DiamondRock Hospitality Co
Form 10-K
March 01, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to

Commission file number 001-32514

DIAMONDROCK HOSPITALITY COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	**20-1180098** (I.R.S. Employer Identification Number)
6903 Rockledge Drive, Suite 800 Bethesda, Maryland (Address of Principal Executive Offices)	**20817** (Zip Code)

Registrant s telephone number, including area code: (240) 744-1150

Title of Each Class	**Name of Exchange On Which Registered**
Common Stock, $.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

The aggregate market value of the common equity held by non-affiliates of the Registrant (assuming for these purposes, but without conceding, that all executive officers and Directors are affiliates of the Registrant) as of June 16, 2006, the last business day of the Registrant s most recently completed second fiscal quarter, was $949.4 million (based on the closing sale price of the Registrant s Common Stock on that date as reported on the New York Stock Exchange).

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

As of February 28, 2007 there were 94,534,132 shares of common stock outstanding.

Documents Incorporated by Reference

Proxy Statement for the registrant s 2007 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2006, is incorporated by reference in Part III herein.

DIAMONDROCK HOSPITALITY COMPANY

INDEX

		Page
	PART I	
Item 1.	Business	3
Item 1A	Risk Factors	9
Item 1B.	Unresolved Staff Comments	24
Item 2.	Properties	25
Item 3.	Legal Proceedings	38
Item 4.	Submission of Matters to a Vote of Security Holders	38
	PART II	
Item 5.	Market for Our Common Stock and Related Stockholder Matters	39
Item 6.	Selected Financial Data	42
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	45
Item 7a.	Quantitative and Qualitative Disclosures About Market Risk	63
Item 8.	Financial Statements and Supplementary Data	64
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	64
Item 9A	Controls and Procedures	64
Item 9B.	Other Information	64
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance	65
Item 11.	Executive Compensation	65
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	65
Item 13.	Certain Relationships and Related Transactions	65
Item 14.	Principal Accounting Fees and Services	65
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	65

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words believes, project, expects, anticipates, estimates, intends, strategy, plan, may, will, would, will be, will continue, will likely result, and similar expressions. Forward are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Item 1A Risk Factors of this Annual Report on Form 10-K. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

Item 1. Business

Overview

We are a lodging focused real estate company that owns, as of February 28, 2007, twenty-one hotels and resorts that contain nearly 10,000 guest rooms.

We differentiate ourselves from our competitors because of our adherence to three basic principles:

- high quality urban and resort focused real estate;
- conservative capital structure; and
- thoughtful asset management.

High Quality Urban and Resort Focused Real Estate

We own and seek to acquire premium hotels and resorts in North America. Since our formation in May 2004, we have acquired 21 properties, with purchase prices aggregating over $2 billion, including five hotels with purchase prices aggregating over $700 million in 2006. These hotels and resorts are all categorized as upper upscale as defined by Smith Travel Research and are generally located in high barrier to entry markets with multiple demand generators.

Our properties are concentrated in five key gateway cities (New York City, Los Angeles, Chicago, Boston and Atlanta) and in destination resorts (such as the U.S. Virgin Islands and Vail, Colorado). We believe that these gateway cities and destination resorts are high growth markets because they are attractive business and leisure destinations. We also believe that these locations are better insulated from new supply due to relatively high barriers to entry and expensive construction costs.

We believe that the higher quality lodging assets create more dynamic cash flow growth and superior long-term capital appreciation.

Conservative Capital Structure

We are committed to maintaining a conservative and flexible capital structure with prudent leverage levels. During 2004 through 2006, we have taken advantage of the low interest environment by fixing our debt rates for an extended period of time. Depending on the outlook for interest rates in the future we maintain the flexibility to modify these strategies.

As of December 31, 2006, 100% of our debt carried fixed interest rates, with a weighted-average interest rate of 5.69%, and a weighted-average maturity date of 8.8 years. As of December 31, 2006, we had $841.2 million of debt outstanding, representing a net debt-to-enterprise value ratio of 37%, which is calculated as our market capitalization plus net debt.

We prefer a relatively simple but efficient capital structure. We have not invested in joint ventures and have not issued any operating partnership units or preferred stock. We endeavor to structure our hotel acquisitions so that they will not overly complicate our capital structure; however, we will consider a more complex transaction if we believe that the projected returns to our stockholders will significantly exceed the returns that would otherwise be available.

Thoughtful Asset Management

We believe that we are able to create significant value in our portfolio by utilizing our management s extensive experience and our innovative asset management strategies.

Our senior management team has established a broad network of hotel industry contacts and relationships, including relationships with hotel owners, financiers, operators, project managers and contractors and other key industry participants.

Our philosophy is to negotiate management agreements that give us the right to exert significant influence over the management of our properties, annual budgets and all capital expenditures, and then to use those rights to continually monitor and improve the performance of our properties. We cooperatively partner with the managers of our hotels in an attempt to increase operating results and long-term asset values at our hotels. In addition to working directly with the personnel at our hotels, our senior management team also has long-standing professional relationships with our hotel managers senior executives, and we work directly with these senior executives to improve the performance of our portfolio.

We believe we can create significant value in our portfolio through innovative asset management strategies such as rebranding, renovating and repositioning. We are committed to regularly evaluating our portfolio to determine if we can employ these value-added strategies at our hotels. During 2006, we completed a significant amount of capital reinvestment in our hotels completing projects that ranged from a room renovation (Courtyard Manhattan/Midtown East, Los Angeles Airport Marriott, Bethesda Marriott Suites) to a total renovation and repositioning of the hotel (Torrance Marriott and the Oak Brook Hills Marriott Resort). In connection with our planned renovations and repositionings, our senior management team and our asset managers are individually committed to completing these renovations on time, on budget and with minimum disruption at our hotels. We are optimistic that, when completed, these renovations will enable us to achieve higher rates and greater demand for our hotels.

A core of our asset management strategy is to leverage national hotel brands. We strongly believe in the value of powerful national brands because we believe that they are able to produce incremental revenue and profits compared to similar unbranded hotels. Dominant national hotel brands typically have very strong reservation and reward systems and sales organizations, as a result, all of our hotels are operated under a brand owned by one of the top three national brand companies (Marriott, Starwood or Hilton) and all but two of the hotels are operated by the brand company directly. Generally, we are interested in acquiring only those hotels that are operated under a nationally recognized brand or can be converted into a branded hotel.

Our Company

We commenced operations in July 2004. As of December 31, 2006, we owned 20 hotels that contained over 9,000 hotel rooms, located in the following markets: Atlanta, Georgia (4); Austin, Texas; Chicago, Illinois (2); Fort Worth, Texas; Lexington, Kentucky; Los Angeles, California (2); New York, New York

(2); Northern California; Oak Brook, Illinois; Orlando, Florida; Salt Lake City, Utah; Washington D.C.; St. Thomas, U.S. Virgin Islands; and Vail, Colorado. The address of our principal executive office is 6903 Rockledge Drive, Suite 800, Bethesda, Maryland 20817. Our phone number is 240-744-1150.

Recent Developments

Follow-on offering. We completed a follow-on offering of our common stock on January 17, 2007. We sold 18,342,500 shares of common stock, including the underwriters over-allotment of 2,392,500 shares, at an offering price of $18.15 per share. The net proceeds to us, after deduction of offering costs, was $317.6 million.

Acquisition of the Westin Boston Waterfront Hotel. Subsequent to year end, we acquired a leasehold interest in the Westin Boston Waterfront Hotel and in the attached 100,000 square feet of potential retail space. We also purchased an option to acquire a leasehold interest in an adjacent parcel of land which could permit us to expand the hotel (or construct a new hotel) by more than 300 rooms. The contractual purchase price for the Westin Boston Waterfront Hotel, the retail space, and the expansion option was $330.3 million. The Westin Boston Waterfront Hotel opened in June 2006 and contains 793 rooms and 32,000 square feet of meeting space.

Amended and Restated Credit Facility. We amended and restated our $75 million secured credit facility to expand it into a $200 million unsecured credit facility on February 28, 2007.

Our Relationship with Marriott

Investment Sourcing Relationship

We have an investment sourcing relationship with Marriott, a leading worldwide hotel brand, franchise and management company. Pursuant to this relationship, Marriott regularly provides us with an early opportunity to bid on hotel acquisition and investment opportunities known to Marriott. This relationship has generated a large number of additional acquisition opportunities, with many of the properties being off-market transactions, meaning that they are not made generally available to other real estate investment companies. However, we have not entered into a binding agreement or commitment setting forth the terms of this investment sourcing relationship. As a result, we cannot assure you that our investment sourcing relationship with Marriott will continue or not be modified.

Our senior management team regularly meets with senior representatives of Marriott to explore how to further our investment sourcing relationship in order to maximize the value of the relationship to both parties.

Key Money and Yield Support

Marriott has contributed to us certain amounts in exchange for the right to manage hotels we have acquired or the completion of certain brand enhancing capital projects. We refer to these amounts as key money. Marriott has provided us with key money of approximately $12 million in the aggregate in connection with our acquisitions of five of our hotels.

In addition, Marriott has provided us with operating cash flow guarantees for certain hotels and will fund shortfalls of actual hotel operating income compared to a negotiated target net operating income. We refer to these guarantees as yield support. Marriott provided us with yield support for the Oak Brook Hills Marriott Resort for fiscal years 2006 and 2007. The total guarantee obligation of Marriott is capped at $2.5 million. We received $1 million of yield support for the Orlando Airport Marriott for fiscal year 2006 and are not entitled to any further yield support. Finally, the SpringHill Suites Atlanta Buckhead is entitled to a maximum of $200,000 of yield support during 2006 and 2007. During the year ended December 31, 2006 we earned an aggregate of $2.8 million of yield support at the three properties.

Investment in DiamondRock

In connection with our July 2004 private placement, Marriott purchased 3.0 million shares of common stock at the same purchase price as all other investors in our private placement. In connection with our initial public offering, Marriott purchased 1,428,571 shares of our common stock at the same purchase price as all other investors. As of December 31, 2006, Marriott owned 5.8% of our outstanding common stock. Subsequent to the completion of our follow on offering in January 2007, Marriott owns 4.7% of our outstanding common stock.

Our Corporate Structure

We conduct our business through a traditional umbrella partnership REIT, or UPREIT, in which our hotels are owned by subsidiaries of our operating partnership, DiamondRock Hospitality Limited Partnership. We are the sole general partner of our operating partnership and currently own, either directly or indirectly, all of the limited partnership units of our operating partnership. In order for the income from our hotel investments to constitute rents from real properties for purposes of the gross income test required for REIT qualification, we must lease each of our hotels to a wholly-owned subsidiary of our taxable REIT subsidiary, or TRS, or an unrelated third party. However, we may structure our properties, which are not subject to U.S. federal income tax differently from the structures we use for our U.S. properties. For example, the Frenchman s Reef & Morning Star Marriott Beach Resort is held by a United States Virgin Islands corporation, which we have elected to be a TRS.

The following chart shows our corporate structure as of the date of this report:

Environmental Matters

Under various federal, state and local environmental laws and regulations, a current or previous owner, operator or tenant of real estate may be required to investigate and clean up hazardous or toxic substances or petroleum product releases or threats of releases at such property and may be held liable to a government entity or to third parties for property damage and for investigation, clean-up and monitoring costs incurred by such parties in connection with the actual or threatened contamination. These laws typically impose clean-up responsibility and liability without regard to fault, or whether or not the owner, operator or tenant knew of or caused the presence of the contamination. The liability under these laws may be joint and several for the full amount of the investigation, clean-up and monitoring costs incurred or to be incurred or actions to be undertaken, although a party held jointly and severally liable may obtain contributions from other identified, solvent, responsible parties of their fair share toward these costs. These costs may be substantial and can exceed the value of the property. The presence of contamination, or the failure to properly remediate contamination, on a property may adversely affect the ability of the owner, operator or tenant to sell or rent that property or to borrow funds using such property as collateral and may adversely impact our investment in that property.

Federal regulations require building owners and those exercising control over a building s management to identify and warn, via signs and labels, of potential hazards posed by workplace exposure to installed asbestos-containing materials and potential asbestos-containing materials in their building. The regulations also set forth employee training, record keeping and due diligence requirements pertaining to asbestos-containing materials and potential asbestos-containing materials. Significant fines can be assessed for violation of these regulations. Building owners and those exercising control over a building s management may be subject to an increased risk of personal injury lawsuits by workers and others exposed to asbestos-containing materials and potential asbestos-containing materials as a result of these regulations. The regulations may affect the value of a building containing asbestos-containing materials and potential asbestos-containing materials in which we have invested. Federal, state and local laws and regulations also govern the removal, encapsulation, disturbance, handling and disposal of asbestos-containing materials and potential asbestos-containing materials when such materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a building. Such laws may impose liability for improper handling or a release to the environment of asbestos-containing materials and potentially asbestos-containing materials and may provide for fines to, and for third parties to seek recovery from, owners or operators of real estate facilities for personal injury or improper work exposure associated with asbestos-containing materials and potential asbestos-containing materials.

Prior to closing any property acquisition, we obtain Phase I environmental assessments in order to attempt to identify potential environmental concerns at the properties. These assessments are carried out in accordance with an appropriate level of due diligence and will generally include a physical site inspection, a review of relevant federal, state and local environmental and health agency database records, one or more interviews with appropriate site-related personnel, review of the property s chain of title and review of historic aerial photographs and other information on past uses of the property. We may also conduct limited subsurface investigations and test for substances of concern where the results of the Phase I environmental assessments or other information indicates possible contamination or where our consultants recommend such procedures. We cannot assure you that these assessments will discover every environmental condition that may be present on a property.

Competition

The hotel industry is highly competitive and our hotels are subject to competition from other hotels for guests. Competition is based on a number of factors, including convenience of location, brand affiliation, price, range of services, guest amenities, and quality of customer service. Competition is specific to the individual markets in which our properties are located and will include competition from existing and new hotels operated under brands in the full-service, select-service and extended-stay segments. We believe that properties flagged with a Marriott, Starwood Hotels & Resorts Worldwide, Inc. (Starwood) or Hilton Hotels Corporation (Hilton) brands will enjoy the competitive advantages associated with their operations under such brand. These national brands reservation systems and national advertising, marketing and promotional services combined with the strong management expertise they provide enable our properties to perform favorably in terms of both occupancy and room rates. These brands guest loyalty programs generate repeat guest business that might otherwise go to competing hotels. Increased competition may have a material adverse effect on occupancy, ADR and RevPAR or may require us to make capital improvements that we otherwise would not undertake, which may result in decreases in the profitability of our hotels.

We face competition for the acquisition of hotels from institutional pension funds, private equity investors, REITs, hotel companies and others who are engaged in the acquisition of hotels. Some of these competitors have substantially greater financial and operational resources than we have and may have greater knowledge of the markets in which we seek to invest. This competition may reduce the number of suitable investment opportunities offered to us and increase the cost of acquiring our targeted hotel investments.

Employees

We currently employ 17 full-time employees. We believe that our relations with our employees are good. None of our employees is a member of any union; however, the employees working at the Courtyard Manhattan/Fifth Avenue hotel, the Oak Brook Hills Marriott Resort, Frenchman s Reef & Morning Star Marriott Beach Resort and the Westin Boston Waterfront Hotel are currently represented by labor unions and are subject to collective bargaining agreements.

Legal Proceedings

We are not involved in any material litigation nor, to our knowledge, is any material litigation pending or threatened against us, other than routine litigation arising out of the ordinary course of business or which is expected to be covered by insurance and not expected to harm our business, financial condition or results of operations.

Regulation

Our properties must comply with Title III of the Americans with Disabilities Act, or ADA, to the extent that such properties are public accommodations as defined by the ADA. The ADA may require removal of structural barriers to access by persons with disabilities in certain public areas of our properties where such removal is readily achievable. We believe that our properties are in substantial compliance with the ADA and that we will not be required to make substantial capital expenditures to address the requirements of the ADA. However, noncompliance with the ADA could result in imposition of fines or an award of damages to private litigants. The obligation to make readily achievable accommodations is an ongoing one, and we will continue to assess our properties and to make alterations as appropriate in this respect.

Insurance

We carry comprehensive liability, fire, extended coverage, earthquake, business interruption and rental loss insurance covering all of the properties in our portfolio under a blanket policy. In addition, we carry earthquake and terrorism insurance on our properties in an amount and with deductibles, which we believe are commercially reasonable. We do not carry insurance for generally uninsured losses such as loss from riots, war or acts of God. Certain of the properties in our portfolio are located in areas known to be seismically active or subject to hurricanes and we have appropriate insurance for those risks, although they are subject to higher deductibles than ordinary property insurance.

Most of our hotel management agreements generally provide that we are responsible for obtaining and maintaining property insurance, business interruption insurance, flood insurance, earthquake insurance (if the hotel is located in an earthquake prone zone as determined by the U.S. Geological Survey) and other customary types of insurance related to hotels and the manager is responsible for obtaining general liability insurance, workers compensation and employer s liability insurance.

Securities Exchange Act Reports

We maintain an internet website at the following address: www.drhc.com. The information on our website is not incorporated by reference in this annual report on Form 10-K.

We make available on or through our website certain reports and amendments to those reports that we file with or furnish to the Securities and Exchange Commission (the SEC) in accordance with the Securities Exchange Act of 1934, as amended (the Exchange Act). These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and Section 16 filings. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC.

Item 1A. Risk Factors

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties not presently known to us or that it may currently deem immaterial also may impair its business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be adversely affected.

Risks Related to Our Business and Operations

Our business model, especially our concentration in premium full-service hotels, can be highly volatile.

We own hotels, a very different asset class from many other REITs. A typical office REIT, for example, has long-term leases with third party tenants, which provides a relatively stable long-term stream of revenue. Our TRS, on the other hand, does not enter into a lease with a hotel manager. Instead, our TRS engages the hotel manager pursuant to a management agreement and pays the manager a fee for managing the hotel. The TRS receives all the operating profit or losses at the hotel. Moreover, virtually all hotel guests stay at the hotel for only a few nights, so the rate and occupancy at each of our hotels changes every day. As a result, we may have highly volatile earnings.

In addition to fluctuations related to our business model, our hotels are and will continue to be subject to various long-term operating risks common to the hotel industry, many of which are beyond our control, including:

- competition from other hotels that may be located in our markets, some of which may have greater marketing and financial resources than us;

- an over-supply or over-building of hotels in our markets, which could adversely affect occupancy rates and revenues at our properties;

- dependence on business and commercial travelers and tourism, both of which vary with consumer and business perceptions as to the strength of the general economy;

- increases in energy costs and other expenses affecting travel, which may affect travel patterns and reduce the number of business and commercial travelers and tourists;

- increases in operating costs due to inflation and other factors that may not be offset by increased room rates; and
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance.

In addition, our hotels are mostly in the premium full-service segment of the hotel business that tends to have the best operating results in a strong economy and the worst results in a weak economy. In periods of weak demand, profitability is negatively affected by the relatively high fixed costs of operating premium full-service hotels when compared to other classes of hotels.

The occurrence of any of the foregoing factors could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Our portfolio is highly concentrated in a handful of core markets.

We expect that in 2007 more than 75% of our earnings will be derived from our hotels in three destination resorts (Frenchman s Reef, Vail Marriott, and the Lodge at Sonoma) and five gateway cities (New York City, Boston, Chicago, Los Angeles and Atlanta) and as such, the operations of these hotels will have a material impact on our overall results of operations. As a result, we have a highly concentrated portfolio and this concentration may lead to volatility in our results. In the event of an economic downturn in any of these cities, the unpopularity of any of these destinations resorts, or a manmade or natural disaster or casualty or other damage to one of our key hotels, our overall results of operations may be adversely affected.

Our recently built or converted hotels have limited operating history and, as such, the hotels may not achieve the returns that we are expecting, and as a result, our overall returns may be negatively impacted.

The Westin Boston Waterfront Hotel opened in June 2006, and has limited operating history. Our ability to accurately forecast future operations is accordingly limited. In addition, the Westin Boston Waterfront Hotel is located in a newly developed submarket of Boston. Should the retail, office and apartment developments of this submarket fail to develop as we currently expect, this submarket may not be an attractive destination to travelers. As a result, there is considerable risk this hotel may not achieve the returns we are expecting and our overall returns may be negatively impacted.

The Chicago Conrad converted to the Conrad brand in June 2006, and has limited operating history as a Conrad. Moreover, the Conrad brand does not have the brand recognition of other premium and luxury brands. Our ability to accurately forecast future operations is accordingly limited. As a result, there is considerable risk this hotel may not achieve the returns we are expecting and our overall returns may be negatively impacted.

The Oak Brook Hills Marriott Resort was converted to a Marriott hotel in July 2005 and the transition to a Marriott was initially difficult, however, the disruption caused by the transition was minimized by the negotiated yield support that we received from Marriott. That yield support expires at the end of 2007. If the hotel continues to perform below our expectations, there is a risk that after the yield support terminates, that our returns may be negatively impacted.

Our hotels are subject to significant competition.

Currently, we believe the supply and demand in the markets where our hotels are located is in balance and, with few exceptions, the markets are very competitive. However, historically, a material increase in the supply of new hotel rooms to a market can quickly destabilize that market and existing hotels can experience rapidly decreasing RevPAR and profitability. If such over-building occurs in one or more of our major markets, we may experience a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

In the event of natural disasters, terrorist attacks, significant military actions, outbreaks of contagious diseases or other events for which we may not have adequate insurance, our operations may suffer.

One of our major hotels, Frenchman s Reef & Morning Star Marriott Beach Resort, is located on the side of a cliff facing the ocean in the United States Virgin Islands, which is in the so-called hurricane belt in the Caribbean. The hotel was partially destroyed by a hurricane in the mid-1990 s and since then has been damaged by subsequent hurricanes. In addition, three of our hotels, the Los Angeles Airport Marriott, the Torrance Marriott and The Lodge at Sonoma, a Renaissance Resort & Spa, are located in areas that are seismically active. Finally, seven of our hotels are located in metropolitan markets that have been, or may in the future be, targets of actual or threatened terrorist attacks, including New York City, Chicago, Boston and Los Angeles. These hotels are each material to our financial results. Chicago Marriott, Frenchman s Reef & Morning Star Marriott Beach Resort, Los Angeles Airport Marriott, the Torrance Marriott, Courtyard Manhattan/Midtown East, the Lodge at Sonoma, Courtyard Manhattan/Fifth Avenue and Conrad Chicago constituted 16.5%, 10.6%, 11.1%, 4.5%, 5.3%, 3.7%, 3.2% and 0.7% of our revenues in 2006, respectively. Additionally, even in the absence of direct physical damage to our hotels, the occurrence of any natural disasters, terrorist attacks, significant military actions, outbreaks of contagious diseases, such as SARS or the avian bird flu, or other casualty events affecting the United States, will likely have a material adverse effect on business and commercial travelers and tourists, the economy generally and the hotel and tourism industries in particular. While we cannot predict the impact of the occurrence of any of these events, such impact could result in a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

We have acquired and intend to maintain comprehensive insurance on each of our hotels, including liability, terrorism, fire and extended coverage, of the type and amount we believe are customarily obtained for or by hotel owners. We cannot assure you that such coverage will be available at reasonable rates or with reasonable deductibles. For example, Frenchman s Reef & Morning Star Marriott Beach Resort has a high deductible if it is damaged due to a wind storm. Various types of catastrophic losses, like earthquakes, floods, losses from foreign terrorist activities such as those on September 11, 2001, or losses from domestic terrorist activities such as the Oklahoma City bombing may not be insurable or are generally not insured because of economic infeasibility, legal restrictions or the policies of insurers. Future lenders may require such insurance and our failure to obtain such insurance could constitute a default under loan agreements. Depending on our access to capital, liquidity and the value of the properties securing the affected loan in relation to the balance of the loan, a default could have a material adverse effect on our results of operations and ability to obtain future financing.

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

With or without insurance, damage to any of our hotels, or to the hotel industry generally, due to fire, hurricane, earthquake, terrorism, outbreaks such as avian bird flu or other man-made or natural disasters or casualty events could materially and adversely affect our business, financial condition, results of operations and our ability to make distributions to our stockholders.

The hotel industry is capital intensive and we are subject to risks associated with our ongoing need for renovations and capital improvements as well as financing for such expenditures.

In order to remain competitive, our hotels have an ongoing need for renovations and other capital improvements, including replacements, from time to time, of furniture, fixtures and equipment. These capital improvements may give rise to the following risks:

- construction cost overruns and delays;
- a possible shortage of available cash to fund capital improvements and the related possibility that financing for these capital improvements may not be available to us on affordable terms;
- disruptions in the operations of the hotel as well as in demand for the hotel while capital improvements are underway; and
- disputes with franchisors/hotel managers regarding compliance with relevant management/franchise agreements.

The costs of these capital improvements could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

In addition, we may not be able to fund capital improvements or acquisitions solely from cash provided from our operating activities because we generally must distribute at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction, each year to maintain our REIT tax status. As a result, our ability to fund capital expenditures, or investments through retained earnings, is very limited. Consequently, we will rely upon the availability of debt or equity capital to fund our investments and capital improvements, but these sources of funds may not be available on favorable terms and conditions. Neither our charter nor our bylaws limits the amount of debt that we can incur; however, we may not be able to obtain additional equity or debt financing on favorable terms, if at all.

Our hotel portfolio is not diverse by brand or manager and there are risks associated with using Marriott s brands on most of our hotels and having Marriott manage most of our hotels.

Our success depends in part on the success of Marriott.

Eighteen of our current hotels utilize brands owned by Marriott. As a result, our success is dependent in part on the continued success of Marriott and its brands. If market recognition or the positive perception of these Marriott brands is reduced or compromised, the goodwill associated with Marriott branded hotels may be adversely affected and the results of operations of our hotels may be adversely affected. As a result, we could experience a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Our success depends in part on maintaining good relations with Marriott.

Due to the differences in how each company earns its money, which company is responsible for operating losses and capital expenditures, and tensions between an individual hotel and the brand standards of a large chain, there are natural conflicts between an owner of a hotel and a brand company, such as Marriott. Over the last several years, Marriott has been involved in contractual and other disputes with owners of the hotels it manages. Although we currently maintain good relations with Marriott, we cannot assure you that disputes between us and Marriott regarding the management of our properties will not arise. Should our relationship with Marriott deteriorate, we believe that two of our competitive advantages (namely our ability to work with senior executives at Marriott to improve the asset management of our hotels and our investment sourcing relationship) could be eliminated, which may have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Our results of operations are highly dependent on the management of our hotel properties by third-party hotel management companies, including Marriott.

In order to qualify as a REIT, we cannot operate our hotel properties or participate in the decisions that affect the daily operations of our hotel properties. Our TRS lessees may not operate these hotel properties and, therefore, they must enter into third-party hotel management agreements with one or more eligible independent contractors (including Marriott). Thus, third-party hotel management companies that enter into management contracts with our TRS lessees will control the daily operations of our hotel properties.

Under the terms of the hotel management agreements that we have entered into, or that we will enter into in the future, our ability to participate in operating decisions regarding our hotel properties is limited. We currently rely, and will continue to rely, on these hotel management companies to adequately operate our hotel properties under the terms of the hotel management agreements. We do not have the authority to require any hotel property to be operated in a particular manner or to govern any particular aspect of its operations (for instance, setting room rates). Thus, even if we believe our hotel properties are being operated inefficiently or in a manner that does not result in satisfactory occupancy rates, ADRs and operating profits, we may not have sufficient rights under our hotel management agreements to enable us to force the hotel management company to change its method of operation. We can only seek redress if a hotel management company violates the terms of the applicable hotel management agreement with the TRS lessee, and then only to the extent of the remedies provided for under the terms of the hotel management agreement. Our current management agreements are generally non-terminable, subject to certain exceptions for cause, and in the event that we need to replace any of our hotel management companies pursuant to termination for cause, we may experience significant disruptions at the affected properties, which may have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Marriott may encourage us to enter into transactions or hotel management agreements that are not favorable to us.

We have pursued and intend to continue to pursue, hotel investment opportunities referred to us by Marriott, and we intend to work with Marriott as our preferred hotel management company. Marriott is paid a fee based on gross revenues at the hotels while we only benefit from operating profits at a hotel. It is possible that Marriott will encourage us to acquire a hotel which generates significant gross revenues, but little or no operating profits.

Marriott may also have short-term or long-term goals and objectives that conflict with our own, including the terms of the agreements under which our hotels are managed. These differences may be significant and may include the fees payable to Marriott, the term of any hotel management agreement, trade area restrictions with respect to competition by Marriott or its affiliates or differing policies, procedures or practices. As a result of these potentially differing objectives, Marriott may present to us, and we may invest in, hotel investment opportunities, and enter into management agreements, that are less favorable to us than other alternatives. If we do enter into below market management agreements, our returns on invested capital and operating results will suffer.

These differing objectives could result in deterioration in our relationship with Marriott and may adversely affect our ability to execute our business strategies, which in turn, would have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Our ownership of properties through ground leases exposes us to the risk that we may have a difficulty financing such properties, may sell such properties for a lower price or may lose such properties upon breach or termination of the ground leases.

We acquired interests in four hotels (Bethesda Marriott Suites, Courtyard Manhattan/Fifth Avenue, the Salt Lake City Marriott Downtown and the Westin Boston Waterfront Hotel), the parking lot associated with another hotel (Renaissance Worthington) and two golf courses associated with two additional hotels (Marriott Griffin Gate Resort and Oak Brook Hills Marriott Resort) by acquiring a leasehold interest in land underlying the property. We may acquire additional hotels in the future through the purchase of hotels subject to ground leases. In the past, from time to time, secured lenders have been unwilling to lend, or otherwise charged higher interest rates, for loans secured by a leasehold mortgage compared to loans secured by a fee simple mortgage. In addition, at any given time, investors may be disinterested in buying properties subject to a ground lease and may pay a lower price for such properties than for a comparable property in fee simple or they may not purchase such properties at any prices, so we may find that we will have a difficult time selling a property subject to a ground lease or may receive less proceeds from such sale. Finally, as lessee under ground leases, we are exposed to the possibility of losing the hotel, or a portion of the hotel, upon termination, or an earlier breach by us, of the ground lease, which could result in a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Due to restrictions in our hotel management agreements, mortgage agreements and ground leases, we may not be able to sell our hotels at the highest possible price (or at all).

Our current hotel management agreements are long-term and contain certain restrictions on selling our hotels, which may affect the value of our hotels.

The hotel management agreements that we have entered into, and those we expect to enter into in the future, contain provisions restricting our ability to dispose of our hotels which, in turn, may have an adverse affect on the value of our hotels. Our hotel management agreements generally prohibit the sale of a hotel to:

- certain competitors of the manager;
- purchasers who are insufficiently capitalized; or
- purchasers who might jeopardize certain liquor or gaming licenses.

In addition, there are rights of first refusal in the hotel management agreement for the Salt Lake City Marriott Downtown and in both the franchise agreement and management agreement for the Vail Marriott Mountain Resort & Spa. These rights of first refusal might discourage certain purchasers from expending resources to conduct due diligence and making an offer to purchase these hotels from us, thus resulting in a lower sales price.

Finally, our current hotel management agreements contain initial terms ranging from ten to forty years and certain agreements have renewal periods, exercisable at the option of the property manager, of ten to forty-five years. Because our hotels would have to be sold subject to the applicable hotel management agreement, the term length of a hotel management agreement may deter some potential purchasers and could adversely impact the price realized from any such sale. To the extent we receive less sale proceeds, we could experience a material adverse effect on our business financial conditions, results of operations and our ability to make distributions to stockholders.

Our mortgage agreements contain certain provisions that may limit our ability to sell our hotels.

In order to assign or transfer our rights and obligations under certain of our mortgage agreements, we generally must:

- obtain the consent of the lender;
- pay a fee equal to a fixed percentage of the outstanding loan balance; and
- pay any costs incurred by the lender in connection with any such assignment or transfer.

These provisions of our mortgage agreements may limit our ability to sell our hotels which, in turn, could adversely impact the price realized from any such sale. To the extent we receive less sale proceeds, we could experience a material adverse effect on our business financial conditions, results of operations and our ability to make distributions to stockholders.

Our ground leases contain certain provisions that may limit our ability to sell our hotels.

Our ground lease agreements with respect to Bethesda Marriott Suites, Salt Lake City Marriott Downtown and the Westin Boston Waterfront require the consent of the lessor for assignment or transfer. These provisions of our ground leases may limit our ability to sell our hotels which, in turn, could adversely impact the price realized from any such sale. In addition, at any given time, investors may be disinterested in buying properties subject to a ground lease and may pay a lower price for such properties than for a comparable property in fee simple or they may not purchase such properties at any price. Accordingly, we may find it difficult to sell a property subject to a ground lease or may receive less proceeds from any such sale. To the extent we receive less sale proceeds, we could experience a material adverse effect on our business financial conditions, results of operations and our ability to make distributions to stockholders.

We face competition for the acquisition of hotels and we may not be successful in identifying or completing hotel acquisitions that meet our criteria, which may impede our growth.

One component of our business strategy is expansion through acquisitions, and we may not be successful in identifying or completing acquisitions that are consistent with our strategy. We compete with institutional pension funds, private equity investors, REITs, hotel companies and others who are engaged in the acquisition of hotels. This competition for hotel investments may increase the price we pay for hotels and these competitors may succeed in acquiring those hotels that we seek to acquire. Furthermore, our potential acquisition targets may find our competitors to be more attractive suitors because they may have greater financial resources, may be willing to pay more or may have a more compatible operating philosophy. In addition, the number of entities competing for suitable hotels may increase in the future, which would increase demand for these hotels and the prices we must pay to acquire them. If we pay higher prices for hotels, our returns on investment and profitability may be reduced. Also, future acquisitions of hotels or hotel companies may not yield the returns we expect and may result in stockholder dilution.

Noncompliance with governmental regulations could adversely affect our operating results.

Environmental matters.

Our hotels are, and the hotels we acquire in the future will be, subject to various federal, state and local environmental laws. Under these laws, courts and government agencies may have the authority to require us, as owner of a contaminated property, to clean up the property, even if we did not know of or were not responsible for the contamination. These laws also apply to persons who owned a property at the time it became contaminated. In addition to the costs of cleanup, environmental contamination can affect the value of a property and, therefore, an owner s ability to borrow funds using the property as collateral or to sell the property. Under the environmental laws, courts and government agencies also have the authority to require that a person who sent waste to a waste disposal facility, such as a landfill or an incinerator, pay for the clean-up of that facility if it becomes contaminated and threatens human health or the environment. A person that arranges for the disposal or treatment, or transports for disposal or treatment, a hazardous substance at a property owned by another person may be liable for the costs of removal or remediation of hazardous substances released into the environment at that property.

Furthermore, various court decisions have established that third parties may recover damages for injury caused by property contamination. For instance, a person exposed to asbestos while staying in a hotel may seek to recover damages if he or she suffers injury from the asbestos. Lastly, some of these environmental laws restrict the use of a property or place conditions on various activities. For example, certain laws require a business using chemicals (such as swimming pool chemicals at a hotel) to manage them carefully and to notify local officials that the chemicals are being used.

We could be responsible for the costs associated with a contaminated property. The costs to clean up a contaminated property, to defend against a claim, or to comply with environmental laws could be material and could adversely affect the funds available for distribution to our stockholders. We cannot assure you that future laws or regulations will not impose material environmental liabilities or that the current environmental condition of our hotels will not be affected by the condition of the properties in the vicinity of our hotels (such as the presence of leaking underground storage tanks) or by third parties unrelated to us.

We may face liability regardless of:

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

Although we have taken and will take commercially reasonable steps to assess the condition of our properties, there may be unknown environmental problems associated with our properties. If environmental contamination exists on our properties, we could become subject to strict, joint and several liability for the contamination by virtue of our ownership interest. In addition, we are obligated to indemnify our lenders for any liability they may incur in connection with a contaminated property.

The presence of hazardous substances or petroleum contamination on a property may adversely affect our ability to sell the property and could cause us to incur substantial remediation costs. The discovery of environmental liabilities attached to our properties could have a material adverse effect on our results of operations and financial condition and our ability to pay dividends to our stockholders.

Americans with Disabilities Act and other changes in governmental rules and regulations.

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

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

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

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

Because real estate investments are relatively illiquid, our ability to promptly sell one or more hotel properties or investments in our portfolio in response to changing economic, financial and investment conditions may be limited. The real estate market is affected by many factors that are beyond our control, including:

- adverse changes in international, national, regional and local economic and market conditions;
- changes in interest rates and in the availability, cost and terms of debt financing;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the ongoing need for capital improvements, particularly in older structures;
- changes in operating expenses; and
- civil unrest, acts of God, including earthquakes, floods and other natural disasters and acts of war or terrorism, including the consequences of terrorist acts such as those that occurred on September 11, 2001, which may result in uninsured losses.

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

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

A portion of our revenues may be attributable to operations outside of the United States, which will subject us to different legal, monetary and political risks, as well as currency exchange risks, and may cause unpredictability in a significant source of our cash flows that could adversely affect our ability to make distributions to our stockholders.

We may acquire selective hotel properties outside of the United States. International investments and operations generally are subject to various political and other risks that are different from and in addition to risks in U.S. investments, including:

- the enactment of laws prohibiting or restricting the foreign ownership of property;
- laws restricting us from removing profits earned from activities within the foreign country to the United States, including the payment of distributions, i.e., nationalization of assets located within a country;
- variations in the currency exchange rates, mostly arising from revenues made in local currencies;
- change in the availability, cost and terms of mortgage funds resulting from varying national economic policies;
- changes in real estate and other tax rates and other operating expenses in particular countries; and
- more stringent environmental laws or changes in such laws.

In addition, currency devaluations and unfavorable changes in international monetary and tax policies could have a material adverse effect on our profitability and financing plans, as could other changes in the international regulatory climate and international economic conditions. Liabilities arising from differing legal, monetary and political risks as well as currency fluctuations could adversely affect our financial condition, operating results and our ability to make distributions to our stockholders. In addition, the requirements for qualifying as a REIT limit our ability to earn gains, as determined for federal income tax purposes, attributable to changes in currency exchange rates. These limitations may significantly limit our ability to invest outside of the United States or impair our ability to qualify as a REIT.

Any properties we invest in outside of the United States may be subject to foreign taxes.

We may invest in hotel properties located outside the United States. Jurisdictions outside the United States will generally impose taxes on our hotel properties and our operations within their jurisdictions. To the extent possible, we will structure our investments and activities to minimize our foreign tax liability, but we will likely incur foreign taxes with respect to non-U.S. properties. Moreover, the requirements for qualification as a REIT may preclude us from always using the structure that minimizes our foreign tax liability. Furthermore, as a REIT, we and our stockholders will derive little or no benefit from the foreign tax credits arising from the foreign taxes we pay. As a result, foreign taxes we pay will reduce our income and available cash flow from our foreign hotel properties, which, in turn, could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

We are a relatively young company and are subject to all of the risks associated with being at an early stage of development.

We commenced operations in July 2004 and, as a result, have a limited operating history. We have experienced rapid growth in our short history and have developed our business strategies based on the expectation of continued rapid growth. We cannot assure you that we will be able to adapt our management, administrative, accounting and operational systems, or hire and retain qualified operational staff to integrate and manage our investment in our hotels. Our failure to successfully integrate and manage acquisitions could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Our success depends on senior executive officers whose continued service is not guaranteed.

We depend on the efforts and expertise of our senior executive officers to manage our day-to-day operations and strategic business direction. The loss of any of their services could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

Seasonality of the hotel business can be expected to cause quarterly fluctuations in our earnings.

The hotel industry is seasonal in nature. Generally, our earnings are higher in the second and fourth quarters. As a result, we may have to enter into short-term borrowings in our first and third quarters in order to offset these fluctuations in earnings and to make distributions to our stockholders.

Risks Related to Our Status as a REIT

We cannot assure you that we will remain qualified as a REIT.

We believe we are qualified to be taxed as a REIT for our taxable year ended December 31, 2006, and we expect to continue to qualify as a REIT for future taxable years, but we cannot assure you that we have qualified, or will remain qualified, as a REIT.

The REIT qualification requirements are extremely complex and official interpretations of the federal income tax laws governing qualification as a REIT are limited. Certain aspects of our REIT qualification are beyond our control. For example, we will fail to qualify as a REIT if one of our hotel managers acquires directly or constructively more than 35% of our stock. Accordingly, we cannot be certain that we will be successful in operating so that we can remain qualified as a REIT. At any time, new laws, interpretations, or court decisions may change the federal tax laws or the federal income tax consequences of our qualification as a REIT.

Moreover, our charter provides that our board of directors may revoke or otherwise terminate our REIT election, without the approval of our stockholders, if it determines that it is no longer in our best interest to continue to qualify as a REIT.

If we fail to qualify as a REIT and do not qualify for certain statutory relief provisions, or otherwise cease to be a REIT, we will be subject to federal income tax on our taxable income. We might need to borrow money or sell assets in order to pay any such tax. Unless we were entitled to relief under certain federal income tax laws, we could not re-elect REIT status until the fifth calendar year after the year in which we failed to qualify as a REIT.

Maintaining our REIT qualification contains certain restrictions and drawbacks.

Complying with REIT requirements may cause us to forego otherwise attractive opportunities.

To remain qualified as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. In order to meet these tests, we may be required to forego attractive business or investment opportunities. For example, we may not lease to our TRS any hotel which contains gaming. Thus, compliance with the REIT requirements may hinder our ability to operate solely to maximize profits.

Failure to make required distributions would subject us to tax.

In order to remain qualified as a REIT, we generally are required to distribute at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction, each year to our stockholders. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws. As a result, for example, of differences between cash flow and the accrual of income and expenses for tax purposes, or of nondeductible expenditures, our REIT taxable income in any given year could exceed our cash available for distribution. Accordingly, we may be required to borrow money or sell assets to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the distribution requirement and to avoid federal corporate income tax and the 4% nondeductible excise tax in a particular year.

The formation of our TRSs and TRS lessees increases our overall tax liability.

Bloodstone TRS, Inc. and any other of our domestic TRSs are subject to federal and state income tax on their taxable income. The taxable income of our TRS lessees is included in the taxable income of Bloodstone TRS, Inc. and currently consists and generally will continue to consist of revenues from the hotels leased by our TRS lessees plus, in certain cases, Key Money payments (amounts paid to us by a hotel management company in exchange for the right to manage a hotel we acquire), net of the operating expenses for such properties and rent payments to us. Such taxes could be substantial. Our non-U.S. TRSs also may be subject to tax in jurisdictions where they operate.

We incur a 100% excise tax on transactions with our TRSs that are not conducted on an arms-length basis. For example, to the extent that the rent paid by one of our TRS lessees exceeds an arms-length rental amount, such amount potentially is subject to the excise tax. While we believe we structure all of our leases on an arms-length basis, upon an audit, the IRS might disagree with our conclusion.

You may be restricted from transferring our common stock.

In order to maintain our REIT qualification, among other requirements, no more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal income tax laws to include various kinds of entities) during the last half of any taxable year (other than the first year for which a REIT election is made). In addition, the REIT rules generally prohibit a manager of one of our hotels from owning, directly or indirectly, more than 35% of our stock and a person who holds 35% or more of our stock from also holding, directly or indirectly, more than 35% of any such hotel management company. To qualify for and preserve REIT status, our charter contains an aggregate share ownership limit and a common share ownership limit. Generally, any shares of our stock owned by affiliated owners will be added together for purposes of the aggregate share ownership limit, and any shares of common stock owned by affiliated owners will be added together for purposes of the common share ownership limit.

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

Risks Related to Our Organization and Structure

Provisions of our charter may limit the ability of a third party to acquire control of our company.

Our charter provides that no person may beneficially own more than 9.8% of our common stock or of the value of the aggregate outstanding shares of our capital stock, except certain look-through entities, such as mutual funds, which may beneficially own up to 15% of our common stock or of the value of the aggregate outstanding shares of our capital stock. Our board of directors has waived this ownership limitation for Marriott Hotel Services, Inc. and certain institutional investors in the past. Our bylaws waive this ownership limitation for certain other classes of investors. These ownership limitations may prevent an acquisition of control of our company by a third party without our board of directors approval, even if our stockholders believe the change of control is in their best interests.

Our charter also authorizes our board of directors to issue up to 200,000,000 shares of common stock and up to 10,000,000 shares of preferred stock, to classify or reclassify any unissued shares of common stock or preferred stock and to set the preferences, rights and other terms of the classified or reclassified shares. Furthermore, our board of directors may, without any action by the stockholders, amend our charter from time to time to increase or decrease the aggregate number of shares of stock of any class or series that we have authority to issue. Issuances of additional shares of stock may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium to the market price of our common stock or otherwise be in our stockholders best interests.

Certain advance notice provisions of our bylaws may limit the ability of a third party to acquire control of our company.

Our bylaws provide that (a) with respect to an annual meeting of stockholders, nominations of persons for election to our board of directors and the proposal of business to be considered by stockholders may be made only (i) pursuant to our notice of the meeting, (ii) by the board of directors or (iii) by a stockholder who is entitled to vote at the meeting and has complied with the advance notice procedures set forth in the bylaws and (b) with respect to special meetings of stockholders, only the business specified in our notice of meeting may be brought before the meeting of stockholders and nominations of persons for election to the board of directors may be made only (i) pursuant to our notice of the meeting, (ii) by the board of directors or (iii) provided that the board of directors has determined that directors shall be elected at such meeting, by a stockholder who is entitled to vote at the meeting and has complied with the advance notice provisions set forth in the bylaws. These advance notice provisions may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium to the market price of our common stock or otherwise be in our stockholders best interests.

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

The Maryland General Corporation Law, or the MGCL, has certain restrictions on a business combination and control share acquisition which we have opted out of. If an affirmative majority of votes cast by a majority of stockholders entitled to vote approve it, our board of directors may opt in to such provisions of the MGCL. If we opt in, and the shareholders approve it, these provisions may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interests.

Additionally, Title 3, Subtitle 8 of the MGCL permits our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to take certain actions that may have the effect of delaying, deferring or preventing a transaction or a change in control of our company that might involve a premium to the market price of our common stock or otherwise be in our stockholders best interests.

We have entered into an agreement with each of our senior executive officers that provides each of them benefits in the event his employment is terminated by us without cause, by him for good reason, or under certain circumstances following a change of control of our company.

We have entered into an agreement with each of our senior executive officers that provides each of them with severance benefits if his employment is terminated under certain circumstances following a change of control of our company. Certain of these benefits and the related tax indemnity could prevent or deter a change of control of our company that might involve a premium price for our common stock or otherwise be in the best interests of our stockholders.

Risk of future dilution.

As hotel acquisition opportunities arise from time to time, we may issue additional shares of common stock or preferred stock to raise the capital necessary to finance the hotel acquisitions or may issue common stock or preferred stock or partnership units, which are redeemable on a one-to-one basis for our common stock, to acquire hotels. Such issuances could result in dilution of shareholders equity.

Future offerings of debt securities or preferred stock, which would be senior to our common stock upon liquidation and for the purpose of distributions, may cause the market price of our common stock to decline.

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 stock or common stock. We will be able to issue additional shares of common stock or preferred stock without stockholder approval, unless stockholder approval is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution. Preferred stock and debt, if issued, could have a preference on liquidating distributions or a preference on dividend or interest payments that could limit our ability to make a distribution to the holders of our common stock. 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 stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their interest.

Risks Related to Our Debt and Financing

Our existing indebtedness contains financial covenants that could limit our operations and our ability to make distributions to our stockholders.

Our existing indebtedness contains financial and operating covenants, such as net worth requirements, fixed charge coverage, debt ratios and other limitations which will restrict our ability to make distributions or other payments to our stockholders, sell all or substantially all of our assets and engage in mergers, consolidations and certain acquisitions. In addition, our existing indebtedness contains restrictions (including cash management provisions) that may under circumstances specified in the loan agreements prohibit our subsidiaries that own our hotels from making distributions or paying dividends, repaying loans to us or other subsidiaries or transferring any of their assets to us or another subsidiary. Failure to meet our financial covenants could result from, among other things, changes in our results of operations, the incurrence of debt or changes in general economic conditions. These covenants may restrict our ability to engage in transactions that we believe would otherwise be in the best interests of our stockholders. This could cause one or more of our lenders to accelerate the timing of payments and could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

There is refinancing risk associated with our debt.

Our typical debt contains limited principal amortization, therefore the vast majority of the principal must be repaid at the maturity of the loan in a so-called balloon payment. At the maturity of these loans, assuming we do not have sufficient funds to repay the debt, we will need to refinance this debt. If, at the time of any refinancing, prevailing interest rates or other factors result in higher interest rates on refinancings, increases in interest expense will adversely affect our cash flow, and, consequently, our cash available for distribution to our stockholders. If we are unable to refinance our debt on acceptable terms, we may be forced to dispose of our hotels on disadvantageous terms, potentially resulting in losses that could have a material adverse effect on our business, financial condition, results of operations and our ability to make distributions to our stockholders.

If we default on our secured debt in the future, the lenders may foreclose on our hotels.

All of our indebtedness for borrowed money, except our amended and restated unsecured senior credit facility, is secured by single property first mortgages on the applicable property. Should we default on any of the loans, the lender will be able to foreclose on the property pledged to the relevant lender under that loan.

In addition to losing the property, a foreclosure may result in recognition of taxable income. Under the Internal Revenue Code, a foreclosure would be treated as a sale of the property for a purchase price equal to the outstanding balance of the debt secured by the mortgage. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we would recognize taxable income on foreclosure even though we did not receive any cash proceeds. As a result, we may be required to identify and utilize other sources of cash for distributions to our stockholders. If this occurs, our financial condition, cash flow and ability to satisfy our other debt obligations or ability to pay distributions may be adversely affected.

Future debt service obligations may adversely affect our operating results, require us to liquidate our properties, jeopardize our tax status as a REIT and limit our ability to make distributions to our stockholders.

In the future, we and our subsidiaries may be able to incur substantial additional debt, including secured debt. Incurring such debt could subject us to many risks, including the risks that:

- our cash flow from operations will be insufficient to make required payments of principal and interest;
- we may be more vulnerable to adverse economic and industry conditions;
- we may be required to dedicate a substantial portion of our cash flow from operations to the repayment of our debt, thereby reducing the cash available for distribution to our stockholders, funds available for operations and capital expenditures, future investment opportunities or other purposes;
- the terms of any refinancing may not be as favorable as the terms of the debt being refinanced; and
- the use of leverage could adversely affect our stock price and the ability to make distributions to our stockholders.

If we violate covenants in our future indebtedness agreements, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on favorable terms, if at all.

If we obtain debt in the future and do not have sufficient funds to repay our debt at maturity, it may be necessary to refinance this debt through additional debt financing, private or public offerings of debt securities, or additional equity financings. If, at the time of any refinancing, prevailing interest rates or other factors result in higher interest rates on refinancings, increases in interest expense could adversely affect our cash flow, and, consequently, our cash available for distribution to our stockholders. If we are unable to refinance our debt on acceptable terms, we may be forced to dispose of our hotel properties on disadvantageous terms, potentially resulting in losses adversely affecting cash flow from operating activities. In addition, we may place mortgages on our hotel properties to secure our line of credit or other debt. To the extent we cannot meet these debt service obligations, we risk losing some or all of those properties to foreclosure. Additionally, our debt covenants could impair our planned strategies and, if violated, result in a default of our debt obligations.

Higher interest rates could increase debt service requirements on our floating rate debt and could reduce the amounts available for distribution to our stockholders, as well as reduce funds available for our operations, future investment opportunities or other purposes. We may obtain in the future one or more forms of interest rate protection in the form of swap agreements, interest rate cap contracts or similar agreements to hedge against the possible negative effects of interest rate fluctuations. However, we cannot assure you that any hedging will adequately mitigate the adverse effects of interest rate increases or that counterparties under these agreements will honor their obligations. In addition, we may be subject to risks of default by hedging counter-parties. Adverse economic conditions could also cause the terms on which we borrow to be unfavorable.

Item 1B. Unresolved Staff Comments

None.

Item 2. Our Properties

Overview

The following table sets forth certain operating information for each of our hotels as of and for the year ended December 31, 2006.

Property	Location	Number of Rooms	Average Occupancy (%)	ADR ($)	RevPAR ($)	% Change from 2005 RevPAR(1)
Chicago Marriott	Chicago, Illinois	1,192	81.9 %	$ 210.08	$ 172.10	16.0 %
Los Angeles Airport Marriott	Los Angeles, California	1,004	74.7	114.87	85.83	9.3
Renaissance Waverly Hotel	Atlanta, Georgia	521	41.0	138.52	56.77	(23.6)
Salt Lake City Marriott Downtown	Salt Lake City, Utah	510	68.8	130.16	89.54	5.6
Frenchman s Reef & Morning Star Marriott Beach Resort	St. Thomas, U.S. Virgin Islands	504	79.9	219.78	175.59	11.8
Renaissance Worthington	Fort Worth, Texas	504	75.6	166.52	125.89	8.1
Renaissance Austin Hotel	Austin, Texas	492	50.4	131.85	66.43	16.8
Torrance Marriott	Los Angeles County, California	487	78.2	112.06	87.58	9.4
Orlando Airport Marriott	Orlando, Florida	486	72.2	112.70	81.35	1.4
Marriott Griffin Gate Resort	Lexington, Kentucky	408	60.9	131.98	80.36	3.0
Oak Brook Hills Marriott Resort	Oak Brook, Illinois	384	57.2	129.28	73.93	19.0
Westin Atlanta North at Perimeter	Atlanta, Georgia	369	65.4	139.69	91.42	12.4
Vail Marriott Mountain Resort & Spa	Vail, Colorado	346	63.8	213.78	136.34	21.0
Marriott Atlanta Alpharetta	Atlanta, Georgia	318	64.5	140.99	90.97	13.1
Courtyard Manhattan/Midtown East	New York, New York	312	84.1	264.28	222.14	9.7
Conrad Chicago	Chicago, Illinois	311	57.4	254.72	146.20	23.7
Bethesda Marriott Suites	Bethesda, Maryland	272	73.3	176.08	129.03	3.9
SpringHill Suites Atlanta Buckhead	Atlanta, Georgia	220	67.0	114.21	76.55	12.7
Courtyard Manhattan/ Fifth Avenue	New York, New York	185	89.6	256.95	230.17	37.4
The Lodge at Sonoma, a Renaissance Resort & Spa	Sonoma, California	182	70.4	219.04	154.20	7.3
TOTAL/WEIGHTED AVERAGE		9,007	72.8 %	$ 165.27	$ 120.26	11.7 %

(1) The % change from 2005 RevPAR for our 2006 acquisitions compares the 2005 RevPAR of the comparable period in 2005 to our 2006 ownership period.

25

The following table sets forth information regarding our investment in each of our hotels:

Property	Location	Year Opened	Number of Rooms(1)	Total Investment(1) (in thousands)	Total Investment Per Room(1)
Chicago Marriott	Chicago, IL	1978	1,192	$ 309,860	$ 259,950
Los Angeles Airport Marriott	Los Angeles, CA	1973	1,004	127,665	127,156
Renaissance Waverly Hotel	Atlanta, GA	1983	521	128,720	247,063
Salt Lake City Marriott Downtown	Salt Lake City, UT	1981	510	53,054	104,027
Frenchman s Reef & Morning Star Marriott Beach Resort	St. Thomas, USVI	1973/1984	504	82,919	164,522
Renaissance Worthington	Fort Worth, TX	1981	504	82,823	164,331
Renaissance Austin Hotel	Austin, TX	1986	492	107,406	218,305
Torrance Marriott	Los Angeles County, CA	1985	487	71,979	147,801
Orlando Airport Marriott	Orlando, FL	1983	486	78,557	161,640
Marriott Griffin Gate Resort	Lexington, KY	1981	408	51,294	125,721
Oak Brook Hills Marriott Resort	Oak Brook, IL	1987	384	74,359	193,643
Westin Atlanta North at Perimeter	Atlanta, GA	1987	369	61,795	167,466
Vail Marriott Mountain Resort & Spa	Vail, CO	1983/2002	346	67,781	195,899
Marriott Atlanta Alpharetta	Atlanta, GA	2000	318	39,099	122,953
Courtyard Manhattan/Midtown East	New York, NY	1998	312	78,352	251,128
Conrad Chicago	Chicago, IL	2001	311	117,397	377,482
Bethesda Marriott Suites	Bethesda, MD	1990	272	46,949	172,607
SpringHill Suites Atlanta Buckhead	Atlanta, GA	2005	220	34,381	156,277
Courtyard Manhattan/Fifth Avenue	New York, NY	1990	185	43,986	237,762
The Lodge at Sonoma, a Renaissance Resort & Spa	Sonoma, CA	2001	182	32,890	180,714
Total/Weighted Average			**9,007**	**$ 1,691,266**	**$ 187,772**

(1) As of December 31, 2006.

Our Hotels

Bethesda Marriott Suites

Bethesda Marriott Suites is located in the Rock Spring Corporate Office Park near downtown Bethesda, Maryland, with convenient access to Washington, D.C. s Beltway (I-495) and the I-270 Technology Corridor. Rock Spring Corporate Office Park contains several million feet of office space and includes companies such as Marriott and Lockheed Martin Corp., as well as the National Institute of Health. The hotel contains 272 guestrooms, all of which are suites, and 5,000 square feet of total meeting space.

The hotel was built in 1990. We completed the refurbishment of guestrooms during 2006.

We hold a ground lease interest in the property. The current term of the ground lease will expire in 2087.

Chicago Marriott

The Chicago Marriott opened in 1978 and contains 1,192 rooms, 60,000 square-feet of meeting space, and three food and beverage outlets. The 46-story hotel sits amid the world-famous shops and restaurants on Michigan Avenue, in the heart of downtown Chicago.

We own a fee simple interest in the hotel.

Conrad Chicago

The Conrad Chicago opened in 2001 as a Le Meridien and contains 311 rooms, 33 of which are suites, and 13,000 square-feet of meeting space. The property is located on several floors within the 17-story

former McGraw-Hill Building, amid Chicago s Magnificent Mile. The Conrad Chicago rises above the Westfield North Bridge Shopping Centre and the Nordstrom department store on North Michigan Avenue. The property is approximately one half block away from our Chicago Marriott.

The Conrad Chicago changed management to Hilton in November 2005 and had its official Conrad launch in June 2006. Conrad Hotels has approximately 20 luxury properties worldwide, but currently just four are open in the United States. Conrad Hotels are to be Hilton s equivalent of Marriott s Ritz-Carlton brand or Starwood s St. Regis brand, and is expected to grow significantly both domestically and overseas now that Hilton and Hilton International have combined.

We own a fee simple interest in the hotel.

Courtyard Manhattan/Fifth Avenue

The Courtyard Manhattan/Fifth Avenue is located on 40th Street, just off of Fifth Avenue in Midtown Manhattan, across the street from the New York Public Library. The hotel is situated in a convenient tourist and business location. It is within walking distance from Times Square, Broadway theaters, Grand Central Station, Rockefeller Center and the Empire State Building. The hotel includes 185 guestrooms.

We completed significant capital improvements in 2005 and 2006 in connection with our re-branding, renovation and repositioning plan. The capital improvement plan included a complete soft goods renovation of the guestrooms, purchasing new furniture and bedding for the guestrooms, renovation of the bathrooms with granite vanity tops, installation of a new exercise facility, construction of a boardroom meeting space and modifications to make the hotel more accommodating to persons with disabilities.

We hold a ground lease interest in the hotel. The term of the ground lease expires in 2085, inclusive of one 49-year extension.

Courtyard Manhattan/Midtown East

The Courtyard Manhattan/Midtown East is located in Manhattan s East Side, on Third Avenue between 52nd and 53rd Streets. The hotel has 312 guestrooms and 1,500 square feet of meeting space.

Prior to 1998, the building was used as an office building, but then was completely renovated and opened in 1998 as a Courtyard by Marriott. We completed a complete guestroom and public space renovation during 2006.

We hold a fee simple interest in a commercial condominium unit, which includes a 47.725% undivided interest in the common elements in the 866 Third Avenue Condominium; the rest of the condominium is owned predominately (48.2%) by the building s other major occupant, Memorial Sloan-Kettering. The hotel occupies the lobby area on the 1st floor, all of the 12th-30th floors and its pro rata share of the condominium s common elements.

Frenchman s Reef & Morning Star Marriott Beach Resort

The Frenchman s Reef & Morning Star Marriott Beach Resort is a 17-acre resort hotel located in St. Thomas, U.S. Virgin Islands. The hotel is located on a cliff overlooking Charlotte Amalie Harbor and the Caribbean Sea. The hotel has 504 guestrooms, including 27 suites, and approximately 60,000 square feet of meeting space. The hotel caters primarily to tourists, but also attracts group business travelers.

The Frenchman s Reef section of the resort was built in 1973 and the Morning Star section of the resort was built in 1984. Following severe damage from a hurricane, the entire resort was substantially rebuilt in 1996 as part of a $60 million capital improvement.

We own a fee simple interest in the hotel.

Los Angeles Airport Marriott

The Los Angeles Airport Marriott was built in 1973 and has 1,004 guestrooms, including 19 suites, and approximately 55,000 square feet of meeting space. The hotel underwent a significant renovation in 2006. The hotel attracts both business and leisure travelers due to its convenient location minutes from Los Angeles International Airport (LAX), the fourth busiest airport in the world. The property attracts large groups due to its significant amount of meeting space, guestrooms and parking spaces.

We own a fee simple interest in the hotel.

Marriott Atlanta Alpharetta

The Marriott Atlanta Alpharetta is located in the city of Alpharetta, Georgia, approximately 22 miles north of Atlanta. Alpharetta is located in North Fulton County, a rapidly growing, very affluent county, which is characterized by being the national or regional headquarters of a number of large corporations, and it contains a large network of small and mid-sized companies supporting these corporations. The hotel is located in the Windward Office Park near several major corporations, including ADP, AT&T, McKesson, Siemens, Nortel and IBM. The hotel provides all of the amenities that are desired by business guests and is one of the few full-service hotels in a market predominately characterized by chain-affiliated select-service hotels.

The hotel opened in 2000. The hotel includes 318 guestrooms and 9,000 square feet of meeting space.

We own a fee simple interest in the hotel.

Marriott Griffin Gate Resort

Marriott Griffin Gate Resort is a 163-acre regional resort located north of downtown Lexington, Kentucky. The resort has 408 guestrooms, including 21 suites, as well as 13,000 square feet of meeting space. The resort contains three distinct components: the seven story main hotel and public areas, the Griffin Gate Golf Club, with a Rees Jones-designed 18-hole golf course, and The Mansion (which was originally constructed in 1854 and was Lexington s first AAA 4-Diamond restaurant). The hotel is near all the area s major corporate office parks and regional facilities of a number of major companies such as IBM, Toyota, Lexel Corporation and Lexmark International. The hotel also is located in proximity to downtown Lexington, the University of Kentucky, the historic Keeneland Horse Track and the Kentucky Horse Park.

The hotel originally opened in 1981. In 2003, the prior owner, Marriott International, initiated a major renovation and repositioning of the resort, with an approximate $10 million capital improvement plan. We completed the renovation plan in 2005. The renovation included a complete guestroom and guestroom corridor renovation, as well as a renovation of the exterior façade. We also significantly renovated the public space at the hotel.

We own a fee simple interest in the hotel, The Mansion, and most of the Griffin Gate Golf Club. However, there is a ground lease interest under approximately 54 acres of the golf course. The ground lease runs through 2033 (inclusive of four five-year renewal options), and contains a buyout right beginning at the end of the term in 2013 and at the end of each five-year renewal term thereafter. We are the sub-sublessee under another minor ground lease of land adjacent to the golf course, with a term expiring in 2020.

Oak Brook Hills Marriott Resort

In July 2005, we acquired the Oak Brook Hills Resort & Conference Center, replaced the existing manager with an affiliate of Marriott and re-branded the hotel as the Oak Brook Hills Marriott Resort.

The hotel underwent a significant renovation in 2006 and early 2007. The resort was built in 1987 and has 384 guestrooms, including 37 suites. The hotel markets itself to national and regional conferences by providing over 40,000 square feet of meeting space at a hotel with a championship golf course that is convenient to both O Hare and Chicago Midway airports and is near downtown Chicago. The resort is located in Oak Brook, Illinois.

The hotel is located on approximately 18 acres that we own in fee simple. The hotel is adjacent to an 18-hole, approximately 110-acre, championship golf course that we lease pursuant to a ground lease, which has approximately 40 years remaining, including renewal terms. Rent for the entire initial term of the ground lease has been paid in full.

Orlando Airport Marriott

The Orlando Airport Marriott was built in 1983 and has 486 guestrooms, including 14 suites, and approximately 26,000 square feet of meeting space. The hotel underwent a significant renovation in 2006. The hotel has a resort-like setting yet is well-located in a successful commercial office park five minutes from the Orlando International Airport. The hotel serves predominantly business transient guests as well as small and mid-size groups that enjoy the hotel s amenities as well as its proximity to the airport.

We own a fee simple interest in the hotel.

Renaissance Austin Hotel

The Renaissance Austin opened in 1986 and includes 492 rooms (14 of which were added in 2006), 60,000 square feet of meeting space, a restaurant, lounge and delicatessen. The hotel is situated in the heart of Austin s Arboretum area, near the major technology firms located in Austin, including Dell, Motorola, IBM, Samsung and National Instruments. In close proximity are office complexes, high-end shopping and upscale restaurants. The hotel is 12 miles from downtown Austin, home of the 6th Avenue Historic District, the State Capitol, and the University of Texas.

We own a fee simple interest in the hotel.

Renaissance Waverly Hotel

The Renaissance Waverly opened in 1983 and includes 521 rooms, 65,000 square feet of meeting space, and multiple food and beverage outlets. The Renaissance Waverly consists of a 13-story rectangular tower with an impressive atrium rising to the top floor. The Renaissance Waverly is connected to the Galleria shopping complex and the 320,000 square-foot Cobb Galleria Centre convention facility. The Galleria office complex is within Atlanta s 2nd largest office sub-market and in close proximity to Home Depot s world headquarters, as well as offices for IBM, Lockheed Martin and Coca-Cola. Within walking distance of the property are the Cumberland Mall, which is undergoing an $80 million renovation, and the new $145 million, 2,750-seat, Cobb Energy Performing Arts Center, which is scheduled to open in 2007.

We own a fee simple interest in the hotel.

Renaissance Worthington

The Renaissance Worthington is Fort Worth s only AAA Four Diamond hotel. It has 504 guestrooms, including 30 suites, and approximately 57,000 total square feet of meeting space. The hotel is located in downtown Fort Worth in Sundance Square, a sixteen-block retail area. It is also near Fort Worth s Convention Center, which hosts a wide range of events, including conventions, conferences, sporting events, concerts and trade and consumer shows.

The hotel was opened in 1981 and underwent $4 million in renovations in 2002 and 2003.

While the hotel does not currently face significant competition from its competitors, the City of Fort Worth has announced that it will heavily subsidize the construction of a new hotel to be managed by Omni to be built next to the convention center. We expect that hotel to become the Renaissance Worthington s primary competitor in the market. The Omni is scheduled to open in 2009.

We acquired a fee simple interest in the hotel. A portion of the land under the parking garage (consisting of 0.28 acres of the entire 3.46 acre site) is subject to three co-terminous ground leases. Each of the ground leases extends to July 31, 2022 and provides for three successive renewal options of 15 years each. The ground leases provide for adjustments to the fixed ground rent payments every ten years during the term.

Salt Lake City Marriott Downtown

The Salt Lake City Marriott Downtown has 510 guestrooms, including 6 suites, and approximately 22,300 square feet of meeting space. The hotel is located in downtown Salt Lake City across from the Salt Palace Convention Center near Temple Square. Demand for the hotel is generated primarily by the Convention Center, the Church of Jesus Christ of Latter-Day Saints, the University of Utah, government offices and nearby ski destinations. The hotel is connected to Crossroads Plaza Mall, which is currently completing a major reconstruction as part of a redevelopment that is expected to include the construction of up to 900 residential units.

The hotel was built in 1981 and, immediately prior to the 2002 Salt Lake Olympic games, the prior owner made significant capital improvements, including the replacement of soft goods in the guestrooms and a refurbishment of the lobby, ballroom and public space.

We hold ground lease interests in the hotel and the extension that connects the hotel to Crossroads Plaza Mall. The term of the ground lease for the hotel runs through 2056, inclusive of five ten-year renewal options. The term of the ground lease for the extension of the hotel (containing approximately 1,078 square feet) runs through 2017, inclusive of the one remaining ten-year renewal option.

SpringHill Suites Atlanta Buckhead

The SpringHill Suites Atlanta Buckhead is located in the heart of the Buckhead submarket of Atlanta, Georgia. Buckhead is one of the country s largest urban mixed-use development areas, combining major office, retail, hotel, restaurant/entertainment and high-rise residential development within its commercial core area.

The hotel is recently constructed and first opened for business in July 2005. We purchased the hotel upon opening from the developer of the hotel.

We own a fee simple interest in this 220-room all-suite hotel. The hotel also has 2,000 square feet of meeting space.

The Lodge at Sonoma, a Renaissance Resort & Spa

The Lodge at Sonoma, a Renaissance Resort & Spa, was built in 2000 and is located in the heart of the Sonoma Valley wine country, 45 miles from San Francisco, in the town of Sonoma, California. Numerous wineries are located within a short driving distance from the resort. The area is served by the Sacramento, Oakland and San Francisco airports. The resort is readily accessible by a variety of local, county, and state highways, including Highway 101. Leisure demand is generated by Sonoma Valley and Napa Valley wine country attractions. Group and business demand is primarily generated from companies located in San Francisco and the surrounding Bay Area, and some ancillary demand is generated from the local wine industry.

We own a fee simple interest in the hotel, which is comprised of the main two-story Lodge building, including 76 guestrooms and 18 separate cottage buildings, containing the remaining 102 guestrooms and 4 suites. The Raindance Spa is located in a separate two-story building at the rear of the cottages. The hotel also has 22,000 square feet of meeting and banquet space.

Torrance Marriott

The Torrance Marriott was built in 1985 and has 487 guestrooms, including 11 suites, and approximately 23,000 square feet of indoor and outdoor meeting space. The hotel underwent a significant renovation in 2006. The hotel is located in Los Angeles County in Torrance, California, a major automotive center. Three major Japanese automobile manufacturers, Honda, Nissan and Toyota, have their U.S. headquarters in the Torrance area and generate significant demand for the hotel. It is also adjacent to the Del Amo Fashion Center mall, one of the largest malls in America.

We own a fee simple interest in the hotel.

Westin Atlanta North at Perimeter

In May 2006, we acquired the Westin Atlanta North at Perimeter. The 20-story hotel opened in 1987 and contains 369 rooms and 20,000 square-feet of meeting space. The property is located within the Perimeter Center sub-market of Atlanta, Georgia. Comprising over 23 million square-feet of office space, Perimeter Center is one of the largest office markets in the southeast, representing substantial levels of corporate demand including: UPS, Hewlett Packard, Microsoft, Newell Rubbermaid and GE.

We own a fee simple interest in the hotel.

Westin Boston Waterfront Hotel

In January 2007, we acquired the Westin Boston Waterfront Hotel. The hotel opened in June 2006 and contains 793 rooms and 32,000 square feet of meeting space. The Boston Westin Hotel is attached to the recently built 1.6 million square foot Boston Convention and Exhibition Center, or BCEC, and is located in the Seaport District. The Westin Boston Waterfront Hotel includes a full service restaurant, a lobby lounge, a Starbucks licensed café, a 400-car underground parking facility, a fitness center, an indoor swimming pool, a business center, a gift shop and retail space.

The retail space is a separate three-floor, 100,000 square foot unfinished building attached to the Westin Boston Waterfront Hotel. When the retail space is leased to third-party tenants, we or the tenants will complete the necessary tenant improvements.

We also acquired a leasehold interest in a parcel of land with development rights to build a 320 to 350 room hotel. The expansion hotel, should we decide to build it, will be located on a 1 ½ acre parcel of developable land that is immediately adjacent to the Westin Boston Waterfront Hotel. We are still investigating the cost to construct and the potential returns associated with, an expansion hotel and have not concluded whether or not to pursue this portion of the project.

Vail Marriott Mountain Resort & Spa

The Vail Marriott Mountain Resort & Spa is located at the base of Vail Mountain in Vail, Colorado. The hotel has 346 guestrooms, including 61 suites, and approximately 21,000 square feet of meeting space.

The hotel is approximately 150 yards from the Eagle Bahn Express Gondola, which transports guests to the top of Vail Mountain, the largest single ski mountain in North America, with over 5,289 acres of skiable terrain. The hotel is located in Lions Head Village, the center of which is currently undergoing a massive renovation to create a new European-inspired plaza which will include luxury condominiums and a small 36 room hotel, as well as equipment rentals, ski storage, lockers, ski and snowboard school, shopping and an après ski restaurant and bar; dining and shopping opportunities; and a winter ice-skating plaza and entertainment venues. Vail Resorts is scheduling the renovation to be completed before the 2007-2008 season.

The hotel opened in 1983 and underwent a luxurious renovation of the public space, guest rooms and corridors in 2002. We completed the renovation of certain meeting space and pre-function space during 2006.

We own a fee simple interest in the hotel.

Our Hotel Management Agreements

We are a party to hotel management agreements with Marriott for seventeen of the twenty-one properties. The Vail Marriott Mountain Resort & Spa is managed by an affiliate of Vail Resorts and is under a long-term franchise agreement with Marriott; the Westin Atlanta North at Perimeter is managed by Noble Investment Group; the Conrad Chicago is managed by Conrad Hotels USA, Inc., a subsidiary of Hilton; and the Westin Boston Waterfront Hotel is managed by Starwood.

Each hotel manager is responsible for (i) the hiring of certain executive level employees, subject to certain veto rights, (ii) training and supervising the managers and employees required to operate the properties and (iii) purchasing supplies, for which we generally will reimburse the manager. The manager provides centralized reservation systems, national advertising, marketing and promotional services, as well as various accounting and data processing services. Each manager also prepares and implements annual operations budgets subject to our review and approval. Each of our management agreements limit our ability to sell, lease or otherwise transfer the hotels unless the transferee (i) is not a competitor of the manager, (ii) assumes the related management agreements and (iii) meets specified other conditions.

Term

The following table sets forth the agreement date, initial term and number of renewal terms under the respective hotel management agreements for each of our hotels. Generally, the term of the hotel management agreements generally renew automatically for a negotiated number of consecutive periods upon the expiration of the initial term unless the property manager gives notice to us of its election not to renew the hotel management agreement.

	Date of Agreement	Intitial Term	Number of Renewal Terms
Austin Renaissance Hotel	6/2005	20 years	Three ten-year periods
Atlanta Alpharetta Marriott	9/2000	30 years	Two ten-year periods
Atlanta Westin North at Perimeter	5/2006	10 years	Two five-year periods
Bethesda Marriott Suites	12/2004	21 years	Two ten-year periods
Boston Westin Waterfront	5/2004	20 years	Four ten-year periods
Chicago Marriott Downtown	3/2006	32 years	Two ten-year periods
Conrad Chicago	11/2005	10 years	Two five-year periods
Courtyard Manhattan/Fifth Avenue	01/2005	30 years	None
Courtyard Manhattan/Midtown East	11/2004	30 years	Two ten-year periods
Frenchman s Reef & Morning Star Marriott Beach Resort	9/2000	30 years	Two ten-year periods
Los Angeles Airport Marriott	9/2000	30 years	Two ten-year periods
Marriott Griffin Gate Resort	12/2004	20 years	One ten-year period
Oak Brook Hills Marriott Resort	7/2005	30 years	None
Orlando Airport Marriott	11/2005	30 years	None
Renaissance Worthington	9/2000	30 years	Two ten-year periods
Salt Lake City Marriott Downtown	12/2001	30 years	Three fifteen-year periods
SpringHill Suites Atlanta Buckhead	7/2005	30 years	Two ten-year periods
The Lodge at Sonoma, a Renaissance Resort & Spa	10/2004	20 years	One ten-year period
Torrance Marriott	1/2005	40 years	None
Waverly Renaissance Hotel	6/2005	20 years	Three ten-year periods
Vail Marriott Mountain Resort & Spa	6/2005	15 ½ years	None

Amounts Payable under our Hotel Management Agreements

Under our current hotel management agreements, the property manager receives a base management fee and, if certain financial thresholds are met or exceeded, an incentive management fee. The base management fee is generally payable as a percentage of gross hotel revenues for each fiscal year. The incentive management fee is generally based on hotel operating profits and is typically equal to between 20% and 25% of hotel operating profits, but the fee only applies to that portion of hotel operating profits above a negotiated return on our invested capital. We refer to this excess of operating profits over a return on our invested capital as available cash flow.

The following table sets forth the base management fee and incentive management fee, generally due and payable each fiscal year, for each of our properties:

	Base Management Fee(1)		Incentive Management Fee(2)
Austin Renaissance Hotel	3%		20%(3)
Atlanta Alpharetta Marriott	3%		25%(4)
Atlanta North at Perimeter Westin	3%	(5)	10%(6)
Bethesda Marriott Suites	3%		50%(7)
Boston Westin Waterfront	2.5%		20%(8)
Chicago Marriott Downtown	3%		20%(9)
Conrad Chicago	2%	(10)	15%(11)
Courtyard Manhattan/Fifth Avenue	5%	(12)	25%(13)
Courtyard Manhattan/Midtown East	5%		25%(14)
Frenchman s Reef & Morning Star Marriott Beach Resort	3%		25%(15)
Los Angeles Airport Marriott	3%		25%(16)
Marriott Griffin Gate Resort	3%		20%(17)
Oak Brook Hills Marriott Resort	3%		20% or 30%(18)
Orlando Airport Marriott	3%		20% or 25%(19)
Renaissance Worthington	3%		25%(20)
Salt Lake City Marriott Downtown	3%		Not more than 20%(21)
SpringHill Suites Atlanta Buckhead	5%	(22)	25%(23)
The Lodge at Sonoma, a Renaissance Resort & Spa	3%		20%(24)
Torrance Marriott	3%		20%(25)
Waverly Renaissance Hotel	3%		20%(26)
Vail Marriott Mountain Resort & Spa	3%		20%(27)

(1) As a percentage of gross revenues.

(2) Based on a percentage of hotel operating profits above a negotiated return on our investment capital as more fully described in the following footnotes.

(3) Calculated as a percentage of operating profits in excess of the sum of (i) $6.0 million and (ii) 10.75% of certain capital expenditures.

(4) Calculated as a percentage of operating profits in excess of the sum of (i) $4.1 million and (ii) 10.75% of certain capital expenditures.

(5) The base management fee will be equal to 3% of gross revenues for fiscal years 2006 through 2008, with up to 1% of gross revenues forfeited from 2006 to 2008 if DiamondRock does not achieve an 8.5% unlevered yield in 2006, 9.5% unlevered yield in 2007, or 10.75% unlevered yield in 2008.

(6) Calculated as a percentage of operating profits in excess of 10.75% of certain capital expenditures.

(7) Calculated as a percentage of operating profits in excess of the sum of (i) the payment of certain loan procurement costs, (ii) 10.75% of certain capital expenditures, (iii) an agreed-upon return on certain expenditures and (iv) the value of certain amounts paid into a reserve account established for the replacement, renewal and addition of certain hotel goods. The owners priority expires in 2023.

(8) Calculated as a percentage of operating profits in excess of the sum of (i) actual debt service and (ii) 15% of cumulative and compounding return on equity, which results with each sale.

(9) Calculated as 20% of net operating income before base management fees. There is no owner s priority.

(10) The base management fee will be equal to 2.5% of gross revenues for fiscal years 2008 and 2009 and 3% for fiscal years thereafter.

(11) Calculated as a percentage of operating profits after a pre-set dollar amount of owner s priority. Beginning in fiscal year 2011, the incentive management fee will be 103% of the prior year cash flow.

(12) The base management fee will be equal to 5.5% of gross revenues for fiscal years 2010 through 2014 and 6% for fiscal year 2015 and thereafter until the expiration of the agreement. Also, beginning in 2007, the base management fee may increase to 5.5% at the beginning of the next fiscal year if operating profits equal or exceed $4.7 million, and beginning in 2011, the base management fee may increase to 6.0% at the beginning of the next fiscal year if operating profits equal or exceed $5.0 million.

(13) Calculated as a percentage of operating profits in excess of 12% of the sum of (i) $38.8 million and (ii) the amount of certain capital expenditures, less 5% of the total real estate tax bill (for as long as the hotel is leased to a party other than the manager).

(14) Calculated as a percentage of operating profits in excess of 10.75% of the sum of (i) $73.7 million and (ii) the amount of certain capital expenditures.

(15) Calculated as a percentage of operating profits in excess of the sum of (i) $8.4 million and (ii) 10.75% of certain capital expenditures.

(16) Calculated as a percentage of operating profits in excess of the sum of (i) $9.4 million and (ii) 10.75% of certain capital expenditures.

(17) Calculated as a percentage of operating profits in excess of the sum of (i) $5.5 million and (ii) 10.75% of certain capital expenditures.

(18) Calculated as a percentage of operating profits in excess of the sum of (i) $8.1 million and (ii) 10.75% of certain capital expenditures. The percentage of operating profits is 20% except from 2011 through 2025 when it is 30%.

(19) Calculated as a percentage of operating profits in excess of 10.75% of our acquisition costs plus certain capital expenditures. We estimate that the threshold will be approximately $9 million. The percentage of operating profits is 20% except from 2011 through 2025 when it is 25%.

(20) Calculated as a percentage of operating profits in excess of the sum of (i) $7.6 million and (ii) 10.75% of certain capital expenditures.

(21) The incentive management fee is equal to the available cash flow for each fiscal year, subject to a cap of 20% of operating profit for such fiscal year. Commencing with the fiscal year 2002, the operating profit with respect to each fiscal year is reduced by an amount equal to 10.75% of all material capital expenditures funded by the TRS lessee; provided that the material capital expenditures are included in the calculation of the incentive management fee with respect to the fiscal year or fiscal years during which such expenditures occurred (on a pro rata basis).

(22) The base management fee will be equal to 6% of gross revenues for fiscal years 2008 through 2016 and 6.5% of gross revenues thereafter. In the event that the property s operating profit is below certain thresholds in 2006 and 2007, the base management fee may be reduced by up to $100,000 per year. In addition, in the event that the hotel s operating profit is above certain thresholds starting in 2008, the base management fee will be increased to 6.5% and if the hotel s operating profit is above an additional threshold starting in 2012, the base management fee will be increased to 7.0%

(23) Calculated as a percentage of operating profits in excess of the sum of (i) $4.1 million and (ii) 12% of certain capital expenditures and pre-conversion expenses.

(24) Calculated as a percentage of operating profits in excess of the sum of (i) $3.6 million and (ii) 10.75% of capital expenditures.

(25) Calculated as a percentage of operating profits in excess of the sum of (i) $7.5 million and (ii) 10.75% of certain capital expenditures.

(26) Calculated as a percentage of operating profits in excess of the sum of (i) $10.3 million and (ii) 10.75% of certain capital expenditures.

(27) Calculated as a percentage of operating profits in excess of 11% of our invested capital. The incentive management fee rises to 25% if the hotel achieves operating profits in excess of 15% of our invested capital.

We recorded $19.7 million and $7.9 million of management fees to Marriott during the year ended December 31, 2006 and December 31, 2005, respectively. The management fees for the year ended December 31, 2006 consisted of $8.4 million of incentive management fees and $11.3 million of base management fees. The management fees for the year ended December 31, 2005 consisted of $0.6 million of incentive management fees and $7.3 million of base management fees.

Our Ground Lease Agreements

Four of our hotels are subject to ground lease agreements that cover all of the land underlying the respective hotel:

- The Bethesda Marriott Suites hotel is subject to a ground lease that runs until 2087. There are no renewal options.

- The Courtyard Manhattan/Fifth Avenue is subject to a ground lease that runs until 2085, inclusive of one 49-year renewal option.

- The Salt Lake City Marriott Downtown is subject to two ground leases: one ground lease covers the land under the hotel and the other ground lease covers the portion of the hotel that extends into the Crossroads Plaza Mall. The term of the ground lease covering the land under the hotel runs through 2056, inclusive of our renewal options, and the term of the ground lease covering the extension runs through 2017, inclusive of the remaining ten-year renewal option.

- The Westin Boston Waterfront is subject to a ground lease that runs until 2099. There are no renewal options.

In addition, part of one of the parking garages adjacent to one of our hotels is subject to a ground lease agreement:

- A portion of the parking garage relating to the Renaissance Worthington is subject to three ground leases that cover, contiguously with each other, approximately one-fourth of the land on which the parking garage is constructed. Each of the ground leases has a term that runs through July 2067, inclusive of the three 15-year renewal options.

Finally, two of the golf courses adjacent to two of our hotels are subject to ground lease agreements:

- The golf course that is part of the Marriott Griffin Gate Resort is subject to a ground lease covering approximately 54 acres. The ground lease runs through 2033, inclusive of our renewal options. We have the right, beginning in 2013 and upon the expiration of any 5-year renewal term, to purchase the property covered by such ground lease for an amount ranging from $27,500 to $37,500 per acre, depending on which renewal term has expired. The ground lease also grants us the right to purchase the leased property upon a third party offer to purchase such property on the same terms and conditions as the third party offer. We are also the sub-sublessee under another minor ground lease of land adjacent to the golf course, with a term expiring in 2020.

- The golf course that is part of the Oak Brook Hills Marriott Resort is subject to a ground lease covering approximately 110 acres. The ground lease runs through 2045 including renewal options.

These ground leases generally require us to make rental payments (including a percentage of gross receipts as percentage rent with respect to the Courtyard Manhattan/Fifth Avenue ground lease) and payments for all, or in the case of the ground leases covering the Salt Lake City Marriott Downtown extension and a portion of the Marriott Griffin Gate Resort golf course, our tenant s share of, charges, costs, expenses, assessments and liabilities, including real property taxes and utilities. Furthermore, these ground leases generally require us to obtain and maintain insurance covering the subject property.

The following table reflects the annual base rents of our ground leases:

Property	Term(1)	Annual Rent
Ground leases under hotels		
Bethesda Marriott Suites	Through 10/87	$411,466(2)
Courtyard Manhattan/Fifth Avenue(3)(4)	10/97 9/07	800,000
	10/07 9/17	906,000
	10/17 9/27	1,132,812
	10/27 9/37	1,416,015
	10/37 9/47	1,770,019
	10/47 9/57	2,212,524
	10/57 9/67	2,765,655
	10/67 9/77	3,457,069
	10/77 9/85	4,321,336
Salt Lake City Marriott Downtown		
(Ground Lease for Hotel)	Through 12/56	Greater of $132,000 or 2.6%
		of annual gross room sales
(Ground Lease for Extension)	Through 12/07	$9,343
	1/08 12/12	10,277
	1/13 12/17	11,305
Westin Boston Waterfront Hotel (6) (Base Rent)	Through 6/11	$0
	7/11 6/15	500,000
	7/15 6/20	750,000
	7/20 6/25	1,000,000
	7/25 6/30	1,500,000
	7/30 6/35	1,750,000
	7/35 6/99	No base rent
Westin Boston Waterfront Hotel (Percentage Rent)	Through 6/16	0% of annual gross revenue
	7/16 6/26	1.0% of annual gross revenue
	7/26 6/36	1.5% of annual gross revenue
	7/36 6/46	2.75% of annual gross revenue
	7/46 6/56	3.0% of annual gross revenue
	7/56 6/66	3.25% of annual gross revenue
	7/66 6/99	3.5% of annual gross revenue
Ground leases under parking garage		
Renaissance Worthington	Through 7/12	$36,613
	8/12 7/22	40,400
	8/22 7/37	46,081
	8/37 7/52	51,764
	8/52 7/67	57,444
Ground leases under golf course		
Marriott Griffin Gate Resort	9/03 8/08	$90,750
	9/08 8/13	99,825
	9/13-8/18	109,800
	9/18-8/23	120,750
	9/23-8/28	132,750
	9/28-8/33	147,000
Oak Brook Hills Marriott Resort	10/85-9/25	1(5)

(1) These terms assume our exercise of all renewal options.

(2) Represents rent for the year ended December 31, 2006. Rent will increase annually by 5.5%.

(3) The ground lease term is 49 years. We have the right to renew the ground lease for an additional 49 year term on the same terms then applicable to the ground lease.

(4) The total annual rent includes the fixed rent noted in the table plus a percentage rent equal to 5% of gross receipts for each lease year, but only to the extent that 5% of gross receipts exceeds the minimum fixed rent in such lease year.

(5) We have the right to extend the term of this lease for two consecutive renewal terms of ten years each with rent at then market value.

(6) Total annual rent under the ground lease is capped at 2.5% of hotel gross revenues during the initial 30 years of the ground lease.

Subject to certain limitations, an assignment of the ground leases covering the Courtyard Manhattan/Fifth Avenue, a portion of the Marriott Griffin Gate Resort golf course and the Oak Brook Hills Marriott Resort golf course do not require the consent of the ground lessor. With respect to the ground leases covering the Salt Lake City Marriott Downtown hotel and extension, Bethesda Marriott Suites and Westin Boston Waterfront, any proposed assignment of our leasehold interest as ground lessee under the ground lease requires the consent of the applicable ground lessor. As a result, we may not be able to sell, assign, transfer or convey our ground lessee s interest in any such property in the future absent the consent of the ground lessor, even if such transaction may be in the best interests of our stockholders.

Mortgage Debt

As of December 31, 2006, we had approximately $841.2 million of outstanding mortgage debt. The following table sets forth our mortgage debt obligations on our hotels.

Property	Principal Balance (in thousands)	Interest Rate	Maturity Date	Amortization Provisions
Bethesda Marriott Suites	$ 18,742	7.69%	2/23	25 years
Frenchman s Reef & Morning Star Marriott Beach Resort	62,500	5.44%	8/15	30 years(1)
Marriott Griffin Gate Resort	29,806	5.11%	1/10	25 years
Los Angeles Airport Marriott	82,600	5.30%	7/15	Interest Only
Courtyard Manhattan/Fifth Avenue	51,000	6.48%	6/16	Interest Only
Courtyard Manhattan/Midtown East	43,215	5.195%	12/09	25 years
Orlando Airport Marriott	59,000	5.68%	12/15	30 years (2)
Salt Lake City Marriott Downtown	36,888	5.50%	1/15	20 years(3)
Renaissance Worthington	57,400	5.40%	7/15	30 years(4)
Chicago Marriott	220,000	5.975%	4/16	30 years(5)
Austin Renaissance Hotel	83,000	5.507%	12/16	Interest Only
Waverly Renaissance Hotel	97,000	5.503%	12/16	Interest Only
Total	$ 841,151			

(1) The debt has a three-year interest only period that commenced in July 2005. After the expiration of that period, the debt will amortize based on a thirty-year schedule.

(2) The debt has a five-year interest only period that commenced in December 2005. After the expiration of that period, the debt will amortize based on a thirty-year schedule.

(3) There is an accelerated amortization provision based on a predetermined formula of available cash flow.

(4) The debt has a four-year interest only period that commenced in June 2005. After the expiration of that period, the debt will amortize based on a thirty-year schedule.

(5) The debt has a 3.5 year interest only period that commenced in April 2006. After the expiration of that period, the debt will amortize based on a thirty-year schedule.

Item 3. Legal Proceedings

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our stockholders during the fourth quarter of the fiscal year ended December 31, 2006.

PART II

Item 5. Market for our common stock and related stockholder matters

Market Information

Our common stock trades on the New York Stock Exchange, or NYSE, under the symbol DRH . The following table sets forth, for the indicated period, the high and low closing prices for the common stock, as reported on the NYSE:

	Price Range High	Low
Year Ended December 31, 2005		
First Quarter(1)	N/A	N/A
Second Quarter(1)	$ 11.73	$ 10.50
Third Quarter	$ 12.62	$ 11.14
Fourth Quarter	$ 12.00	$ 10.84
Year Ended December 31, 2006		
First Quarter	$ 13.52	$ 11.63
Second Quarter	$ 15.66	$ 12.95
Third Quarter	$ 16.85	$ 13.90
Fourth Quarter	$ 18.13	$ 16.16
Year Ended December 31, 2007		
First Quarter (as of February 28, 2007)	$ 19.28	$ 18.00

(1) Our common stock commenced trading on the NYSE on May 26, 2005.

The closing price of our common stock on the NYSE on February 28, 2007 was $18.09 per share.

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

- 90% of our REIT taxable income determined without regard to the dividends paid deduction, plus;
- 90% of the excess of our net income from foreclosure property over the tax imposed on such income by the U.S. Internal Revenue Code of 1986, as amended (the Code), minus;
- Any excess non-cash income.

The following graph provides a comparison of cumulative total stockholder return for the period from May 25, 2005 (the date of our initial public offering) through December 31, 2006, among DiamondRock Hospitality Company, the Standard & Poor s 500 Index (the ***S&P 500 Total Return***) and Morgan Stanley REIT Index (the ***RMZ Total Return***).

The total return values were calculated assuming a $100 investment on May 25, 2005 with reinvestment of all dividends in (i) our common stock, (ii) the S&P 500 Total Return, and (iii) the RMZ Total Return. The total return values do not include any dividends declared, but not paid, during the period.

	May 25, 2005	December 31, 2005	December 31, 2006
DiamondRock Hospitality Company Total Return	$ 100.00	117.58	$ 185.72
RMZ Total Return	$ 100.00	111.73	$ 151.85
S&P 500 Total Return	$ 100.00	106.07	$ 122.82

During the first fiscal quarter of 2006, the Company s board of directors declared a cash dividend of $0.18 per share of our common stock. The dividend was paid on April 11, 2006, to all stockholders of record as of March 24, 2006. During the second fiscal quarter of 2006, our board of directors declared a cash dividend of $0.18 per share of our common stock. The dividend was paid on June 22, 2006 to stockholders of record as of June 16, 2006. During the third fiscal quarter of 2006, our board of directors declared a cash dividend of $0.18 per share of our common stock. The dividend was paid on September 19, 2006 to stockholders of record as of September 8, 2006. During the fourth fiscal quarter of 2006, our board of directors declared a cash divided of $0.18 per share of our common stock. The dividend was paid on January 4, 2007 to stockholders on record as of December 21, 2006.

As of February 28, 2007, there were 18 record holders of our common stock. In order to comply with certain requirements related to our qualification as a REIT, our charter, subject to certain exceptions, limits the number of common shares that may be owned by any single person or affiliated group to 9.8% of the outstanding common shares.

Distribution Information

In order to maintain our qualification as a REIT, we must make annual distributions to our stockholders of at least 90% of our taxable income (excluding net capital gains). For federal income tax purposes, distributions that we make may consist of ordinary income, capital gains, nontaxable return of capital or a combination of those items. Distributions that exceed our current and accumulated earnings and profits (calculated for tax purposes) constitute a return of capital rather than a dividend, which reduces a stockholder s basis in the shares of common stock and will not be taxable to the extent that the distribution equals or is less than the stockholder s basis in the stock. To the extent that a distribution exceeds both current and accumulated earnings and profits and the stockholder s basis in the stock, that distribution will be treated as a gain from the sale or exchange of that stockholder s shares. Every year, we notify stockholders of the taxable composition of distributions paid during the preceding year. The Company made distributions per common share for the 2006 tax year of $0.684521, of which 82.438% ($0.564303 per common share) is taxable as ordinary income and 17.562% ($0.120218 per common share) is taxable as qualified dividends. The Company made distributions per common share for the 2005 tax year of $0.295723, of which 84.976% ($0.251293 per common share) was taxable as ordinary income and 15.024% ($0.044430 per common share) was taxable as qualified dividends.

Equity compensation plan information. The following table sets forth information regarding securities authorized for issuance under our equity compensation plan, the 2004 Stock Option and Incentive Plan, as of December 31, 2006. Under our 2004 Stock Option and Incentive Plan, we have only issued shares of restricted stock and deferred stock units. We have not issued any options to purchase shares of the Company s common stock and do not intend to issue any such options in 2007. See Note 5 to the accompanying consolidated financial statements for a complete description of the 2004 Stock Option and Incentive Plan.

Equity Compensation Plan Information

Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted-average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)**
Equity compensation plans approved by security holders	1,206,763	N/A	793,237
Equity compensation plans not approved by security holders		N/A	
Total	1,206,763	N/A	793,237

Item 6. Selected Financial Data

The selected historical financial information as of and for the years ended December 31, 2006 and 2005 and as of December 31, 2004 and the period from May 6, 2004 to December 31, 2004, has been derived from our audited historical financial statements. The selected historical financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, the consolidated financial statements as of and for the years ended December 31, 2006 and 2005 and as of December 31, 2004 and the period from May 6, 2004 to December 31, 2004, and the related notes contained elsewhere in this Form 10-K.

We present the following two non-GAAP financial measures that we believe are useful to investors as key measures of our operating performance: (1) EBITDA; and (2) FFO. We caution investors that amounts presented in accordance with our definitions of EBITDA and FFO may not be comparable to similar measures disclosed by other companies, since not all companies calculate these non-GAAP measures in the same manner. EBITDA and FFO should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. EBITDA and FFO may include funds that may not be available for our discretionary use due to functional requirements to conserve funds for capital expenditures and property acquisitions and other commitments and uncertainties. Although we believe that EBITDA and FFO can enhance your understanding of our results of operations, these non-GAAP financial measures, when viewed individually, are not necessarily better indicators of any trend as compared to GAAP measures such as net income (loss) or cash flow from operations. In addition, you should be aware that adverse economic and market conditions may harm our cash flow. Under this section, as required, we include a quantitative reconciliation of EBITDA and FFO to the most directly comparable GAAP financial performance measure, which is net income (loss).

	Historical (in thousands, except per share data)		
	Year Ended December 31, 2006	Year Ended December 31, 2005	Period from May 6, 2004 to December 31, 2004
Statement of operations data:			
Revenues:			
Rooms	$ 322,198	$ 151,756	$ 5,137
Food and beverage	143,493	63,261	1,508
Other	26,199	14,433	429
Total Revenues	491,890	229,450	7,074
Operating costs and expenses:			
Rooms	74,521	37,433	1,455
Food and beverage	96,145	47,281	1,267
Other hotel expenses and management fees	185,588	96,555	3,445
Corporate expenses	12,403	13,462	4,114
Depreciation and amortization	52,362	27,590	1,053
Total operating expenses	421,019	222,321	11,334
Operating income (loss)	70,871	7,129	(4,260)
Interest income	(4,657)	(1,549)	(1,333)
Interest expense	36,934	17,367	773
Income (loss) before income taxes	38,594	(8,689)	(3,700)
Income tax (expense) benefit	(3,383)	1,353	1,582
Net income (loss)	$ 35,211	$ (7,336)	$ (2,118)
Income (loss) per share basic	$ 0.51	$ (0.19)	$ (0.12)
Income (loss) per share diluted	$ 0.51	$ (0.19)	$ (0.12)
Cash dividends declared per common share	$ 0.72	$ 0.38	$
FFO(1)	$ 87,573	$ 20,254	$ (1,065)
EBITDA(2)	$ 127,890	$ 36,268	$ (1,874)

	As of December 31, 2006	As of December 31, 2005	As of December 31, 2004
Balance sheet data (in thousands):			
Property and equipment, net	$ 1,686,426	$ 870,562	$ 285,642
Cash and cash equivalents	19,691	9,432	76,983
Total assets	1,818,965	966,011	391,691
Total debt	843,771	431,177	180,772
Total other liabilities	190,266		