage leases are designed to allow us to participate in growth in revenues at our hotels. The percentage lease formulas are based on certain projections including projected revenues for the newly-developed and newly-renovated hotels. We cannot assure you that future revenues for the hotels will be consistent with prior performance or the estimates. With respect to hotels subject to purchase price adjustment, until the purchase price adjustment dates the rent is a fixed annual rent payable quarterly. After the adjustment dates, rent will be computed based on a percentage of revenues of those hotels. These percentage leases generally provide for the lessees to pay in each month or calendar quarter the greater of a base rent or percentage rent. The percentage rent for each hotel leased to HHMLP is comprised of:

- a percentage of room revenues up to a certain threshold amount,
- a percentage of room revenues in excess of the first threshold but less than a second incentive threshold,
- a percentage of room revenues in excess of the second incentive threshold and
- a percentage of revenues other than room revenues.

The incentive thresholds are designed to provide incentive to HHMLP to generate higher revenues at each hotel by reducing the percentage of revenue paid as rent above certain thresholds. In the case of any newly-renovated hotels or newly-developed hotels, our lessees pay a fixed rent until an adjustment date, after which our lessees pay the greater of a base rent or percentage rent.

Under the percentage leases, we make available to our lessees for the replacement and refurbishment of furniture, fixtures and equipment and other capital improvements, determined in accordance with GAAP, when and as deemed necessary by the lessees, an amount equal to 4% (6% for the Holiday Inn Hotel and Conference Center, Harrisburg, Pennsylvania) of gross revenues per quarter on a cumulative basis. Our obligation will be carried forward to the extent that the lessees have not expended such amount, and any unexpended amounts will remain our property upon termination of the percentage leases. Other than as described above, our lessees are responsible for all repair and maintenance of the hotels and any capital improvements thereto.

**Management Agreements**

Our TRSs have engaged HHMLP as the property manager for our hotels pursuant to substantially similar management agreements. Each management agreement provides for a five year term and is subject to early

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termination upon the occurrence of defaults and certain other events described therein. As required under the REIT qualification rules, HHMLP must qualify as an eligible independent contractor during the term of the management agreements.

Under the management agreements, HHMLP generally pays the operating expenses of our hotels. All operating expenses or other expenses incurred by HHMLP in performing its authorized duties are reimbursed or borne by our TRS to the extent the operating expenses or other expenses are incurred within the limits of the applicable approved hotel operating budget. HHMLP is not obligated to advance any of its own funds for operating expenses of a hotel or to incur any liability in connection with operating a hotel.

For its services, HHMLP receives a base management fee, and if a hotel meets and exceeds certain thresholds, an additional incentive management fee. The base management fee for a hotel is due monthly and is equal to 3% of the gross revenues associated with that hotel for the related month. The incentive management fee, if any, for a hotel is due annually in arrears on the sixtieth day following the end of each fiscal year and is equal to an amount determined by our TRS and HHMLP prior to the commencement of each fiscal year and is generally based upon the financial performance of the hotel.

HHMLP must from time to time make expenditures for repairs and maintenance as are necessary to keep a hotel in good operating condition. Our TRS or we may elect to, from time to time at its or our expense, make alterations, additions, or improvements (including structural changes or repairs) in or to our hotels.

Under the management agreements, our TRSs retain the right to sell, lease, transfer or otherwise dispose of our hotels. HHMLP may not transfer or assign any of its rights and obligations under a management agreement without the prior written consent of our TRS. On the other hand, our TRSs may transfer or assign their rights and obligations under a management agreement without the consent of HHMLP. However, HHMLP will have the right to terminate the management agreement after receiving notice of such transfer or assignment.

## **Environmental Matters**

We believe that our hotels are in compliance in all material respects with all federal, state and local ordinances and regulations regarding hazardous or toxic substances and other environmental matters. Neither we nor, to our knowledge, any of the former owners of our hotels have been notified by any governmental authority of any material noncompliance, liability or claim relating to hazardous or toxic substances or other environmental matter in connection with any of the hotels.

Operating costs may be affected by the obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of future legislation. Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances on, under or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. The cost of complying with environmental laws could materially adversely affect amounts available for distribution to shareholders. Phase I environmental assessments have been obtained on all of our hotels. Phase I environmental assessments are intended to identify potential environmental issues for which an owner or operator of the hotel would be liable. The Phase I assessments we have obtained have not revealed any environmental liability that we believe would have a material adverse effect on our business, assets, results of operations or liquidity, nor are we aware of any such liability. Nevertheless, it is possible that these reports do not reveal all environmental liabilities or that there are material environmental liabilities of which we are unaware.

**Insurance**

We and HHMLP (as required in the percentage leases), maintain customary casualty, crime, workers compensation, general liability and other insurance coverages in amounts we consider adequate.



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### **Employees**

As of August 31, 2003, we had five employees who were principally engaged in managing the affairs of the company unrelated to property management. HHMLP had approximately 600 employees at that date. Our and HHMLP's relations with our respective employees are satisfactory.

### **Sales and Marketing**

Sales and marketing for our hotels is conducted by HHMLP. HHMLP has 20 employees dedicated to sales and marketing. Our sales and marketing team includes the corporate sales office, which consists of the Corporate Director of Sales, area sales members and corporate tour sales, and a regional sales team which consists of a regional sales director, a corporate foreign international travel coordinator, a regional educational sports market sales director, regional sales team members and their respective support staff. HHMLP also has property sales teams at many of our hotels. These teams vary from one full time sales person for every 150 rooms for limited service hotels to a staff of five sales professionals for the full service convention hotels.

### **Legal Proceedings**

We are not presently subject to any material litigation. To our knowledge, no litigation has been threatened against us other than routine actions and administrative proceedings, substantially all of which we expect to be covered by liability insurance and which, in the aggregate, we do not expect to have a material adverse effect on our business or financial condition.

**Table of Contents****MANAGEMENT****Trustees and Executive Officers**

Our Board of Trustees consists of seven members, five of whom are independent trustees under the rules of the American Stock Exchange. All of the trustees serve staggered terms of two years and the trustees are divided into two classes. Each trustee in Class I holds office for a term expiring at the 2004 annual meeting of shareholders and the election and qualification of his successor and each trustee in Class II holds office initially for a term expiring at the 2005 annual meeting of shareholders and the election and qualification of his successor. Certain information regarding our trustees and executive officers is set forth below.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Hasu P. Shah	59	Chairman of the Board, Chief Executive Officer and Trustee (Class II)
Jay H. Shah	35	President and Chief Operating Officer
Ashish R. Parikh	34	Chief Financial Officer
Neil H. Shah	29	Director of Acquisitions & Development
Kiran P. Patel	54	Corporate Secretary
David L. Desfor	42	Treasurer
K.D. Patel	60	Trustee (Class II)
Michael A. Leven	65	Independent Trustee (Class II)
Donald J. Landry	54	Independent Trustee (Class I)
John M. Sabin	48	Independent Trustee (Class II)
Thomas S. Capello	59	Independent Trustee (Class I)
William Lehr, Jr.	63	Independent Trustee (Class I)

Hasu P. Shah has been the Chairman of the Board and Chief Executive Officer since our inception in 1998. Mr. Shah is also the founder and CEO of the Hersha Group. Mr. Shah founded Hersha with the purchase of a single hotel in Harrisburg, Pennsylvania in 1984. In the last twenty years, Mr. Shah has developed, owned, or managed over fifty hotels across the Eastern United States and started affiliated businesses in general construction, purchasing, and hotel management. He has earned numerous awards including the Entrepreneur of the Year, the Creating a Voice award, and was recently named a Fellow of Penn State University. Mr. Shah and his wife, Hersha, are active members of the local community and remain involved with charitable initiatives in India as well. Mr. Shah has been an active Rotarian for nearly twenty years and continues to serve as a Trustee of several community service and spiritual organizations including Vraj Hindu Temple and the India Heritage Research Foundation. Mr. Shah received a Bachelors of Science degree in Chemical Engineering from Tennessee Technical University and obtained a Masters degree in Administration from Pennsylvania State University. Mr. Shah is also an alumnus of the Owner and President's Management program at Harvard Business School.

Jay H. Shah was named President and Chief Operating Officer of the Company on September 3, 2003. Prior to his appointment, Mr. Shah was a principal in the law firm of Shah & Byler, LLP, which he founded in 1997, and managing director of the Hersha Group. Mr. Shah previously was a consultant with Coopers & Lybrand LLP, served the late Senator John Heinz on Capitol Hill, and was employed by the Philadelphia District Attorney's office and two Philadelphia-based law firms. Mr. Shah received a Bachelor of Science degree from the Cornell University School of Hotel Administration, a Masters degree from the Temple University School of Business Management and a Law degree from Temple University School of Law. Mr. Shah is the son of Hasu P. Shah, our Chairman and Chief Executive Officer.

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Ashish R. Parikh has been Chief Financial Officer of Hersha Hospitality Trust since 1999. Previously, Mr. Parikh was Assistant Vice President in the Mergers and Acquisition Group for Fleet Financial Group where he developed valuable expertise in numerous forms of capital raising activities including leveraged buyouts, bank

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syndications and venture financing. Mr. Parikh has also been employed by Tyco International Ltd and Ernst & Young LLP. Mr. Parikh received his MBA from New York University and a BBA from the University of Massachusetts at Amherst. Mr. Parikh is a licensed Certified Public Accountant.

Neil H. Shah has served as the Company's Director of Acquisitions & Development since May 2002 and had been a principal of the Hersha Group since 2000. Prior to joining the Company, he served in senior management positions with the Advisory Board Company and the Corporate Executive Board. Mr. Shah graduated with honors from the University of Pennsylvania and the Wharton School with degrees in Management and Political Science. Mr. Shah earned his MBA from the Harvard Business School. Mr. Shah is the son of Hasu P. Shah, our Chairman and Chief Executive Officer.

Kiran P. Patel is the Company's Secretary and has been a principal of the Hersha Group since 1993. Prior to Hersha, Mr. Patel was employed by AMP Incorporated (electrical component manufacturer), in Harrisburg, Pennsylvania. Mr. Patel serves on various Boards for community service organizations. Mr. Patel received a Bachelor of Science degree in Mechanical Engineering from M.S. University of India and obtained a Masters of Science degree in Industrial Engineering from the University of Texas in Arlington.

David L. Desfor has served as Treasurer of the Company since December 2002. Previously, Mr. Desfor has been a principal and comptroller of the Hersha Group since 1992. Mr. Desfor previously co-founded and served as President of a hotel management company focused on conference centers and full service hotels. Mr. Desfor earned his undergraduate degree from East Stroudsburg University in Hotel Administration.

K.D. Patel currently serves as the President of Hersha Hospitality Management, L.P., the lessee of 14 of our hotels and the manager of all our hotels. Mr. Patel has been a principal of the Hersha Group since 1989. Mr. Patel was previously employed by Dupont Electronics from 1973 to 1990. Mr. Patel is currently a Board member of the International Association of Holiday Inns and has been a member of the Board of Trustees of the regional chapter of the American Red Cross and the Advisory Board of Taneytown Bank and Trust. Mr. Patel has served on our Board of Trustees since our initial public offering in 1999. Mr. Patel received a Bachelor of Science degree in Mechanical Engineering from the M.S. University of India and earned a Professional Engineering License from the Commonwealth of Pennsylvania.

Michael A. Leven is the Chairman and Chief Executive Officer of US Franchise Systems, Inc. (USFS), which franchises the Microtel, Hawthorn Suites and Best Inns & Suites hotel brands. Prior to forming USFS in 1995, he was President of Holiday Inns Worldwide. During his five-year tenure, the new Holiday Inn Express brand grew from zero to 330 open hotels. From 1985 to 1990, Mr. Leven was President of Days Inn of America leading the company from reorganization of a regional chain to one of the largest brands in the world with over 1,000 units. Mr. Leven is a co-founder of the Asian American Hotel Owners Association (AAHOA) which now has over 7,000 members. Mr. Leven is a Trustee of The Marcus Foundations, serves on the Boards of the Marcus Institute and the Georgia Aquarium, and the United Jewish Communities. He has received honorary doctorate degrees from The Johnson & Wales University and The College of Hospitality and Tourism Management of Niagara University. Mr. Leven has served on our Board of Trustees since 2001. Mr. Leven holds a Bachelor of Arts from Tufts University and a Master of Science from Boston University.

Donald J. Landry is president and owner of Top Ten, an independent hospitality industry consulting company. Mr. Landry has over thirty years of lodging and hospitality experience in a variety of leadership positions. Most recently, Mr. Landry was the Chief Executive Officer, President and Vice Chairman of Sunburst Hospitality Inc. Mr. Landry has also served as an executive officer for Choice Hotels International, Inc., Manor Care Hotel Division and Richfield Hotel Management. Mr. Landry currently serves on the corporate advisory boards of Unifocus and Campo Architects and numerous non-profit boards. Mr. Landry is a frequent guest lecturer at the Harvard Business School, Cornell University and University of New Orleans. Mr. Landry has served on the Board of Trustees since our 2001 annual meeting. Mr. Landry holds a Bachelor of Science from the University of New Orleans and was the University's Alumnus of the Year in 1999. Mr. Landry is a Certified Hotel Administrator.



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John M. Sabin is Chief Financial Officer, General Counsel and Secretary of NovaScreen Biosciences Corporation, a private bioinformatics and contract research biotech company. Prior to joining NovaScreen in 2000, he served as Chief Financial Officer of Hudson Hotels Corporation from 1998 to 1999. From 1997 to 1998, Mr. Sabin was with Vistana, Inc., a public vacation time-share company where he held positions of Senior Vice President, Treasurer and CFO. Previously, Mr. Sabin served as an executive with Choice Hotels International, Inc., Manor Care, Inc. and Marriott International, Inc. Mr. Sabin also serves on the Board of Competitive Technologies, Inc. Mr. Sabin joined the Board of Trustees on June 30, 2003.

Thomas S. Capello is a Private Investor and a Consultant specializing in strategic planning, mergers and acquisitions. From 1988 to 1999, Mr. Capello was the President, Chief Executive Officer and Director of First Capitol Bank in York, Pennsylvania. From 1983 to 1988, Mr. Capello served as Vice President and Manager of the Loan Production Office of The First National Bank of Maryland. Prior to his service at The First National Bank of Maryland, Mr. Capello served as Vice President and Senior Regional Lending Officer at Commonwealth National Bank and worked at the Pennsylvania Development Credit Corporation. Mr. Capello is the Chairman of the York regional Board of Directors of Community Bank, Inc. Mr. Capello is an active member for the board of WITF, Martin Library, Motter Printing Company, and Eastern York Dollars for Scholars. Mr. Capello has served on the Board of Trustees since the our initial public offering in January 1999. Mr. Capello is a graduate of the Stonier Graduate School of Banking at Rutgers University and holds an undergraduate degree with a major in Economics from the Pennsylvania State University.

William Lehr, Jr. retired from Hershey Foods Corporation in 1995. He had been Senior Vice President and Secretary of the Corporation, as well as its Treasurer. During a 28 year career with Hershey Foods, Mr. Lehr had a multitude of diverse responsibilities, including senior management, corporate governance, law, finance, human resources, and public affairs. Mr. Lehr is currently devoting his time to working with various nonprofit organizations in the following capacities. He is Chairman of the Board of Trustees of Lebanon Valley College; Chairman of the Board of the Greater Harrisburg Foundation as well as Chairman of the Capital Region's Early Childhood Training Institute; a director and Vice Chairman of Capital Blue Cross; a director and immediate past Chairman of Americans for the Arts and a director and immediate past President of the Susquehanna Art Museum. Mr. Lehr holds a Bachelor's degree in Business Administration from the University of Notre Dame, where he graduated cum laude, and a law degree from Georgetown University Law Center. Mr. Lehr is also a graduate of the Stanford Executive Program and successfully completed The Governing for Nonprofit Excellence Course at Harvard University's Graduate School of Business Administration.

## **Independent Trustees**

Our independent trustees are persons who are not officers, directors, trustees or employees of the company, any lessee or any underwriter or placement agent of our shares that has been engaged by us within the past three years or any affiliates thereof.

## **Committees and Meetings of the Board of Trustees**

*Trustees Meetings.* Our business is under the general management of our Board of Trustees as provided by our Bylaws and the laws of Maryland. The Board of Trustees holds regular quarterly meetings during our fiscal year and holds additional meetings as needed in the ordinary course of business. The Board of Trustees held four meetings and eight board conference calls during 2002. All trustees attended at least 75% of the aggregate of (i) the total number of the meetings of the Board of Trustees and (ii) the total number of meetings of all committees of the Board on which the trustee then served.

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We presently have an Audit Committee, Nominating Committee and a Compensation Committee of our Board of Trustees. We may, from time to time, form other committees as circumstances warrant. These committees have authority and responsibility as delegated by the Board of Trustees.

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*Audit Committee.* The Audit Committee consists of Messrs. Capello (Chairperson), Landry, Lehr and Sabin, all of whom are independent trustees. The Audit Committee is responsible for the engagement of independent public accountants, reviews with the independent public accountants the plans and results of the audit engagement, approves professional services provided by the independent public accountants, reviews the independence of the independent public accountants, considers the range of audit and non-audit fees and reviews the adequacy of our internal accounting controls. The Audit Committee met five times during 2002 and discussed relevant topics regarding financial reporting and auditing procedures.

*Compensation Committee.* The Compensation Committee consists of Messrs. Leven, Sabin, Landry and Lehr, all of whom are independent trustees. The Compensation Committee determines compensation for our executive officers and administers our Option Plan. The Compensation Committee met and discussed relevant topics regarding compensation at the meetings of the Board of Trustees and did not schedule separate meetings during 2002.

*Nominating Committee.* The Nominating Committee consists of Messrs. Hasu P. Shah, Capello and Landry. The Nominating Committee recommends candidates for election as trustees and in some cases the election of officers. The Nominating Committee met and discussed relevant topics regarding trustee and officer nominations at the meetings of the Board of Trustees and did not schedule separate meetings during 2002.

## **Compensation of Trustees**

Each independent and non-affiliated trustee is paid \$10,000 per year while each affiliated trustee is paid \$7,500 per year, payable in quarterly installments. In addition, we will reimburse all trustees for reasonable out-of-pocket expenses incurred in connection with their services on the Board of Trustees.

In addition, we have adopted the Hersha Hospitality Trust Non-Employee Trustees Option Plan (the Trustees Plan) to provide incentives to attract and retain independent trustees. The Trustees Plan authorizes the issuance of up to 200,000 Class B common shares. Options granted under the Trustees Plan will be exercisable only if (1) we obtain a per share closing price on the Class A common shares of \$9.00 for 20 consecutive trading days and (2) the per share closing price on for the Class A common shares for the prior trading day was \$9.00 or higher. Options issued under the Trustees Plan are exercisable for five years from the date of grant. The Trustees Plan provides that in the event the Class B common shares are converted or exchanged into or for any other securities, share grants and options will be granted in such other security.

Under the Trustees Plan, we granted the following nonqualified options to purchase Class B common shares to our independent trustees who were members of the Board on the effective date of our initial public offering: Mr. Allen, one of our former trustees, 30,000; Mr. Capello, 3,000; and Mr. Parthemer, one of our former trustees, 1,000. The exercise price of each such option was the offering price of \$6.00.

A trustee's outstanding options will become fully exercisable if the trustee ceases to serve on the Board of trustees due to death or disability. All awards granted under the Trustees Plan shall be subject to Board or other approval sufficient to provide exempt status for such grants under Section 16 of the Securities Exchange Act of 1934, as that section and rules thereunder are in effect from time to time. No option may be granted under the Trustees Plan more than 10 years after the date that the Board of Trustees approved the Plan. The Board of Trustees may amend or terminate the Trustees Plan at any time but an amendment will not become effective without shareholder approval if the amendment increases the number of shares that may be issued under the Trustees Plan (other than equitable adjustments upon certain corporate transactions).





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**CERTAIN RELATIONSHIPS AND TRANSACTIONS**

In developing our portfolio since our initial public offering in 1999, we have entered into various transactions with our trustees, officers and entities controlled by them, including transactions relating to the leasing and managing of our hotels, acquisitions and dispositions of hotels, loans made by or for the benefit of us, and the purchase of goods and services. Certain of these transactions have been instrumental in the implementation of our business strategy and the growth of our portfolio. Although we have made certain efforts, described below, to ensure that these transactions were negotiated on an arms-length basis, we cannot assure you of this fact or that the terms of these transactions are as favorable to us as those we may have received from unaffiliated third parties. As a result of the growth in our portfolio, our current growth strategy and modifications to the REIT qualification rules, we have adopted certain policies with respect to transactions with our trustees, officers and entities controlled by them. The following is a summary of certain of these transactions, including a description of the transaction, the business purpose for the transaction and our current policy with respect to such a transaction.

**Portfolio Formation Transactions with Trustees and Officers**

In connection with our initial public offering in 1999, entities controlled by our officers and trustees contributed ten hotels to us in exchange for limited partnership units in our operating partnership. Since that time, we have continued to buy hotels from, and sell hotels to, entities controlled by our officers and trustees when a majority of our independent trustees has determined it was in our best interest to do so.

*Hotel Acquisitions*

We have not, and do not in the future intend to, undertake the risks of developing new hotels. However, since our initial public offering in 1999, we have been able to acquire newly-constructed or newly-renovated hotels from entities controlled by our officers or trustees. Of the 17 hotel properties purchased by us since our initial public offering, 13 were acquired from affiliates, 12 of which were newly-constructed or substantially renovated. In connection with our initial public offering, we entered into an Option Agreement with Hasu Shah, Jay Shah, Neil Shah, K.D. Patel, David Desfor, and Kiran Patel. Pursuant to this agreement, we had the option to purchase any hotels owned or developed by these individuals that was within fifteen miles of any of our hotels or any hotel subsequently acquired by us for two years after such acquisition or development. In connection with this offering, the parties to this agreement have agreed to amend the Option Agreement so that (a) the right of first refusal would apply to all hotels owned or developed by the parties, regardless of proximity to our hotels, and (b) the right of first refusal would apply to each party until one year after such party ceases to be an officer or trustee of our company. This arrangement gives us access to a pipeline of newly-constructed and newly-renovated hotels, without bearing all the risks associated with development and renovation.

As of September 2001, the Board of Trustees has elected to hire an independent accounting firm to review in advance all asset purchases and asset sales between us and related parties. The Board of Trustees will determine the scope of each review on a case-by-case basis. The independent third party accounting firm will review each acquisition or sale to determine if the terms of the transaction are in line with then-current market conditions as well as how the transaction impacts us. The accounting firm then will present its findings to the Board of Trustees to aid it in its evaluation of the terms of the transaction.

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The following table sets forth certain information with respect to all of the acquisitions from entities controlled by our officers or trustees since January 1, 2001.

<i>Hotel</i>	<i>Acquisition Date</i>	<i>Affiliated Sellers</i>	<i>Purchase Price</i>
Hampton Inn, New York, New York	Acquired by our joint venture with CNL on August 29, 2003	Chelsea Grand East, LLC, in which Hasu Shah owns a 100% interest.	\$28 million paid by a joint venture in which we own a one-third interest, including \$16.4 million in assumed debt and \$11.6 in cash.
Doubletree, Jamaica, New York  (JFK Airport)	October 1, 2002	5544 JFK Associates, in which Hasu Shah, Jay Shah, Neil Shah, Kiran Patel, David Desfor, K.D. Patel and their immediate families collectively owned a 86% interest	\$11.5 million, including the assumption of \$8.7 million of mortgage debt, the assumption of \$1 million of related party debt and \$1.8 million of cash
Mainstay Suites, Frederick, Maryland	January 1, 2002	3044 Associates, in which Hasu Shah, Jay Shah, Neil Shah, Kiran Patel, David Desfor, K.D. Patel and their immediate families collectively owned a 82% interest	\$5.5 million, including the assumption of \$3.3 million of debt, the assumption of \$0.8 million of related party debt and \$1.6 million of cash
Holiday Inn Express, Long Island City, New York	November 1, 2001	Metro Two Hotel, LLC, in which Hasu Shah, Jay Shah, Kiran Patel and K.D. Patel and their immediate families collectively owned a 88% interest	\$8.5 million, including the assumption of \$6.5 million of mortgage debt, \$1.5 million of cash, and \$0.5 million of common limited partnership units in our operating partnership
Mainstay Suites and Sleep Inn Hotel, King of Prussia, Pennsylvania	August 1, 2001	3244 Associates, in which Hasu Shah, Jay Shah, Kiran Patel and K.D. Patel and their immediate families collectively owned a 82% interest	\$9.4 million, including the assumption of \$6.8 million of mortgage debt, the assumption of \$1 million of related party debt and \$1.6 million of cash

*Hotel Acquisition Repricing*

Each of these hotels were newly-developed or newly-renovated hotels that did not have an operating history on which we could base purchase price decisions. In buying these hotels we have utilized, a re-pricing methodology that, in effect, adjusts the initial purchase price for the hotel, one or two years after we initially purchase the hotel, based on the actual operating performance of the hotel during the previous twelve months.

The initial purchase price for each of these hotels was based upon management's projections of the hotel's performance for one or two years following our purchase. The leases for these hotels provide for fixed initial rent for the one- or two-year adjustment period that provides us with a 12% annual yield on the initial purchase price, net of certain expenses. At the end of the one- or two-year period, we calculate an initial value for the hotel, based on the actual net income during the previous twelve months, net of certain expenses, such that it would have yielded a 12% return. We then apply the percentage rent formula to the hotel's historical revenues for the previous twelve months on a pro forma basis. If the pro forma percentage rent formula would not have yielded a pro forma annual return to us of 11.5% to 12.5% based on this calculated value, this value is adjusted either upward or downward to produce a pro forma return of either 11.5% or 12.5%, as applicable. If this final purchase price is higher than the initial purchase price, then the seller of the hotel will receive consideration in an amount equal to the increase in price. If the final purchase price is lower than the initial purchase price, then the sellers of the hotel will return to us consideration in an amount equal to the difference. Any purchase price adjustment will be made either in common limited partnership units in our operating partnership or cash as determined by our Board of Trustees. Any common limited partnership units issued by us or returned to us as a result of the purchase price

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adjustment will be based upon a value per unit approved by our Board of Trustees, including our independent trustees. The sellers are entitled to receive quarterly distributions on the common limited partnership units prior to the units being returned to us in connection with a downward purchase price adjustment. In addition, the sellers are not entitled to receive any retroactive distributions in connection with any upward purchase price adjustment.

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The five hotel purchases described above are subject to future re-pricing. We originally purchased these hotels with anticipated repricing dates from December 31, 2002 to December 31, 2004. Due to the current operating environment, the ramp up and stabilization for these newly-built properties is expected to take longer than initially projected. As a result, effective January 1, 2003, we entered into an agreement with the sellers of these five hotels to extend the repricing periods for these hotels. At the same time, we amended the percentage leases with HHMLP for these hotels to extend the initial fixed rent period to coincide with the extension period of the repricing and to delay the transition to percentage rent. In addition, we have the right to sell each of these properties back to the entities that initially sold the hotels to us at the end of the applicable repricing period if adequate stabilization has not occurred during the repricing period for a price not less than the purchase price of the asset.

We have also acquired hotels in the past where the purchase prices were subject to adjustment in a similar manner. On January 1, 2002, we issued an aggregate of 333,541 additional common limited partnership units to the sellers of the Holiday Inn Express & Suites, Harrisburg, the Hampton Inn, Danville and the Hampton Inn & Suites, Hershey, Pennsylvania in connection with the re-pricing of those hotels.

In the future, we do not intend to use any re-pricing methodology in acquisitions from entities controlled by our officers and trustees.

## *Dispositions*

Since our initial public offering in 1999, we have sold a total of eight hotels, including four hotels sold back to entities controlled by our officers or trustees at the same price at which we acquired the hotels from those entities. All sales to these entities were in situations where we believed an independent buyer would demand seller financing, which we were not willing to provide. We do not intend to sell hotels to such entities in the future.

Effective as of January 1, 2002, we sold the Sleep Inn, Coraopolis, Pennsylvania to 1944 Associates, an entity in which Hasu Shah, Jay Shah, Neil Shah, Kiran Patel, K.D. Patel and David Desfor have a 74% interest, for approximately \$5.5 million, including the assumption of approximately \$3.5 million in indebtedness, and redemption of 327,038 common limited partnership units valued at approximately \$2.0 million. We initially purchased this property from this same entity as of October 1, 2000 for \$5.5 million. The buyer is currently looking for a third party buyer. This sale was supported by an analysis of the property by an independent accounting firm and was approved by our independent trustees. We do not intend to sell hotels to our affiliates in the foreseeable future.

On November 1, 2001, we sold the Comfort Inn in McHenry, Maryland to the entity that sold the hotel to us for approximately \$1.8 million (the same price at which we acquired that hotel), including the assumption of approximately \$1.2 million in indebtedness. The acquiring entity was controlled by Hasu P. Shah, Jay H. Shah, Kiran P. Patel and K.D. Patel. This entity then sold the hotel on November 10, 2001 for approximately \$2.0 million, including the assumption of approximately \$1.2 million in indebtedness, \$300,000 in cash and seller financing in the amount of approximately \$500,000. We did not sell this hotel directly to the independent buyer because we did not want to expose ourselves to the risks associated with carrying an unsecured or secondary mortgage.

On November 1, 2001, we sold the Comfort Inn Riverfront in Harrisburg, Pennsylvania back to the entity that sold the hotel to us for approximately \$3.5 million (the same price at which we acquired that hotel), including the assumption of approximately \$2.5 million in indebtedness. This entity was controlled by Hasu P. Shah, Jay H. Shah and Neil H. Shah, and then sold the hotel in April 2002 for approximately \$3.6 million, including the assumption of approximately \$2.8 million in indebtedness, \$300,000 in cash and seller financing in the amount of approximately \$500,000. We did not sell this hotel directly to the independent buyer because we did not want to expose ourselves to the risks associated with carrying an unsecured or secondary mortgage.



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On April 1, 2001, we sold the Best Western in Indiana, Pennsylvania back to the entity that sold us that property for \$2.2 million (the same price at which we acquired that hotel), including the assumption of approximately \$1.4 million in indebtedness. The acquiring entity was controlled by Hasu P. Shah, Jay H. Shah, Kiran P. Patel and K.D. Patel. This entity then sold the hotel on May 1, 2001 for approximately \$2.2 million, including the assumption of approximately \$1.4 million in indebtedness, \$400,000 of cash, and seller financing in the amount of approximately \$400,000. We did not sell this hotel directly to the independent buyer because we did not want to expose ourselves to the risks associated with carrying an unsecured or secondary mortgage.

### *Hotel Development Loans*

We approved the lending of up to \$10.0 million to entities owned in part by Hasu P. Shah, Jay H. Shah, Kiran P. Patel, Neil H. Shah, David L. Desfor and K.D. Patel to construct hotels and related improvements on specific hotel projects. These loans are secured by unrecorded liens on the development projects and pledges of any limited partnership units in our operating partnership owned by persons or entities borrowing the funds. In addition to the option described above, we maintain the first right of refusal to purchase the hotel assets collateralized by these development loans. We have previously purchased three hotels that were developed using these funds. As of June 30, 2003, these affiliates owed us \$8.7 million related to this borrowing. These affiliates have borrowed this money from us at an interest rate of 12.0% per annum. Interest income from these advances was \$206,000 for the year ended December 31, 2002 and \$210,000 for the six month ended June 30, 2003. These loans were approved by our independent trustees. We intend to continue to use these loans to facilitate our acquisitions of newly-constructed hotels, consistent with our strategy of avoiding the risks associated with developing hotels directly but still maintaining an acquisition pipeline of newly-constructed and newly-renovated projects.

### *Guarantees*

As required due to the size of our company at the time of the loans, the lenders required that Mr. Hasu P. Shah guarantee the indebtedness related to four of the hotels, and the bankruptcy of Mr. Shah would constitute a default under the related loan documents. In addition, if the hotels that serve as collateral for the guarantees by Mr. Hasu Shah experience financial difficulty, we may be more likely to invest in those hotels with income from other hotels so that Mr. Shah will not be required to fund his guarantees. Three of these four loans will be paid in full with the proceeds of this offering, and we do not intend to allow officers or trustees to guarantee our loans in the future.

### *Loans From Shreenathji Enterprises, Ltd.*

We borrowed funds from Shreenathji Enterprises, Ltd., a company in which Jay H. Shah, Neil A. Shah, Kiran P. Patel, and K.D. Patel own a 75% interest. Our total borrowings outstanding from Shreenathji Enterprises, Ltd. as of June 30, 2003 was approximately \$1.0 million at a fixed rate of 6.5% per annum. The highest outstanding amount of borrowings from Shreenathji Enterprises since January 1, 2002 was approximately \$1.0 million. Shreenathji Enterprises, Ltd. funded our loan with the proceeds from a loan it received from a third party financial institution which was secured by one of our properties. The third party financial institution required the loan to be made through Shreenathji Enterprises, Ltd. instead of us because it had a prior relationship with Shreenathji Enterprises, Ltd. We do not intend to borrow funds from related parties in the future.

### **Leases and Management Agreements with HHMLP**

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Fourteen of our hotels are leased to HHMLP. Each percentage lease with HHMLP has an initial non-cancelable term of five years. All, but not less than all, of the percentage leases for these hotels may be extended for an additional five-year term at HHMLP's option. At the end of the first extended term, HHMLP, at its option, may extend some or all of the percentage leases for these hotels for an additional five-year term. Pursuant to the



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terms of the percentage leases, HHMLP is required to pay initial fixed rent, base rent or percentage rent and certain other additional charges and is entitled to all profits from the operations of the hotel after the payment of certain operating expenses. Total rent payments to us from HHMLP for the six months ended June 30, 2003 and for all of 2002 were \$6.3 million and \$11.4 million, respectively. For the full year of 2002, HHMLP had net loss \$0.67 million.

Four of our hotels, each of which is leased to our wholly-owned TRS, are managed by HHMLP pursuant to management agreements. In addition, the hotel owned by our joint venture with CNL is managed by HHMLP pursuant to a management agreement. Total payments to HHMLP pursuant to these management agreements for the six month ended June 30, 2003 were \$22,900.

The reason we do not operate our own hotels is that we are not permitted to do so by the REIT qualification rules. Furthermore, under the REIT qualification rules in effect when we acquired 14 of our hotels, we were generally required to lease our hotels to a third party and as a result, we lease these hotels to HHMLP. However, the REIT rules that prompted this structure were recently modified and the new rules permit a REIT to lease its hotels to a taxable REIT subsidiary, or TRS, provided that the TRS engages an eligible independent contractor to manage the hotels. Accordingly, since the time of the rule modification we have leased four hotels, whose leases with a third party lessee expired, to a wholly-owned TRS which pays us qualifying rents. We intend to eventually lease all our hotels to a TRS. As their leases expire, we will re-lease to our wholly-owned TRS the 14 hotels currently leased to HHMLP. In connection with this offering HHMLP has agreed to waive its rights to extend the lease terms of these 14 hotels.

The following table shows the expiration date of the leases for our 14 hotels leased to HHMLP:

Comfort Inn, Harrisburg, PA	January 26, 2004
Holiday Inn, Harrisburg, PA	January 26, 2004
Holiday Inn Express, Hershey, PA	January 26, 2004
Holiday Inn Express, New Columbia, PA	January 26, 2004
Hampton Inn, Selinsgrove, PA	January 26, 2004
Hampton Inn, Carlisle, PA	January 26, 2004
Hampton Inn, Danville, PA	September 1, 2004
Holiday Inn Express and Suites, Harrisburg, PA	September 1, 2004
Hampton Inn, Hershey, PA	December 31, 2005
Mainstay Suites, King of Prussia, PA	June 1, 2006
Sleep Inn, King of Prussia, PA	June 1, 2006
Holiday Inn Express, Long Island City, NY	November 1, 2006
Mainstay Suites, Frederick, MD	December 31, 2006
Doubletree, Jamaica, NY	October 1, 2007

**Miscellaneous Services Provided by Affiliated Entities***Administrative Services Agreement with HHMLP*

We have entered into an Administrative Services Agreement with HHMLP for HHMLP to provide accounting and securities reporting services to us. The terms of the agreement provide for a fixed annual fee of \$75,000 with an additional fee of \$10,000 per property per year (pro-rated from the time of acquisition) for each hotel added to our portfolio. A portion of these fees, charged by HHMLP, are allocated to the services of Ashish Parikh, our CFO. For the first six months of 2003 and for all of 2002, we incurred administrative service fee expenses of \$86,000 and

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\$175,000, respectively. As of June 30, 2003 and December 31, 2002, we owed HHMLP \$0 and \$303,000, respectively for replacement FF&E reserve reimbursements. We believe that because of our current size it is more cost effective to outsource these services. We will reevaluate this policy as we continue to grow.

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*Payments to Shah & Byler Law Firm*

We have paid to the law firm of Shah & Byler and its predecessor, Shah Ray & Byler, LLP, whose former senior partner, Jay H. Shah is now our President and Chief Operating Officer and is the son of Hasu P. Shah, legal fees aggregating \$68,000 and \$60,000 during the first six months of 2003 and for all of 2002, respectively. Mr. Shah has resigned from the law firm and relinquished all ownership and control of the firm. Mr. Shah will continue as counsel to the law firm and may receive compensation from the firm for prior client origination. We intend to continue to use the services of Shah & Byler.

*Payments to Hersha Construction Company*

HHMLP has engaged Hersha Construction Company, currently owned by Hasu P. Shah, Jay H. Shah, Neil Shah, Kiran P. Patel, K.D. Patel, David Desfor and other investors, from time to time to perform construction work related to the renovation of our hotel properties. For the first six months of 2003, and for all of 2002, HHMLP paid Hersha Construction Company \$0, and \$4,000, respectively. Hersha Construction Company is not HHMLP's only provider of these services and must bid with a number of unaffiliated providers for our business.

*Payments to Hersha Hotel Supply Company*

HHMLP has purchased hotel supplies for our hotel properties from time to time from Hersha Hotel Supply Company, currently owned by Hasu P. Shah, Jay H. Shah, Neil Shah, Kiran P. Patel, K.D. Patel and other investors. For the first six months of 2003 and for all of 2002, HHMLP paid Hersha Hotel Supply Company \$220,100 and \$957,000, respectively. Hersha Hotel Supply Company is not HHMLP's only provider of hotel supplies and must bid with a number of unaffiliated suppliers for our business.

**Table of Contents****PRINCIPAL SHAREHOLDERS**

The following table sets forth certain information regarding the beneficial ownership of Class A and Class B common shares by (i) each shareholder known by us to beneficially own more than five percent of our common shares, (ii) each of our trustees and executive officers, (iii) all of our trustees and executive officers as a group, and (iv) third party investors in our operating partnership, each as of August 31, 2003. Unless otherwise indicated, all shares are owned directly, and the indicated person has sole voting and investment power.

The number of outstanding Class A common shares at August 31, 2003 was 2,578,703. This table assumes that (i) all limited partnership units held by such person or group of persons are redeemed for Class B common shares or, in the case of CNL, exchanged for Class A common shares; (ii) all Class B common shares are converted into Class A common shares on a one-for-one basis; and (iii) all warrants held by such person are exercised for Class A common shares. The total number of shares outstanding used in calculating the percentage assumes that none of the limited partnership units or warrants held by other persons are redeemed for Class B common shares or exercised for Class A common shares, respectively. Limited partnership units generally are not redeemable for Class B common shares until at least one year following the issuance of such units. Class B common shares automatically will be converted into Class A common shares upon the earlier of (i) the date that is 15 trading days after we send notice to the holders of the Class A common shares that their priority period with respect to dividends and liquidation will terminate in 15 trading days, provided that the closing bid price of the Class A common shares is at least \$7.00 on each trading day during the 15-day period, or (ii) January 26, 2004.

<u>Name of Beneficial Owner</u>	<u>Before Offering</u>		<u>After Offering</u>	
	<u>Number of Shares</u>	<u>Percent of Class</u>	<u>Number of Shares</u>	<u>Percent of Class</u>
CNL Hospitality Partners, L.P.	4,008,601	60.9%	4,008,601	29.3%
CNL Center at City Commons 450 South Orange Avenue Orlando, Florida 32801-3336(1)				
Nayana Gandhi(2)	500,724	16.3%	111,443	1.1%
<b>Officers and Trustees:</b>				
Hasu P. Shah(3)	808,123	23.9%	808,123	7.7%
Neil H. Shah(3)	690,905	21.1%	690,905	6.7%
Jay H. Shah(3)	742,719	22.4%	742,719	7.1%
K.D. Patel(3)(4)	644,590	20.0%	143,086	1.5%
Kiran P. Patel(3)	377,265	12.8%	377,265	3.8%
David L. Desfor(5)	120,786	4.5%	120,786	1.2%
Ashish R. Parikh	2,500	(6)	2,500	(6)
John M. Sabin	500	(6)	500	(6)
Thomas S. Capello	3,000	(6)	3,000	(6)
Donald J. Landry				
Michael A. Leven	2,500	(6)	2,500	(6)
William Lehr Jr.	1,610	(6)	1,610	(6)
Total for all officers and trustees (12 persons)	3,427,202	50.07%	2,929,242	23.2%
Third party investor unitholders (six persons)	1,668,977	39.3%	370,481	3.7%

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- (1) Reflects information filed on September 5, 2003 with the Securities and Exchange Commission on Schedule 13D by CNL Hospitality Partners, L.P., CNL Hospitality GP Corp., and CNL Hospitality Properties, Inc. CNL has sole dispositive and voting power over all 4,008,601 shares, which consists of (a) 2,816,460 Class A common shares issuable upon exchange of 190,266 Series A Preferred Partnership Units in our operating partnership and (b) 1,192,141 Class A common shares issuable upon exchange of CNL's interest in our joint venture. CNL may only vote its shares to the extent they do not exceed 40% of the total issued and outstanding common shares. *See CNL Strategic Alliance.*
- (2) Represents 375 Class A common shares and 500,349 common limited partnership units owned by Nayana Gandhi. Mrs. Gandhi proposes to redeem 389,281 common limited partnership units in connection with this offering.
- (3) Represents limited partnership units owned by such person.
- (4) Mr. K.D. Patel proposes to redeem 501,504 common limited partnership Units in connection with this offering.
- (5) Represents 1,800 Class A common shares and 118,986 common limited participating units owned by Mr. Desfor.
- (6) Less than 1%.

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**CNL STRATEGIC ALLIANCE**

The following summary of the terms of the CNL strategic alliance does not purport to be complete and is subject to and qualified in its entirety by reference to the described agreements, which are exhibits to the Registration Statement of which this Prospectus is a part. See **Additional Information**.

In April of 2003, we entered into a strategic alliance with CNL Hospitality Partners, L.P., a subsidiary of CNL Hospitality Properties, Inc. CNL is a public company, which has been one of the most active investors in lodging properties over the past several years. Since its inception in 1996, CNL has invested over \$2.2 billion in hotel properties. The strategic alliance positions us as one of CNL's preferred partners for investing in mid-scale hotels. Our agreement with CNL provides that it will invest up to \$25 million in our operating partnership and up to \$40 million in a newly formed hotel acquisition joint venture. CNL has currently invested \$19 million in our operating partnership and \$8 million in the joint venture, which acquired its first hotel, the Hampton Inn Chelsea, New York, New York, on August 29, 2003.

**Investment in Series A Convertible Preferred Units of Our Operating Partnership**

On April 21 and May 21, 2003, CNL purchased a total of 150,000 units of a newly created series of convertible preferred limited partnership units of our operating partnership (the **Series A Convertible Preferred Units**) in exchange for CNL's payment of \$15,000,000 in cash, net of certain transaction costs. CNL purchased an additional 40,266 Series A Convertible Preferred Units on August 29, 2003, for approximately \$4 million. CNL may be obligated to purchase up to an additional 59,734 Series A Convertible Preferred Units, also at a per unit price of \$100.00.

*Dividends*

Each Series A Convertible Preferred Unit provides for a quarterly cumulative preferred dividend of 10.5% per annum on the \$100 original issue price per share and a liquidation value of \$100 per share, plus any accrued but unpaid dividends.

*Preemptive Rights*

Each Series A Convertible Preferred Unit has preemptive rights during the three-year period after their date of issuance in the event our operating partnership sells additional partnership units, provided that no such approval shall be required in the event of (i) an issuance of common operating partnership units in exchange for a contribution of properties to the operating partnership approved by our Board of Trustees, (b) the issuance of operating partnership units in connection with an approved employee benefit plan, including issuance of partnership units to our company in connection with the issuance of up to 650,000 Class A common shares pursuant to an approved employee benefit plan, or (c) the issuance of operating partnership units to our company in connection with the issuance of Class A common shares pursuant to a dividend reinvestment plan.

*Exchange and Conversion*

Each Series A Convertible Preferred Unit is exchangeable or convertible at the option of its holder for either (i) one Series A Preferred Share or (ii) approximately 14.8 Class A common shares or ordinary operating partnership units, based on an initial conversion price of \$6.7555 per Class A common share or ordinary operating partnership unit. The initial conversion price represents the volume weighted average closing price for the Class A common shares for the 20 trading days preceding April 21, 2003. The exchange or conversion price is subject to anti-dilution adjustments upon the occurrence of certain events, including share splits and combinations, reclassifications, reorganizations, mergers, consolidations or asset sales, or the sale of Class A common shares or operating partnership units below 85% of the then effective conversion or exchange price (initially \$5.74).

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### *Redemption*

Upon a vote of a majority of the members of our Board of Trustees, we may redeem all or any part of the outstanding Series A Convertible Preferred Units for a per Unit redemption price equal to the sum of the original issue price, all accrued but unpaid dividends and a premium which is initially \$10.50 per unit and declines annually on a straight line basis over a ten-year period. A Series A Convertible Preferred Unit holder who has received a redemption notice will have the opportunity in lieu of redemption to exchange or convert its Series A Convertible Preferred Units into Series A Preferred Shares, Class A common shares or ordinary operating partnership units.

### *Voting Rights*

The holders of Series A Convertible Preferred Units have the right to vote as a single class with holders of ordinary operating partnership interests on all matters upon which they are entitled to vote. The holders of operating partnership units are entitled to a number of votes equal to the number of Class A common shares for which their units would then be exchangeable.

### *Approval Rights*

We must obtain the approval of the holders of a majority of the Series A Convertible Preferred Units to effect the following actions:

any creation, or increase in number of, securities senior to the Series A Convertible Preferred Units;

the issuance of any class or series of equity interest in our operating partnership prior to the first to occur of (i) the issuance of an aggregate of 250,000 Series A Convertible Preferred Units in accordance with the terms of the CNL strategic alliance or (ii) certain terminating events defined in the agreement pursuant to which CNL purchased its Series A Convertible Preferred Units; provided that no such approval shall be required in the event of (i) an issuance of common operating partnership units in exchange for a contribution of properties to the operating partnership approved by our Board of Trustees, (b) the issuance of operating partnership units in connection with an approved employee benefit plan, including issuance of partnership units to our company in connection with the issuance of up to 650,000 Class A common shares pursuant to an approved employee benefit plan, or (c) the issuance of operating partnership units to our company in connection with the issuance of Class A common shares pursuant to a dividend reinvestment plan;

during any period when distributions with respect to the Series A Convertible Preferred Units are in arrears, any purchase, redemption or other acquisition for value (or payment into or setting aside as a sinking fund for such purpose) of any operating partnership units junior to the Series A Convertible Preferred Units;

during any period when distributions with respect to the Series A Convertible Preferred Units are in arrears, any action that results in the declaration or payment of distributions, direct or indirect on account of any junior units;

any action that results in any amendment, alteration, or repeal (by merger or consolidation or otherwise) of any provisions of the amendment to the operating partnership agreement designating the Series A Convertible Preferred Units, any provisions of our Declaration of Trust, as amended, or our By-laws which eliminates, amends or affects any term (adversely or otherwise) of the Series A Preferred Shares and/ or the Class A common shares or shares of any series ranking senior to the Series A Preferred Shares,



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including, without limitation, the redemption, dividend, voting, preemptive, anti-dilution and other powers, rights and preferences of such shares or adversely affects any holder thereof;

any action where our company or the operating partnership or any of our or its material subsidiaries files any voluntary, or consents to the filing of any involuntary, petition for relief under title 11 of the United

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States Code or any successor statute or under any reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law with respect to our company, the operating partnership or any of our or its subsidiaries;

any action where our company, the operating partnership or any of our material subsidiaries appoints or consents to, or acquiesces in, the appointment of a receiver, conservator, trustee or other similar official charged with the administration, control, management, operation, liquidation, dissolution or valuation of our company, the operating partnership or any of our or its material subsidiaries, or any of their respective businesses or assets; and

any agreement to do any of the transactions set forth above.

We are also required to obtain the approval of the holders of a majority of the Series A Convertible Preferred Units to effect the following actions, but only for so long as the holders of Series A Convertible Preferred Units hold in the aggregate that number of Series A Convertible Preferred Units, Class A common shares and any other class or series of our equity that represents, on an as converted or exchanged basis, at least five percent of the Class A common shares then outstanding on a fully diluted basis, assuming the conversion or exchange for Class A common shares of all convertible or exchangeable securities of our company and our operating partnership:

any action where our company or the operating partnership merges with or into or consolidates with any other entity, but excluding any merger effected exclusively for the purpose of changing the domicile of our company or the operating partnership;

any action where the operating partnership or any of its subsidiaries directly or indirectly sells, leases, transfers, conveys or assigns (whether in a single transaction or series of related transactions) all or substantially all of its assets, other than transactions involving leases by the operating partnership of its hotel properties in the ordinary course of its business;

all transactions involving our company or the operating partnership of the type referred in paragraph (a) of Rule 145 under the Securities Act of 1933, as amended, and all transactions involving our company or the operating partnership constituting a change-in-control within the meaning of Rule 14(f) under the Securities Exchange Act of 1934, as amended;

any action where our company, the operating partnership or any of our or its subsidiaries, or HHMLP, on the one hand, engages in any transaction with an affiliate of our company or the operating partnership on the other hand, provided, however, to the extent such transactions are of the type which, but for their affiliated nature, would fall within the ordinary course of business and day-to-day affairs of the operating partnership, such actions need not be approved on a transaction-by-transaction basis but may be entered into pursuant to annual budgets and purchase plans approved by the holders of the Series A Convertible Preferred Units. For purposes of these provisions, affiliate has the meaning set forth in Rule 12b-2 of the Exchange Act and includes, without limitation, (a) the trustees and senior officers of our company, the operating partnership or any of our or its subsidiaries, his or her spouse, parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, aunt, uncle, or first cousin, (b) any person directly or indirectly owning, controlling or holding the power to vote 5% or more of the outstanding voting securities of our company, the operating partnership or any of our or its subsidiaries, and (c) any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by our company, the operating partnership or any of our or its subsidiaries;

for our company, the operating partnership or any of our or its subsidiaries to engage in any business where either the operation of such business or ownership of the assets related to such business will result in our company failing to satisfy the provisions of Section 856 of the Internal Revenue Code;

conducting any business activities or the ownership of any asset of our company (other than operating partnership interests) in each case other than through the operating partnership or one or more subsidiary partnerships as contemplated by the operating partnership agreement; and



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admission of a substitute or additional general partner of the operating partnership.

We are not required to obtain the approval of the Series A Convertible Preferred Unit holders regarding any of the foregoing actions if such action provides that all holders of Series A Convertible Preferred Units shall as a result of and simultaneously with such action receive no less than the liquidation preference plus the applicable premium to which such Units are entitled under the operating partnership agreement.

### *Series A Preferred Shares*

The Series A Preferred Shares, into which the Series A Convertible Preferred Units are exchangeable, entitle the holders thereof to substantially similar rights as those attendant to the Series A Convertible Preferred Units in our operating partnership with respect to dividends, preemptive rights and redemption by us. In addition, holders of the Series A Preferred Shares have substantially similar approval rights as those held by holders of the Series A Convertible Preferred Units.

Each Series A Preferred Share is convertible at the option of its holder into approximately 14.8 Class A common shares, based on an initial conversion price of \$6.7555 per Class A common share and subject to anti-dilution adjustments upon the occurrence of certain events, including share splits and combinations, reclassifications, reorganizations, mergers, consolidations or asset sales, or the sale of Class A common shares or limited partnership units below 85% of the then effective conversion price (initially \$5.74).

Subject to the terms of the standstill agreement described below, holders of Series A Preferred Shares have the right to vote, on an as converted basis, and as a single class, with holders of our Class A common shares on all matters other than the designation, election or removal of trustees. The holders of a majority of the outstanding Series A Preferred Shares have the right to nominate an observer to our Board of Trustees. For so long as the holders of Series A Preferred Shares hold at least five percent of the Class A common shares on an as-converted and fully diluted basis, a majority of the Series A Preferred Share holders will have the right, voting as a separate class, to nominate and elect at least one member of our Board of Trustees, and in no event less than 11.1% of the total members of the Board of Trustees, if (i) they receive a favorable ruling from the Internal Revenue Service which permits CNL to continue to qualify as a REIT under certain circumstances, (ii) there is a change in the law providing for relief comparable to that sought from the IRS as described in clause (i) above, (iii) they receive an opinion of counsel consistent with such relief or (iv) there is a transfer of the Series A Convertible Preferred Units whereby the holder of a majority of the Series A Preferred Shares was a transferee of Series A Convertible Preferred Units which were converted into Series A Preferred Shares and could hold such shares without causing such holder to violate certain IRS rules relating to qualifying as a REIT. In addition, upon the failure of our company or our operating partnership to pay two consecutive dividends or distributions on the Series A Preferred Shares or the Series A Convertible Preferred Units, or our failure to maintain its status as a REIT, the holders of the Series A Preferred Shares will have the right to nominate and elect 40% of the members of our Board of Trustees.

### **Excepted Holder Agreement**

In connection with the strategic alliance, we and CNL entered into an Excepted Holder Agreement pursuant to which we exempted CNL from compliance with the 9.9% ownership limitation regarding any class or series of our equity securities set forth in our Declaration of Trust. Under the Excepted Holder Agreement, and in compliance with its terms, CNL may own up to 100% of the outstanding Series A Preferred Shares and up to 60% of the outstanding Class A common shares (assuming redemption of the outstanding common limited partnership units for Class A common shares), provided that the 60% ownership limit will rise to 100% if our company or our operating partnership fails to pay in full for two consecutive calendar quarters the dividends or distributions due on the Series A Preferred Shares and Series A Convertible Preferred Units or if we fail to maintain our status as a real estate investment trust.



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### **Standstill Agreement**

We have entered into a Standstill Agreement with CNL pursuant to which CNL and its affiliates have agreed not to acquire any additional securities of ours other than as contemplated by the CNL transaction, participate in any solicitation of proxies, call meetings of our shareholders, seek representation on our Board of Trustees or vote its securities in excess of 40% of the total issued and outstanding voting shares. Securities of ours owned by CNL in excess of the 40% limit are voted by proxy in the same manner and proportion as the Class A common shares held by all other holders. The Standstill Agreement provides that it will remain in effect until April 21, 2009 unless terminated earlier by CNL upon:

the failure by our company or our operating partnership to pay two consecutive quarterly dividends or distributions on the Series A Preferred Shares or the Series A Convertible Preferred Units;

our failure to maintain our status as a REIT;

another person acquiring beneficial ownership in excess of 9.9% of our equity shares that are issued and outstanding;

our Board of Trustees authorizing certain business combinations involving us;

another person's submission of a proposal to us relating to such business combinations that is not rejected by our Board as not in the best interests of our shareholders;

in connection with any business combination, our removal of any impediments in our Declaration of Trust or Bylaws to any business combination;

CNL's ownership of our securities, on a fully diluted basis, decreases to less than 9.9% of the Class A common shares then outstanding, on a fully diluted basis and the termination of the Excepted Holder Agreement or other exception to the ownership limit set forth in our Declaration of Trust applicable to CNL and its affiliates; and

the material failure by our company or our operating partnership to comply with any of the terms of the Series A Preferred Shares or the Series A Convertible Preferred Units.

Upon the occurrence of any of the aforementioned events, the 60% ownership limit on CNL's ability to acquire Class A common shares set forth in the Excepted Holder Agreement and the restrictions set forth in the Standstill Agreement on CNL's ability to acquire additional securities of our company will terminate and CNL will be permitted to acquire any amount of additional securities of our company or our operating partnership.

### **Registration Rights**

We have also entered into a Registration Rights Agreement with CNL pursuant to which CNL may, subject to certain cutbacks and restrictions, cause us to register the Class A common shares and Series A Preferred Shares owned by CNL under the Securities Act of 1933, as amended, and under state securities laws of any jurisdiction requested by CNL. In connection with this offering, CNL has agreed not to exercise these

registration rights for a period of 120 days following the date of this prospectus.

#### **Hotel Acquisition Joint Venture**

We have also have formed a joint venture limited partnership with CNL, in which our operating partnership is serving as the sole general partner and in which CNL is the sole limited partner. The joint venture agreement provides that CNL will invest up to \$40 million, and HT will invest up to \$20 million in the joint venture to acquire hotel real estate assets approved by an investment committee comprised of an equal number of representatives from Hersha and CNL. The investments in the joint venture will be subject to satisfaction of the conditions to closing set forth in the joint venture agreement.

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On August 29, 2003, the joint venture made its first acquisition, the Chelsea Hampton Inn, New York, New York and accepted a \$4 million capital contribution from us and an \$8 million capital contribution from CNL.

Net cash flow from operations of the joint venture will be distributed: first, to CNL to provide a 10.5% per annum return on its unreturned capital contributions; second, to us to provide an annual administrative fee of .35% of the cost of the joint venture's assets; third, to us to provide a 13% per annum return on our unreturned capital contributions; and thereafter to CNL and us in proportion to our respective capital contributions to the joint venture. Proceeds from a sale of a joint venture property or other capital event for the joint venture will be distributed: first, to CNL to return its capital contributions; second, to us to return our capital contributions; third, to CNL to provide a 10.5% annual return on its unreturned capital contributions; fourth, to us to provide a 13% annual return on our unreturned capital contributions; and thereafter to CNL and us according to our respective capital contributions.

CNL's limited partnership interest in the joint venture generally will be exchangeable, at CNL's option, for common limited partnership units of our operating partnership or Class A common shares, based on an initial exchange price of \$6.7555 per share, subject to adjustment.

As part of the joint venture, until April 21, 2004, we must present all of our proposed acquisitions to the investment committee of the joint venture, and we may only acquire such acquisition directly if the investment committee or CNL fails to approve that acquisition for the joint venture.



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### **DESCRIPTION OF SHARES OF BENEFICIAL INTEREST**

*The following summary of the terms of our shares of beneficial interest does not purport to be complete and is subject to and qualified in its entirety by reference to our Declaration of Trust and Bylaws, copies of which are exhibits to the Registration Statement of which this Prospectus is a part. See [Where You Can Find More Information](#).*

#### **General**

Our Declaration of Trust provides that we may issue up to 50,000,000 Class A common shares of beneficial interest, \$0.01 par value per share, 50,000,000 Class B common shares of beneficial interest, \$0.01 par value per share, and 10,000,000 preferred shares of beneficial interest, \$0.01 par value per share. As of August 31, 2003, 2,578,703 Class A common shares were issued and outstanding and no Class B common or preferred shares were issued and outstanding. Upon the termination of the priority period (which is the earlier of (i) the date that is 15 trading days after we send notice to the holders of the Class A common shares that their priority period with respect to dividends and liquidation will terminate in 15 trading days, provided that the closing bid price of the Class A common shares is at least \$7.00 on each trading day during the 15-day period, or (ii) January 26, 2004), any outstanding Class B common shares will be automatically converted into Class A common shares on a one-for-one basis, subject to adjustment upon the occurrence of certain events. As permitted by the Maryland REIT Law, our Declaration of Trust contains a provision permitting our Board of Trustees, without any action by our shareholders, to amend the Declaration of Trust to increase or decrease the aggregate number of shares of beneficial interest or the number of shares of any class of shares of beneficial interest that we have authority to issue.

Our Declaration of Trust provides that none of our shareholders is personally liable for any of our obligations solely as a result of his status as a shareholder. Our Bylaws further provide that we shall indemnify each shareholder against any claim or liability to which the shareholder, subject to certain limitations, may become subject by reason of his being or having been a shareholder or former shareholder and that we shall pay or reimburse each shareholder or former shareholder for all legal and other expenses reasonably incurred by him in connection with any claim or liability.

#### **The Class A Common Shares**

##### *General*

The holders of the Class A common shares shall be entitled to priority rights for a priority period. The priority period will end on the earlier of: (i) the date that is 15 trading days after we send notice to the holders of the Class A common shares that their priority rights will terminate in 15 trading days, provided that the closing bid price of the Class A common shares is at least \$7.00 on each trading day during such 15-day period; or (ii) January 26, 2004. Notwithstanding the foregoing, the priority period shall not end until the holders of the Class A common shares have received any accrued, but unpaid, priority distributions.

The priority rights consist of the dividend priority and the liquidation priority. These rights are subordinate to the dividend and liquidation priorities of the Series A Preferred Shares, none of which are currently outstanding.

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Upon termination of the priority period: (i) the holders of the Class A common shares and Class B common shares will be entitled to their pro rata share of our dividends and amounts payable upon liquidation; and (ii) the Class B common shares automatically will be converted into Class A common shares on a one-for-one basis, subject to adjustment.

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*The Dividend Priority*

The holders of the Class A common shares are entitled to receive dividends, when and as authorized by our Board of Trustees and declared by us, out of assets legally available for the payment of dividends. During the priority period, the holders of the Class A common shares are entitled to receive, prior to any distributions to either the holders of the operating partnership units or to the holders of the Class B common shares, cumulative dividends in an amount per Class A common share equal to \$0.18 per quarter (or \$0.72 per year). After the holders of the limited partnership units in our operating partnership and the Class B common shar