

MHI Hospitality CORP
Form 10-Q
May 14, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from to to .

Commission file number 001-32379

MHI HOSPITALITY CORPORATION

(Exact name of registrant as specified in its charter)

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MARYLAND
(State or Other Jurisdiction of

20-1531029
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

410 W. Francis Street, Williamsburg, Virginia 23185

Telephone Number (757) 229-5648

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

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

As of May 14, 2010, there were 9,520,286 shares of the registrant's common stock issued and outstanding.

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Table of Contents**PART I****Item 1. Financial Statements****MHI HOSPITALITY CORPORATION****CONSOLIDATED BALANCE SHEETS**

	March 31, 2010 (unaudited)	December 31, 2009
ASSETS		
<i>Investment in hotel properties, net</i>	\$ 186,953,017	\$ 188,587,507
<i>Investment in joint venture</i>	9,906,228	9,685,844
<i>Cash and cash equivalents</i>	2,390,952	3,490,487
<i>Restricted cash</i>	993,333	701,730
<i>Accounts receivable</i>	2,396,167	1,625,161
<i>Accounts receivable-affiliate</i>	57,054	32,444
<i>Prepaid expenses, inventory and other assets</i>	2,214,297	2,046,082
<i>Notes receivable, net</i>	100,000	100,000
<i>Shell Island lease purchase, net</i>	1,351,103	1,441,176
<i>Deferred income taxes</i>	5,153,436	4,920,973
<i>Deferred financing costs, net</i>	1,131,757	1,328,351
TOTAL ASSETS	\$ 212,647,344	\$ 213,959,755
LIABILITIES		
<i>Line of credit</i>	\$ 75,197,858	\$ 75,522,858
<i>Mortgage loans</i>	72,637,273	72,738,250
<i>Loans payable</i>	4,587,588	4,613,163
<i>Accounts payable and other accrued liabilities</i>	6,473,013	6,696,605
<i>Advance deposits</i>	884,225	547,653
TOTAL LIABILITIES	159,779,957	160,118,529
<i>Commitments and contingencies (see Note 6)</i>		
EQUITY		
<i>MHI Hospitality Corporation stockholders' equity</i>		
<i>Preferred stock, par value \$0.01, 1,000,000 shares authorized, 0 shares issued and outstanding</i>		
<i>Common stock, par value \$0.01, 49,000,000 shares authorized, 9,520,286 shares and 9,096,943 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively</i>	95,203	90,969
<i>Additional paid in capital</i>	55,548,755	52,543,562
<i>Distributions in excess of retained earnings</i>	(15,234,081)	(14,454,238)
<i>Total MHI Hospitality Corporation stockholders' equity</i>	40,409,877	38,180,293
<i>Noncontrolling interest</i>	12,457,510	15,660,933
TOTAL EQUITY	52,867,387	53,841,226
TOTAL LIABILITIES AND EQUITY	\$ 212,647,344	\$ 213,959,755

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

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MHI HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three months ended March 31, 2010	Three months ended March 31, 2009
REVENUE		
<i>Rooms department</i>	\$ 12,094,398	\$ 10,449,089
<i>Food and beverage department</i>	4,307,791	3,906,818
<i>Other operating departments</i>	1,113,401	1,143,282
Total revenue	17,515,590	15,409,189
EXPENSES		
<i>Hotel operating expenses</i>		
<i>Rooms department</i>	3,593,380	3,067,173
<i>Food and beverage department</i>	3,020,367	2,719,389
<i>Other operating departments</i>	172,932	178,885
<i>Indirect</i>	7,176,968	6,932,074
Total hotel operating expenses	13,963,647	12,897,521
<i>Depreciation and amortization</i>	2,131,484	1,910,598
<i>Corporate general and administrative</i>	1,057,604	899,297
Total operating expenses	17,152,735	15,707,416
NET OPERATING INCOME (LOSS)	362,855	(208,227)
<i>Other income (expense)</i>		
<i>Interest expense</i>	(2,310,950)	(2,000,858)
<i>Interest income</i>	5,661	13,486
<i>Equity in joint venture</i>	271,534	111,117
<i>Unrealized gain (loss) on hedging activities</i>	383,945	236,584
Loss, before tax	(1,286,955)	(1,847,898)
<i>Income tax benefit</i>	192,920	896,278
Net loss	(1,094,035)	(951,620)
<i>Add: Net loss attributable to the noncontrolling interest</i>	314,192	332,549
Net loss attributable to the Company	\$ (779,843)	\$ (619,071)
Net loss per share attributable to the Company		
<i>Basic</i>	\$ (0.08)	\$ (0.09)
<i>Diluted</i>	\$ (0.08)	\$ (0.09)
<i>Weighted average number of shares outstanding</i>		
<i>Basic</i>	9,175,652	6,957,915
<i>Diluted</i>	9,191,652	6,983,915

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

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MHI HOSPITALITY CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(unaudited)

	Common Stock		Additional Paid- In Capital	Distributions in Excess of Retained Earnings	Noncontrolling Interest	Total
	Shares	Par Value				
<i>Balances at December 31, 2009</i>	9,096,943	\$ 90,969	\$ 52,543,562	\$ (14,454,238)	\$ 15,660,933	\$ 53,841,226
<i>Issuance of restricted common stock awards</i>	55,175	552	91,144			91,696
<i>Amortization of deferred stock grants</i>			28,500			28,500
<i>Conversion of units in operating partnership to common stock</i>	368,168	3,682	2,885,549		(2,889,231)	
<i>Net loss</i>				(779,843)	(314,192)	(1,094,035)
<i>Balances at March 31, 2010</i>	9,520,286	\$ 95,203	\$ 55,548,755	\$ (15,234,081)	\$ 12,457,510	\$ 52,867,387

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

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MHI HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three months Ended March 31, 2010	Three months ended March 31, 2009
Cash flows from operating activities:		
Net loss	\$ (1,094,035)	\$ (951,620)
<i>Adjustments to reconcile net loss to net cash used in operating activities:</i>		
Depreciation and amortization	2,131,484	1,910,598
Equity in joint venture	(271,534)	(111,117)
Unrealized gain on hedging activities	(383,945)	(236,584)
Amortization of deferred financing costs	196,594	116,112
Charges related to equity-based compensation	120,196	49,010
<i>Changes in assets and liabilities:</i>		
Restricted cash	(112,139)	180,644
Accounts receivable	(771,007)	(1,692,753)
Inventory, prepaid expenses and other assets	(189,345)	(583,961)
Deferred income taxes	(232,463)	(918,871)
Accounts payable and other accrued liabilities	160,353	(390,413)
Advance deposits	336,571	262,385
Due from affiliates	(24,610)	35,001
Net cash used in operating activities	(133,880)	(2,331,568)
Cash flows from investing activities:		
Improvements and additions to hotel properties	(385,789)	(5,783,959)
Distributions from joint venture	51,150	80,040
Funding of restricted cash reserves	(260,576)	(240,618)
Proceeds of restricted cash reserves	81,112	1,826,200
Net cash used in investing activities	(514,103)	(4,118,337)
Cash flows from financing activities:		
Dividends and distributions paid		(107,019)
Proceeds of mortgage refinancing		743,832
Proceeds of credit facility		5,600,000
Payments on credit facility	(325,000)	
Payment of deferred financing costs		(665,464)
Proceeds of loans		4,750,000
Payment of mortgages and loans	(126,552)	(17,597)
Net cash provided by (used in) financing activities	(451,552)	10,303,752
Net increase (decrease) in cash and cash equivalents	(1,099,535)	3,853,847
Cash and cash equivalents at the beginning of the period	3,490,487	1,719,147
Cash and cash equivalents at the end of the period	\$ 2,390,952	\$ 5,572,994
Supplemental disclosures:		
Cash paid during the period for interest	\$ 2,296,893	\$ 2,110,922
Cash paid during the period for income taxes	\$ 23,296	\$ 6,346

The accompanying notes are an integral part of these financial statements

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS

(unaudited)

1. Organization and Description of Business

MHI Hospitality Corporation (the Company) is a self-advised real estate investment trust (REIT) that was incorporated in Maryland on August 20, 2004 to own full-service upper-upscale, upscale and mid-scale hotels located in primary and secondary markets in the mid-Atlantic, Midwest and Southeastern regions of the United States. The hotels operate under well-known national hotel brands such as Hilton, Crowne Plaza, Sheraton and Holiday Inn.

The Company commenced operations on December 21, 2004 when it completed its initial public offering (IPO) and thereafter consummated the acquisition of six hotel properties (initial properties). Substantially all of the Company's assets are held by, and all of its operations are conducted through, MHI Hospitality, L.P. (the Operating Partnership or the Partnership). The Company also owns a 25.0% non-controlling interest in the Crowne Plaza Hollywood Beach Resort through a joint venture with CRP/MHI Holdings, LLC, an affiliate of both Carlyle Realty Partners V, L.P. and The Carlyle Group (Carlyle).

For the Company to qualify as a REIT, it cannot operate hotels. Therefore, the Operating Partnership, which, at March 31, 2010, was approximately 73.9% owned by the Company, leases its hotels to a subsidiary of MHI Hospitality TRS Holding Inc., MHI Hospitality TRS, LLC, (collectively, MHI TRS), a wholly-owned subsidiary of the Operating Partnership. MHI TRS then engages a hotel management company, MHI Hotels Services, LLC (MHI Hotels Services) to operate the hotels under a management contract. MHI TRS is treated as a taxable REIT subsidiary for federal income tax purposes.

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

On February 9, 2009, the indirect subsidiary of the Company, which is a member of the joint venture entity that owns the Crowne Plaza Hollywood Beach Resort, borrowed \$4.75 million from the Carlyle entity that is the other member of such joint venture (the Carlyle Affiliate Lender), for the purpose of improving the Company's liquidity. The interest rate and maturity date of the loan are tied to a note that is secured by a mortgage on the property. In June 2008, the joint venture that owns the property purchased a junior participation in a portion of the mortgage loan from the lender. The amount of the loan from the Carlyle Affiliate Lender approximates the amount the Company contributed to the joint venture to enable the joint venture to purchase its interest in the mortgage loan. The Company makes monthly payments of interest and is required to make principal payments equal to 50.0% of any distributions it receives from the joint venture.

On February 19, 2009, the Company entered into a third amendment to its credit agreement with BB&T, as administrative agent and lender, to address certain financial covenants including the Company's total leverage ratio. The amendment established new methodologies for valuing the Company's hotel properties under renovation and modified certain other aspects of the original credit agreement. In addition to waiving potential covenant defaults in 2008, the amendment increased the Company's interest rate spread for its variable LIBOR-based interest rate by 1.125% establishing a new spread range from 2.75% to 3.25% based on the Company's total leverage ratio and added a one hundred basis point spread for any prime rate loans made under the facility. It also eased the Company's total leverage ratio test by increasing the Company's total maximum permitted leverage from 55.0% to 62.5% of the total value of the Company's assets; established new limitations on cash distributions that the Company may pay to stockholders to a level necessary to maintain the Company's REIT qualification, until such time as the Company meets certain liquidity and other tests; required the Company to add the Company's hotel property in Laurel, Maryland to the credit agreement's borrowing base; and provided for fixed valuation of certain of the Company's hotel properties, for purposes of determining compliance with various financial covenants, through April 2010.

On May 18, 2009, the Company entered into a fourth amendment to its credit agreement modifying the minimum tangible net worth covenant and waiving compliance with respect to such covenant for the quarter ended March 31, 2009. Subject to certain conditions, the fourth amendment permits the Company to pay in any fiscal year a dividend in an amount minimally necessary to maintain the Company's REIT status, provided that no dividend may generally be paid during the first three quarters of such fiscal year. Notwithstanding this limitation, the Company was permitted to pay the dividend declared on or about April 20, 2009. If certain liquidity thresholds and other conditions are met, the Company may be able to declare and pay additional cash dividends in any fiscal year during the term of the credit agreement.

On December 1, 2009, the Company issued 2,132,680 shares of common stock at \$1.60 per share pursuant to a rights offering. The Company received gross proceeds of approximately \$3.4 million, the proceeds of which, after payment of fees and expenses associated with the offering, were used for additional working capital.

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

2. Summary of Significant Accounting Policies

Basis of Presentation The consolidated financial statements of the Company presented herein include all of the accounts of MHI Hospitality Corporation, the Operating Partnership, MHI TRS and subsidiaries as of and for the three months ended March 31, 2010 and 2009. All significant inter-company balances and transactions have been eliminated.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 39 years for buildings and building improvements and 3 to 10 years for furniture, fixtures and equipment. Leasehold improvements are amortized over the shorter of the lease term or the useful lives of the related assets.

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

Properties Under Development Investments in hotel property that have been taken out of service for an extensive renovation in anticipation of re-opening under a new brand are included in properties under development. In March 2009, the property under development in Tampa, Florida re-opened as the Crowne Plaza Tampa Westshore. As of March 31, 2010 and December 31, 2009, there were no properties under development.

For properties under development, interest and real estate taxes incurred during the renovation period are capitalized and depreciated over the lives of the renovated assets. Capitalized interest for the three months ended March 31, 2010 and 2009 was \$0 and \$270,555, respectively.

Investment in Joint Venture Investment in joint venture represents the Company's non-controlling indirect 25.0% equity interest in (i) the entity that owns the Crowne Plaza Hollywood Beach Resort; (ii) the entity that leases the hotel and has engaged MHI Hotels Services, LLC ("MHI Hotels Services") to operate the hotel under a management contract; and (iii) the entity that owns the \$22.0 million junior participation in the existing mortgage. Carlyle owns a 75.0% controlling indirect interest in all these entities. The Company accounts for its investment in the joint venture under the equity method of accounting and is entitled to receive its pro rata share of annual cash flow. The Company also has the opportunity to earn an incentive participation in net sale proceeds based upon the achievement of certain overall investment returns, in addition to its pro rata share of net sale proceeds.

Cash and Cash Equivalents The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Concentration of Credit Risk The Company holds cash accounts at several institutions in excess of the FDIC protection limits of \$250,000. The Company's exposure to credit loss in the event of the failure of these institutions is represented by the difference between the FDIC protection limit and the total amounts on deposit. Management monitors, on a regular basis, the financial condition of the financial institutions along with the balances there on deposit to minimize the Company's potential risk.

Restricted Cash Restricted cash includes real estate tax escrows and reserves for replacements of furniture, fixtures and equipment pursuant to certain requirements in the Company's mortgage agreements with MONY Life Insurance Company ("MONY"), which

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holds mortgages on the Hilton Wilmington Riverside and the Hilton Savannah DeSoto; PNC Bank, trustee for the mortgage holder on the Crowne Plaza Jacksonville Hotel; and TowneBank, which holds the mortgage on the Crowne Plaza Hampton Marina. During the renovation of the property in Hampton, Virginia, TowneBank required the Company to maintain an operating reserve which was returned to the Company in February 2009, upon completion of the renovations.

Inventories Inventories which consist primarily of food and beverage are stated at the lower of cost or market, with cost determined on a method that approximates first-in, first-out basis.

Franchise License Fees Fees expended to obtain or renew a franchise license are amortized over the life of the license or renewal. The un-amortized franchise fees as of March 31, 2010 and December 31, 2009 were \$299,665 and \$311,852, respectively. Amortization expense for the three months ended March 31, 2010 and 2009 totaled \$12,187 and \$10,937, respectively.

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

Deferred Financing Costs Deferred financing costs are recorded at cost and consist of loan fees and other costs incurred in issuing debt. Amortization of deferred financing costs is computed using a method that approximates the effective interest method over the term of the related debt and is included in interest expense in the consolidated statements of operations.

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

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest-rate movements. To accomplish this objective, the Company primarily uses an interest-rate swap as part of its interest-rate risk management strategy. The interest-rate swap is required under its revolving credit agreement and acts as a cash flow hedge involving the receipts of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreement without exchange of the underlying \$30.0 million principal amount. During the three months ended March 31, 2010 and 2009, such derivatives were used to hedge the variable cash flows associated with the credit facility. The Company does not enter into derivative instruments for speculative trading purposes.

At March 31, 2010 and December 31, 2009, the interest-rate swap agreement had an estimated fair value of \$(267,655) and \$(651,600), respectively, and is included in accounts payable and other accrued liabilities.

The Company values its interest-rate swap at fair value, which it defines as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company classifies the inputs used to measure fair value into the following hierarchy:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or
Unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or

Inputs other than quoted prices that are observable for the asset or liability

Level 3 Unobservable inputs for the asset or liability

The Company endeavors to utilize the best available information in measuring fair value. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's interest-rate swap liability was valued by discounting expected future cash flows based on quoted prices for forward interest-rate contracts. As such, these derivative instruments are classified within level 2.

Noncontrolling Interest in Operating Partnership Certain hotel properties have been acquired, in part, by the Operating Partnership through the issuance of limited partnership units of the Operating Partnership. The noncontrolling interest in the Operating Partnership is: (i) increased or decreased by the limited partners' pro-rata share of the Operating Partnership's net income or net loss, respectively; (ii) decreased by distributions; (iii) decreased by redemption of partnership units for the Company's common stock; and

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(iv) adjusted to equal the net equity of the Operating Partnership multiplied by the limited partners' ownership percentage immediately after each issuance of units of the Operating Partnership and/or the Company's common stock through an adjustment to additional paid-in capital. Net income or net loss is allocated to the noncontrolling interest in the Operating Partnership based on the weighted average percentage ownership throughout the period.

Revenue Recognition Revenues from operations of the hotels are recognized when the services are provided. Revenues consist of room sales, food and beverage sales, and other hotel department revenues, such as telephone, rooftop leases and gift shop sales and rentals.

Occupancy and Other Taxes Revenues are reported net of occupancy and other taxes collected from customers and remitted to governmental authorities.

Income Taxes The Company has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code. As a REIT, the Company generally will not be subject to federal income tax on that portion of its net income that does not relate to MHI Hospitality TRS, LLC, the Company's wholly-owned taxable REIT subsidiary. MHI Hospitality TRS, LLC, which leases the Company's hotels from subsidiaries of the Operating Partnership, is subject to federal and state income taxes.

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

The Company accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. In addition, the Company recognizes obligations for interest and penalties related to uncertain tax positions, if any, as income tax expense.

Stock-based Compensation The Company's 2004 Long Term Incentive Plan (Plan) permits the grant of stock options, restricted (non-vested) stock and performance stock compensation awards to its employees for up to 350,000 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its stockholders.

Under the Plan, the Company has made restricted stock and deferred stock awards totaling 165,438 shares including 60,000 shares granted under a deferred stock award to its Chief Operating Officer, 73,438 restricted shares issued to certain executives and employees, and 32,000 restricted shares issued to its directors. The 60,000 shares granted under the deferred stock award vest over five years. Of the 60,000 shares granted to the Company's Chief Operating Officer, only 30,000 shares have vested; another 14,000 shares were issued January 14, 2008, but do not vest until January 1, 2011. Of the 73,438 restricted shares issued to certain of the Company's executives and employees, all have vested except 15,000 shares issued to the Chief Executive Officer upon renewal of his contract which will vest on January 1, 2011. Regarding the restricted shares awarded to the Company's directors, the shares vest at the end of the year of service for which the shares are awarded.

The value of the awards is charged to compensation expense on a straight-line basis over the vesting or service period based on the Company's stock price on the date of grant or issuance. Under the Plan, the Company may issue a variety of performance-based stock awards, including nonqualified stock options. As of March 31, 2010, no performance-based stock awards have been granted. Consequently, stock-based compensation as determined under the fair-value method would be the same under the intrinsic-value method. Total compensation cost recognized under the Plan for the three months ended March 31, 2010 and 2009 was \$42,428 and \$40,695, respectively.

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

Segment Information The Company has determined that its business is conducted in one reportable segment, hotel ownership.

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

Reclassifications Certain reclassifications have been made to the prior period balances to conform to the current period presentation.

Subsequent Events The Company has evaluated subsequent events through the time the financial statements were available for issuance on May 14, 2010.

Recent Accounting Pronouncements In December 2007, the FASB issued authoritative guidance related to ASC Topic 805, *Business Combinations*. This authoritative guidance establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination, recognizing assets acquired and liabilities assumed arising from contingencies, and determining what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. The authoritative guidance is effective for acquisitions consummated in fiscal years beginning after December 15, 2008. On January 1, 2009, the Company adopted the authoritative guidance related to ASC Topic 805, which may have an impact in future periods on its consolidated financial statements, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of any future acquisitions the Company consummates.

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In December 2007, the FASB issued authoritative guidance related to ASC Topic 810, *Consolidation*. This authoritative guidance changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. The Company adopted the authoritative guidance related to ASC Topic 810 on January 1, 2009. Under the authoritative guidance, such noncontrolling interests are reported on the consolidated balance sheets within equity, separate from the Company's equity. On the consolidated statements of operations, revenues, expenses and net income or loss from less-than-wholly-owned subsidiaries are reported at the consolidated amounts, including both the amounts attributable to the Company and noncontrolling interests. Consolidated statements of changes in equity include beginning balances, activity for the period and ending balances for stockholders' equity, noncontrolling interests and total equity.

In March 2008, the FASB issued authoritative guidance related to ASC Topic 815, *Derivatives and Hedging*. This authoritative guidance requires expanded disclosures regarding the location and amounts of derivative instruments in an entity's financial

Table of Contents**MHI HOSPITALITY CORPORATION****NOTES TO FINANCIAL STATEMENTS (Continued)****(unaudited)**

statements, how derivative instruments and related hedged items are accounted for under guidance previously issued in June 1998 and how derivative instruments and related hedged items affect an entity's financial position, operating results and cash flows. The Company adopted the authoritative guidance related to ASC Topic 815 on January 1, 2009, which had no material impact on its consolidated financial statements.

In April 2008, the FASB issued authoritative guidance related to ASC Topics 275, *Risks and Uncertainties* and ASC Topic 350, *Intangibles - Goodwill and Other* to improve the consistency between the useful life of a recognized intangible asset (under guidance previously issued in June 2001) and the period of expected cash flows used to measure the fair value of the intangible asset (under guidance issued in December 2007). This authoritative guidance amends the factors to be considered when developing renewal or extension assumptions that are used to estimate an intangible asset's life under guidance issued in June 2001. The Company adopted the authoritative guidance related to ASC Topics 275 and 350 on January 1, 2009, which had no material impact on its consolidated financial statements.

In November 2008, the FASB ratified authoritative guidance related to ASC Topic 323, *Investments - Equity Method and Joint Ventures*. This authoritative guidance clarifies the accounting for certain transactions and impairment considerations involving equity method investments. The authoritative guidance is effective on a prospective basis for fiscal years beginning after December 15, 2008. The Company adopted the authoritative guidance related to ASC Topic 323 on January 1, 2009, which had no material impact on its consolidated financial statements.

In May 2009, the FASB issued authoritative guidance related to ASC Topic 855, *Subsequent Events*. This authoritative guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company adopted the authoritative guidance related to ASC Topic 855 effective June 15, 2009, which had no material impact on its consolidated financial statements.

In June 2009, the FASB issued Accounting Standards Update (ASU) 2009-01 related to ASC Topic 105, *Generally Accepted Accounting Principles*. The update instituted a major change in the way accounting standards are organized. The accounting standards codification became the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles (GAAP). As of September 30, 2009, only one level of authoritative GAAP exists, other than guidance issued by the Securities and Exchange Commission. All other literature is non-authoritative. The Company adopted the codification in the third quarter of 2009. The adoption of the codification had no impact on the Company's consolidated financial position, results of operations or cash flows.

3. Acquisition of Hotel Properties

There were no new acquisitions during the three months ended March 31, 2010.

4. Investment in Hotel Properties

Investment in hotel properties as of March 31, 2010 and December 31, 2009 consisted of the following (in thousands):

	March 31, 2010 (unaudited)	December 31, 2009
<i>Land and land improvements</i>	\$ 19,145	\$ 19,142
<i>Buildings and improvements</i>	173,498	173,387
<i>Furniture, fixtures and equipment</i>	31,836	31,566
	224,481	224,095
<i>Less: accumulated depreciation</i>	(37,528)	(35,507)
	\$ 186,953	\$ 188,588

5. Debt

Credit Facility. As of March 31, 2010, the Company had a secured, revolving credit facility that enabled the Company to borrow up to \$80.0 million, subject to borrowing base and loan-to-value limitations, with a syndicated bank group comprised of BB&T, Key Bank National Association and Manufacturers and Traders Trust Company. The credit facility was established during the second quarter of 2006 and replaced a \$23.0 million secured, revolving credit facility with BB&T. On August 1, 2007, the Company entered into an amendment to its credit agreement modifying certain provisions of the agreement as well as reducing the rate of interest on the credit facility by 0.375% and extending the maturity date by one year. On April 15, 2008, the Company entered into a second amendment to its credit agreement modifying certain provisions of the agreement including increases in the lenders' revolver commitments by \$20.0 million, thereby enabling the Company to borrow up to \$80.0 million. On February 19, 2009, the Company entered into a third amendment to its credit agreement modifying certain provisions of the agreement as well as increasing the rate of interest on the credit facility by 1.125%. The Company had borrowings under the credit facility of approximately \$75.2 million and \$75.5 million at March 31, 2010 and December 31, 2009, respectively.

Table of Contents**MHI HOSPITALITY CORPORATION****NOTES TO FINANCIAL STATEMENTS (Continued)****(unaudited)**

The credit facility matures during May 2011 and bore interest at a floating rate of LIBOR plus additional interest ranging from 1.625% to 2.125% prior to February 19, 2009 and 2.75% to 3.25% thereafter. On March 31, 2010, LIBOR was 0.249%. The Company is required to pay a fee of 0.25% on the unused portion of the credit facility. Under the terms of the agreement, the Company was required to purchase an interest rate swap in order to hedge against interest rate risk.

The credit facility is secured by the Holiday Inn Brownstone in Raleigh North Carolina, the Hilton Philadelphia Airport, the Sheraton Louisville Riverside, the Holiday Inn Laurel and the Crowne Plaza Tampa Westshore as well as a lien on all business assets of those properties including, but not limited to, equipment, accounts receivable, inventory, furniture, fixtures and proceeds thereof. At March 31, 2010, the five properties had a net carrying value of approximately \$104.8 million. Under the terms of the BB&T line of credit, the Company must satisfy certain financial and non-financial covenants. The Company was in compliance with all required covenants as of March 31, 2010.

Mortgage Debt. As of March 31, 2010, the Company had approximately \$72.6 million of outstanding mortgage debt. The following table sets forth the Company's mortgage debt obligations on its hotels.

Property	Balance Outstanding as of		Prepayment	Maturity	Amortization	Interest Rate
	March 31, 2010	December 31, 2009	Penalties	Date	Provisions	
Crowne Plaza Hampton Marina	\$ 9,000,000	\$ 9,000,000	N	06/2011 ⁽¹⁾	Interest Only	LIBOR plus 2.75% ⁽²⁾
Crowne Plaza Jacksonville Riverfront	18,000,000	18,000,000	⁽³⁾	07/2010 ⁽¹⁾	Interest Only	8.00%
Hilton Savannah DeSoto	23,000,000	23,000,000	⁽⁴⁾	08/2017	25 years ⁽⁵⁾	6.06%
Hilton Wilmington Riverside	22,637,273	22,738,250	⁽⁴⁾	03/2017	25 years ⁽⁶⁾	6.21%
Total	\$ 72,637,273	\$ 72,738,250				

- (1) The notes may each be extended for one 12-month period, subject to certain terms and conditions.
- (2) The note bears a minimum interest rate of 4.75%.
- (3) The note could not be prepaid prior to July 2009. A prepayment may be made currently without penalty.
- (4) The notes may not be prepaid during the first six years of the term. Prepayment can be made with penalty thereafter until 90 days before maturity.
- (5) The note provides for payments of interest only until July 2010 after which payments of principal and interest under a 25-year amortization schedule are due until the note matures in July 2017.
- (6) The note provides for payments of interest only until March 2009 after which payments of principal and interest under a 25-year amortization schedule are due until the note matures in March 2017.

Total mortgage debt maturities as of March 31, 2010 without respect to any loan extensions for the following twelve-month periods were as follows:

March 31, 2011	\$ 18,687,682
March 31, 2012	9,869,184
March 31, 2013	924,054
March 31, 2014	982,387
March 31, 2015	1,044,404
Thereafter	41,129,562

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<i>Total future maturities</i>	\$ 72,637,273
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Other Loans. On February 9, 2009, the indirect subsidiary of the Company which is a member of the joint venture entity that owns the Crowne Plaza Hollywood Beach Resort, borrowed \$4.75 million from the Carlyle Affiliate Lender for the purpose of improving the Company's liquidity. In June 2008, the joint venture that owns the property purchased a junior participation in a portion of the mortgage loan from the lender. The amount of the loan from the Carlyle Affiliate Lender approximated the amount the Company contributed to the joint venture to enable the joint venture to purchase its interest in the mortgage loan. The interest rate and maturity date of the loan are tied to a note that is secured by a mortgage on the property. The loan, which currently bears a rate of LIBOR plus additional interest of 3.00%, requires monthly payments of interest and principal payments equal to 50.0% of any distributions it receives from the joint venture. The maturity date of the mortgage to which the loan is tied matures in August 2010, but can be extended for up to two additional 12-month periods.

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

6. Commitments and Contingencies

Ground, Building and Submerged Land Leases The Company leases 2,086 square feet of commercial space next to the Savannah hotel property for use as an office, retail or conference space, or for any related or ancillary purposes for the hotel and/or atrium space. In December 2007, the Company signed an amendment to the lease to include rights to the outdoor esplanade adjacent to the leased commercial space. These areas are leased under a six-year operating lease, which expired October 31, 2006 and has been renewed for the first of three optional five-year periods expiring October 31, 2011, October 31, 2016 and October 31, 2021, respectively. Rent expense for the three months ended March 31, 2010 and 2009 for this operating lease was \$15,387 and \$20,483, respectively.

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

The Company leases a parking lot adjacent to the Holiday Inn Brownstone in Raleigh, North Carolina. The land is leased under a second amendment, dated April 28, 1998, to a ground lease originally dated May 25, 1966. The original lease is a 50-year operating lease, which expires August 31, 2016. There is a renewal option for up to three additional ten-year periods expiring August 31, 2026, August 31, 2036, and August 31, 2046, respectively. The Company holds an exclusive and irrevocable option to purchase the leased land at fair market value at the end of the original lease term, subject to the payment of an annual fee of \$9,000, and other conditions. Rent expense for each of the three months ended March 31, 2010 and 2009 was \$23,871.

In conjunction with the sublease arrangement for the property at Shell Island, the Company incurs an annual lease expense for a leasehold interest other than the purchased leasehold interest. Lease expense was \$58,700 and \$42,034 for the three months ended March 31, 2010 and 2009, respectively.

The Company leases a parking lot in close proximity to the Sheraton Louisville Riverside. The land is leased under an agreement dated August 17, 2007 with the City of Jeffersonville, which in turn leases the property from the State of Indiana. The lease term for the parking lot coincides with that of the lease with the State of Indiana, which expires December 31, 2011. The Company has the right to renew or extend the lease with the City of Jeffersonville pursuant to the conditions of the original lease provided that the City of Jeffersonville is able to renew or extend the underlying lease with the State of Indiana. For each of the three months ended March 31, 2010 and 2009, rent expense was \$8,400.

The Company leases a parking lot adjacent to the Crowne Plaza Tampa Westshore under a five-year agreement with the Florida Department of Transportation that commenced in July 2009 and expires in July 2014. The agreement requires annual payments of \$2,432 and may be renewed for an additional five years. Rent expense for the three months ended March 31, 2010 was \$608.

The Company leases certain submerged land in the Saint Johns River in front of the Crowne Plaza Jacksonville Hotel from the Board of Trustees of the Internal Improvement Trust Fund of the State of Florida. The submerged land is leased under a five-year operating lease, which expires September 18, 2012 requiring annual payments of \$4,961. Rent expense for each of the three months ended March 31, 2010 and 2009 was \$1,240.

The Company leases 3,542 square feet of commercial office space in Williamsburg, Virginia under an agreement that commenced September 1, 2009 and expires August 31, 2015. Prior to September 1, 2009, the Company leased 1,842 feet of commercial office space under a separate lease that expired August 31, 2009. Rent expense for the three months ended March 31, 2010 and 2009, was \$13,750 and \$11,028, respectively.

The Company leases 1,632 square feet of commercial office space in Rockville, Maryland under an agreement that commenced December 14, 2009 and expires February 28, 2017. The agreement requires monthly payments at an annual rate of \$22,848 for the first year of the lease term and monthly payments at an annual rate of \$45,696 for the second year of the lease term, increasing 2.75% per year for the remainder of the lease term. Rent expense for the three months ended March 31, 2010 was \$11,013.

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

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<i>March 31, 2011</i>	\$ 604,465
<i>March 31, 2012</i>	560,538
<i>March 31, 2013</i>	448,899
<i>March 31, 2014</i>	449,624
<i>March 31, 2015</i>	210,166
<i>Thereafter</i>	261,374
<i>Total future minimum lease payments</i>	\$ 2,535,066

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

Management Agreements Each of the operating hotels that the Company owned at March 31, 2010, except for the Crowne Plaza Tampa Westshore, are operated by MHI Hotels Services under a master management agreement that expires between December 2014 and April 2018. The Company entered into a separate management agreement with MHI Hotels Services for the management of the Crowne Plaza Tampa Westshore that expires in March 2019 (see Note 8).

Franchise Agreements As of March 31, 2010, the Company's hotels operate under franchise licenses from national hotel companies. Under the franchise agreements, the Company is required to pay a franchise fee generally between 2.5% and 5.0% of room revenues, plus additional fees that amount to between 2.5% and 6.0% of room revenues from the hotels. The franchise agreements currently expire between December 2011 and April 2023.

Restricted Cash Reserves Each month, the Company is required to escrow with its lender on the Wilmington Riverside Hilton and the Savannah DeSoto Hilton an amount equal to $\frac{1}{12}$ of the annual real estate taxes due for the properties. The Company is also required to establish a property improvement fund for each of these two hotels to cover the cost of replacing capital assets at the properties. Each month, contributions to the property improvement fund equal 4.0% of gross revenues for the Savannah DeSoto Hilton and the Wilmington Riverside Hilton.

Pursuant to the terms of the mortgage on the Crowne Plaza Jacksonville, the Company is required to make monthly contributions equal to 4.0% of room revenues into a property improvement fund.

Pursuant to the terms of the mortgage on the Crowne Plaza Hampton Marina, the Company is required to make monthly contributions equal to 4.0% of gross revenues to a property improvement fund beginning in January 2010.

Litigation The Company is not involved in any material litigation, nor, to its knowledge, is any material litigation threatened against the Company. The Company is involved in routine legal proceedings arising out of the ordinary course of business, all of which the Company expects to be covered by insurance. The Company does not expect any pending legal proceedings to have a material impact on its financial condition or results of operations.

7. Capital Stock

Common Shares The Company is authorized to issue up to 49,000,000 shares of common stock, \$.01 par value per share. Each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of stockholders. Holders of the Company's common stock are entitled to receive distributions when authorized by the Company's board of directors out of assets legally available for the payment of distributions.

On March 22, 2010, one holder of units in the Operating Partnership redeemed 368,168 units for an equivalent number of shares of the Company's common stock.

On December 1, 2009, the Company issued 2,132,680 shares of common stock at \$1.60 per share pursuant to a rights offering. The Company received gross proceeds of approximately \$3.4 million, the proceeds of which, after payment of fees and expenses associated with the offering, were used for additional working capital.

During February 2010 and February 2009, the Company issued 30,175 shares and 14,650 shares, respectively, of restricted stock to certain executives and independent directors.

In addition, on February 1, 2010, the Company issued 15,000 shares to its Chief Executive Officer in accordance with the terms of his renewed employment contract.

On January 1, 2009, the Company issued 10,000 non-restricted shares to its Chief Operating Officer in accordance with the terms of his employment contract, as amended.

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As of March 31, 2010 and December 31, 2009, the Company had 9,520,286 and 9,096,943 shares of common stock outstanding, respectively.

Warrants The Company has granted no warrants representing the right to purchase common stock.

Preferred Shares The Company is authorized to issue 1,000,000 shares of preferred stock, \$.01 par value per share. As of March 31, 2010, there were no shares of preferred stock outstanding.

Operating Partnership Units Holders of Operating Partnership units have certain redemption rights, which enable them to cause the Operating Partnership to redeem their units in exchange for shares of the Company's common stock on a one-for-one basis or, at the option of the Company, cash per unit equal to the market price of the Company's common stock at the time of redemption.

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MHI HOSPITALITY CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(unaudited)

The number of shares issuable upon exercise of the redemption rights will be adjusted upon the occurrence of stock splits, mergers, consolidations or similar pro-rata share transactions, which otherwise would have the effect of diluting the ownership interests of the limited partners or the stockholders of the Company.

As of March 31, 2010, the total number of Operating Partnership units outstanding was 3,369,439, with a fair market value of approximately \$8.3 million based on the price per share of the common stock on that date.

8. Related Party Transactions

As of March 31, 2010, the members of MHI Hotels Services (a company that is majority-owned and controlled by the Company's chief executive officer, its chief financial officer and two members of its Board of Directors) owned approximately 7.2% of the Company's outstanding common stock and 2,218,670 Operating Partnership units. The following is a summary of the transactions between the Company and MHI Hotels Services:

Accounts Receivable At March 31, 2010 and December 31, 2009, the Company was due \$57,054 and \$32,444, respectively, from MHI Hotels Services.

Shell Island Sublease The Company has a sublease arrangement with MHI Hotels Services on its leasehold interests in the property at Shell Island. Leasehold revenue for each of the three months ended March 31, 2010 and 2009 was \$160,000.

Sublease of Office Space The Company subleased office space in Greenbelt, Maryland from MHI Hotels Services until December 2009. Rent expense was \$10,050 for the three months ended March 31, 2009.

Strategic Alliance Agreement On December 21, 2004, the Company entered into a ten-year strategic alliance agreement with MHI Hotels Services that provides in part for the referral of acquisition opportunities to the Company and the management of its hotels by MHI Hotels Services.

Management Agreements Each of the hotels that the Company owned at March 31, 2010, except for the Crowne Plaza Tampa Westshore, are operated by MHI Hotels Services under a master management agreement that expires between December 2014 and April 2018. The Company entered into a separate management agreement with MHI Hotels Services for the management of the Crowne Plaza Tampa Westshore that expires in March 2019. Under both management agreements, MHI Hotels Services receives a base management fee, and if the hotels meet and exceed certain thresholds, an additional incentive management fee. The base management fee for any hotel is 2.0% of gross revenues for the first full fiscal year and partial fiscal year from the commencement date through December 31 of that year, 2.5% of gross revenues the second full fiscal year, and 3.0% of gross revenues for every year thereafter. Pursuant to the sale of the Holiday Inn Downtown in Williamsburg, Virginia, one of the hotels initially contributed to the Company upon its formation, MHI Hotels Services agreed that the property in Jeffersonville, Indiana shall substitute for the Williamsburg property under the master management agreement. The incentive management fee, if any, is due annually in arrears within 90 days of the end of the fiscal year and will be equal to 10.0% of the amount by which the gross operating profit of the hotels, on an aggregate basis, for a given year exceeds the gross operating profit for the same hotels, on an aggregate basis, for the prior year. The incentive management fee may not exceed 0.25% of gross revenues of all of the hotels included in the incentive fee calculation.

Management fees earned by MHI Hotels Services were \$443,504 and \$441,376 for the three months ended March 31, 2010 and 2009, respectively. In addition, estimated incentive management fees of \$16,275 and \$0 were accrued for the three months ended March 31, 2010 and 2009, respectively.

Employee Medical Benefits The Company purchases employee medical benefits through Maryland Hospitality, Inc. (d/b/a MHI Health), an affiliate of MHI Hotels Services. Premiums for employee medical benefits paid by the Company were \$491,867 and \$459,061 for the three months ended March 31, 2010 and 2009, respectively.

Construction Management Services The Company has engaged MHI Hotels Services to manage certain aspects of the renovations at the Crowne Plaza Tampa Westshore and the Holiday Inn Brownstone. For the three months ended March 31, 2010 and 2009, the Company paid \$50,000 and \$0, respectively, in construction management fees.

9. Retirement Plan

The Company maintains a 401(k) plan for qualified employees which is subject to safe harbor provisions and which requires that the Company match 100% of the first 3% of employee contributions and 50% of the next 2% of employee contributions. All Company matching funds vest immediately in accordance with the safe harbor provision. Company contributions to the plan for the three months ended March 31, 2010 and 2009 were \$9,989 and \$11,526, respectively.

10. Unconsolidated Joint Venture

The Company owns a 25% indirect interest in (i) the entity that owns the Crowne Plaza Hollywood Beach Resort; (ii) the entity that leases the hotel and has engaged MHI Hotels Services to operate the hotel under a management contract; (iii) the entity that has an

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option to purchase a three-acre development site with parking garage adjacent to the hotel and which leases the parking garage for use by the hotel; and (iv) the entity that owns the junior participation in the existing mortgage. Carlyle owns a 75.0% indirect controlling interest in all these entities. The joint venture purchased the property on August 8, 2007 and began operations on September 18, 2007. Summarized financial information for this investment, which is accounted for under the equity method, is as follows:

	March 31, 2010 (unaudited)	December 31, 2009
ASSETS		
<i>Investment in hotel properties, net</i>	\$ 71,432,808	\$ 71,963,948
<i>Cash and cash equivalents</i>	1,289,570	537,698
<i>Restricted cash</i>	3,517,015	3,330,275
<i>Accounts receivable</i>	278,067	326,359
<i>Prepaid expenses, inventory and other assets</i>	971,070	1,232,513
TOTAL ASSETS	\$ 77,488,528	\$ 77,390,793
LIABILITIES		
<i>Mortgage loans, net</i>	\$ 35,600,000	\$ 35,600,000
<i>Accounts payable and other accrued liabilities</i>	1,909,724	2,629,521
<i>Advance deposits</i>	354,076	418,082
TOTAL LIABILITIES	37,863,800	38,647,603
TOTAL MEMBERS EQUITY	39,624,728	38,743,190
TOTAL LIABILITIES AND MEMBERS EQUITY	\$ 77,488,528	\$ 77,390,793
	Three Months Ended March 31, 2010 (unaudited)	Three Months Ended March 31, 2009 (unaudited)
Revenue		
<i>Rooms department</i>	\$ 3,978,440	\$ 3,189,364
<i>Food and beverage department</i>	646,848	564,846
<i>Other operating departments</i>	305,006	240,816
Total revenue	4,930,294	3,995,026
Expenses		
<i>Hotel operating expenses</i>		
<i>Rooms department</i>	671,663	631,690
<i>Food and beverage department</i>	482,008	471,695
<i>Other operating departments</i>	177,580	94,425
<i>Indirect</i>	1,718,350	1,585,975
Total hotel operating expenses	3,049,601	2,783,785
<i>Depreciation and amortization</i>	546,548	546,010
<i>General and administrative</i>	77,638	35,486
Total operating expenses	3,673,787	3,365,281

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<i>Operating income</i>	1,256,507	629,745
<i>Interest expense</i>	(172,487)	(188,560)
<i>Interest income</i>	2,118	3,285
<i>Net income</i>	\$ 1,086,138	\$ 444,470

Table of Contents**MHI HOSPITALITY CORPORATION****NOTES TO FINANCIAL STATEMENTS (Continued)****(unaudited)****11. Income Taxes**

The components of the income tax provision (benefit) for the three months ended March 31, 2010 and 2009 are as follows (in thousands):

	Three Months Ended March 31, 2010 (unaudited)	Three Months Ended March 31, 2009 (unaudited)
<i>Current:</i>		
<i>Federal</i>	\$	\$
<i>State</i>	39	23
	39	23
<i>Deferred:</i>		
<i>Federal</i>	(186)	(701)
<i>State</i>	(46)	(218)
	(232)	(919)
	\$ (193)	\$ (896)

A reconciliation of the statutory federal income tax expense to the Company's income tax provision is as follows (in thousands):

	Three Months Ended March 31, 2010 (unaudited)	Three Months Ended March 31, 2009 (unaudited)
<i>Statutory federal income tax expense</i>	\$ (438)	\$ (628)
<i>Effect of non-taxable REIT income or loss</i>	252	(73)
<i>State income tax expense</i>	(7)	(195)
	\$ (193)	\$ (896)

As of March 31, 2010 and December 31, 2009, the Company had a net deferred tax asset of approximately \$5.2 million and \$4.9 million, respectively, of which, approximately \$4.7 million and \$4.4 million, respectively, are due to accumulated net operating losses. These loss carryforwards will begin to expire in 2024 if not utilized by then. As of March 31, 2010 and December 31, 2009, approximately \$0.4 million of the net deferred tax asset is attributable to the Company's share of start-up expenses related to the Crowne Plaza Hollywood Beach Resort, start-up expenses related to the opening of the Sheraton Louisville Riverside and the Crowne Plaza Tampa Westshore that were not deductible in the year incurred, but are being amortized over 15 years. The remainder of the net deferred tax asset is attributable to year-to-year timing differences including accrued, but not deductible, employee performance awards, vacation and sick pay, bad debt allowance, and depreciation. The Company believes that it is more likely than not that the deferred tax asset will be realized and that no valuation allowance is required.

12. Earnings per Share

The limited partners' outstanding limited partnership units in the Operating Partnership (which may be redeemed for common stock upon notice from the limited partners and following the Company's election to redeem the units for stock rather than cash) have been

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excluded from the diluted earnings per share calculation as there would be no effect on the amounts since the limited partners' share of income would also be added back to net income. The computation of basic and diluted earnings per share is presented below.

	Three months ended March 31, 2010 (unaudited)	Three months ended March 31, 2009 (unaudited)
<i>Net loss attributable to the Company</i>	\$ (779,843)	\$ (619,071)
<i>Basic:</i>		
<i>Weighted average number of common shares outstanding</i>	9,175,652	6,957,915
<i>Net loss per share - basic</i>	\$ (0.08)	\$ (0.09)
<i>Diluted:</i>		
<i>Dilutive awards</i>	16,000	26,000
<i>Diluted weighted average number common shares outstanding</i>	9,191,652	6,983,915
<i>Net loss per share - diluted</i>	\$ (0.08)	\$ (0.09)

Diluted net income per share takes into consideration the pro forma dilution of certain unvested stock awards.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

We are a self-advised REIT incorporated in Maryland in August 2004 to pursue opportunities in the full-service, upper-upscale, upscale and mid-scale segments of the hotel industry. We commenced operations in December 2004 when we completed our initial public offering (IPO) and thereafter consummated the acquisition of six hotel properties (initial properties).

Our hotel portfolio currently consists of nine full-service, upper-upscale, upscale and mid-scale hotels with 2,110 rooms, which operate under well-known brands such as Hilton, Crowne Plaza, Sheraton and Holiday Inn. These hotels are 100% owned by subsidiaries of our operating partnership. We also own a 25.0% indirect non-controlling interest in the Crowne Plaza Hollywood Beach Resort through a joint venture with The Carlyle Group and we have leasehold interests in a resort condominium facility in Wrightsville Beach, North Carolina. As of March 31, 2010, we owned the following nine hotel properties:

Property	Number of Rooms	Location	Date of Acquisition
Crowne Plaza Hampton Marina	173	Hampton, VA	April 24, 2008
Crowne Plaza Jacksonville	292	Jacksonville, FL	July 22, 2005
Crowne Plaza Tampa Westshore	222	Tampa, FL	October 29, 2007
Holiday Inn Brownstone	187	Raleigh, NC	December 21, 2004
Holiday Inn Laurel West	207	Laurel, MD	December 21, 2004
Hilton Philadelphia Airport	331	Philadelphia, PA	December 21, 2004
Hilton Savannah DeSoto	246	Savannah, GA	December 21, 2004
Hilton Wilmington Riverside	272	Wilmington, NC	December 21, 2004
Sheraton Louisville Riverside	180	Jeffersonville, IN	September 20, 2006
Total	2,110		

We conduct substantially all our business through our operating partnership, MHI Hospitality, L.P. We are the sole general partner of our operating partnership, and we own an approximate 73.9% interest in our operating partnership, with the remaining interest being held by the contributors of our initial properties as limited partners.

To qualify as a REIT, we cannot operate hotels. Therefore, our operating partnership leases our hotel properties to MHI Hospitality TRS, LLC, our TRS Lessee, which then engages a hotel management company to operate the hotels under a management contract. Our TRS Lessee has engaged MHI Hotels Services, LLC to manage our hotels. Our TRS Lessee, and its parent, MHI Hospitality TRS Holding, Inc., are consolidated into our financial statements for accounting purposes. The earnings of MHI Hospitality TRS Holding, Inc. are subject to taxation similar to other C corporations.

Recent Portfolio Changes

On March 6, 2009, we re-opened the Crowne Plaza Tampa Westshore after completing a \$23.5 million renovation.

Key Operating Metrics

In the hotel industry, most categories of operating costs, with the exception of franchise, management, credit card fees and the costs of the food and beverage served, do not vary directly with revenues. This aspect of our operating costs creates operating leverage, whereby changes in sales volume disproportionately impact operating results. Room revenue is the most important category of revenue and drives other revenue categories such as food, beverage and telephone. There are three key performance indicators used in the hotel industry to measure room revenues:

Occupancy, or the number of rooms sold, usually expressed as a percentage of total rooms available;

Average daily rate or ADR, which is total room revenue divided by the number of rooms sold; and

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Revenue per available room or RevPAR, which is total room revenue divided by the total number of available rooms.

Results of Operations

The following table illustrates the actual key operating metrics for the three months ended March 31, 2010 and 2009 for the properties we owned during each respective reporting period (actual properties) as well as the eight properties in our portfolio that were not under development during the three months ended March 31, 2009 (same-store properties). Accordingly, the same store data does not reflect the performance of the Crowne Plaza Tampa Westshore.

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Actual Portfolio Metrics	Three months ended March 31, 2010		Three months ended March 31, 2009	
	Actual	Same-Store	Actual	Same-Store
Occupancy %	62.7%	61.8%	54.1%	55.3%
ADR	\$ 101.65	\$ 102.07	\$ 109.98	\$ 109.95
RevPAR	\$ 63.69	\$ 63.08	\$ 59.47	\$ 60.82

Comparison of the Three Months Ended March 31, 2010 to the Three Months Ended March 31, 2009

Revenue. Total revenue for the three months ended March 31, 2010 increased approximately \$2.0 million or 13.0% to approximately \$17.5 million compared to total revenue of approximately \$15.5 million for the three months ended March 31, 2009. Incremental revenue of approximately \$1.7 million from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for most of the increase in revenue.

Room revenues increased approximately \$1.8 million or 17.0% to approximately \$12.1 million compared to room revenue of approximately \$10.3 million for the three months ended March 31, 2009. Incremental room revenue of approximately \$1.4 million from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for most of the increase in room revenue. For the three months ended March 31, 2010, the eight same-store properties experienced a 3.7% increase in room revenue through a combination of a 7.2% decrease in ADR and an 11.7% increase in occupancy as compared to the same period in 2009. Increases in room revenue at our properties in Savannah, Georgia; Philadelphia, Pennsylvania; Jeffersonville, Indiana; and Hampton, Virginia were offset by decreases in room revenue at our other properties, which have been adversely affected by the weakened economy.

Food and beverage revenues increased approximately \$0.4 million or 10.2% to approximately \$4.3 million for the three months ended March 31, 2010 compared to food and beverage revenues of approximately \$3.9 million for the three months ended March 31, 2009. Incremental food and beverage revenues from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for most of the increase in food and beverage revenue.

Revenue from other operating departments for the three months ended March 31, 2010 remained at the same level of revenue from other operating departments for the three months ended March 31, 2009, or approximately \$1.1 million.

Hotel Operating Expenses. Hotel operating expenses, which consist of room expenses, food and beverage expenses, other direct expenses, and management fees, were approximately \$14.0 million, an increase of approximately \$1.1 million or 8.3% for the three months ended March 31, 2010 compared to total hotel operating expenses of approximately \$12.9 million for the three months ended March 31, 2009. Incremental hotel operating expenses from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for approximately \$0.8 million of the increase. Hotel operating expenses at our same-store properties increased approximately \$0.3 million, or 2.4%.

Rooms expense for the three months ended March 31, 2010 increased approximately \$0.6 million or 20.3% to approximately \$3.6 million compared to rooms expense of approximately \$3.0 million for the three months ended March 31, 2009. Incremental rooms expense from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for approximately \$0.4 million of the increase. Rooms expense at our same-store properties increased approximately \$0.2 million, or 6.8%, due mostly to an 11.7% increase in occupancy.

Food and beverage expenses for the three months ended March 31, 2010 increased approximately \$0.3 million to approximately \$3.0 million or 11.1% compared to food and beverage expenses of approximately \$2.7 million for the three months ended March 31, 2009. Incremental food and beverage expense from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for approximately \$0.2 million of the increase. Rooms expense at our same-store properties increased approximately \$0.1 million, or 3.1%.

Indirect expenses at our properties for the three months ended March 31, 2010 increased approximately \$0.3 million or 3.5% to approximately \$7.2 million compared to indirect expenses of approximately \$6.9 million for the three months ended March 31, 2009. Sales and marketing costs, franchise fees, utilities, repairs and maintenance, insurance, management fees, real and personal property taxes as well as general and administrative costs at the property level are included in indirect expenses. Incremental indirect expense from our property in Tampa, Florida, which was not open for a portion of the three months ended March 31, 2009, accounted for most of the increase.

Depreciation and Amortization. Depreciation and amortization expense for the three months ended March 31, 2010 increased approximately \$0.2 million or 11.6% to approximately \$2.1 million compared to depreciation and amortization expense of approximately \$1.9 million for the three months ended March 31, 2009. The increase in depreciation and amortization was primarily

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attributable to the renovations placed in service in March 2009 with the opening of the Crowne Plaza Tampa Westshore.

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Corporate General and Administrative. Corporate general and administrative expenses for the three months ended March 31, 2010 increased approximately \$0.2 million to approximately \$1.1 million or 17.6% compared to corporate general and administrative expense of approximately \$0.9 million for the three months ended March 31, 2009 due mostly to higher personnel costs.

Interest Expense. Interest expense for the three months ended March 31, 2010 increased approximately \$0.3 million or 15.5% to approximately \$2.3 million compared to interest expense of approximately \$2.0 million (net of capitalized interest of approximately \$0.3 million) for the three months ended March 31, 2009. Most of the increase in interest expense relates to the interest on the portion of the borrowings related to the acquisition and renovation of the Crowne Plaza Tampa Westshore, which ceased being capitalized upon the opening of the property in March 2009.

Equity in Joint Venture. Equity in joint venture for the three months ended March 31, 2010 represents our 25.0% share of the net loss from operations of the Crowne Plaza Hollywood Beach Resort. For the three months ended March 31, 2010, the hotel reported occupancy of 89.1%, ADR of \$159.49 and RevPAR of \$142.14. This compares with results reported by the hotel for the three months ended March 31, 2009 of occupancy of 72.8%, ADR of \$156.48 and RevPAR of \$113.95.

Income Taxes. The income tax benefit for the three months ended March 31, 2010 decreased approximately \$0.7 million or 78.5% to approximately \$0.2 million compared to an income tax benefit for the three months ended March 31, 2009 of \$0.9 million. The income tax benefit is primarily derived from the operations of our TRS Lessee. The net operating loss of our TRS Lessee for the three months ended March 31, 2010 was less than the net operating loss for the three months ended March 31, 2009.

Net Loss. The net loss for the Company for the three months ended March 31, 2010 increased approximately \$0.2 million or 26.0% to approximately \$0.8 million as compared to the net loss of approximately \$0.6 million for the three months ended March 31, 2009 as a result of the operating results discussed above.

Funds From Operations

Funds from Operations (FFO) is used by industry analysts and investors as a supplemental operating performance measure of an equity REIT. FFO is calculated in accordance with the definition that was adopted by the Board of Governors of the National Association of Real Estate Investment Trusts, NAREIT. FFO, as defined by NAREIT, represents net income or loss determined in accordance with GAAP, excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated operating real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after adjustment for any noncontrolling interest from unconsolidated partnerships and joint ventures. Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, many investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by itself. Thus, NAREIT created FFO as a supplemental measure of REIT operating performance that excludes historical cost depreciation, among other items, from GAAP net income.

Management believes that the use of FFO, combined with the required GAAP presentations, has improved the understanding of the operating results of REITs among the investing public and made comparisons of REIT operating results more meaningful. Management considers FFO to be a useful measure of adjusted net income for reviewing comparative operating and financial performance because we believe FFO is most directly comparable to net income (loss), which remains the primary measure of performance, because by excluding gains or losses related to sales of previously depreciated operating real estate assets and excluding real estate asset depreciation and amortization, FFO assists in comparing the operating performance of a company's real estate between periods or as compared to different companies. Although FFO is intended to be a REIT industry standard, other companies may not calculate FFO in the same manner as we do, and investors should not assume that FFO as reported by us is comparable to FFO as reported by other REITs.

The following table reconciles net income to FFO for the three months ended March 31, 2010 and 2009 (unaudited):

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
<i>Net loss</i>	\$ (1,094,035)	\$ (951,620)
<i>Add depreciation and amortization</i>	2,131,484	1,910,598
<i>Add equity in depreciation of joint venture</i>	136,111	136,178
<i>FFO</i>	\$ 1,173,761	\$ 1,095,156

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<i>Weighted average shares outstanding</i>	9,175,652	6,957,915
<i>Weighted average units outstanding</i>	3,696,699	3,737,607
<i>Weighted average shares and units</i>	12,872,351	10,695,522
<i>FFO per share and unit</i>	\$ 0.09	\$ 0.10

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Sources and Uses of Cash

Operating Activities. Our principal source of cash to meet our operating requirements, including distributions to unitholders and stockholders as well as repayments of indebtedness, is the operations of our hotels. Cash flow used in operating activities for the three months ended March 31, 2010 was approximately \$0.1 million. We expect that the net cash provided by operations will be adequate to fund our continuing operations, debt service and the payment of dividends in accordance with federal income tax laws which require us to make annual distributions to our stockholders of at least 90% of our REIT taxable income, excluding net capital gains.

Investing Activities. Approximately \$0.4 million was spent during the three months ended March 31, 2010 on capital improvements and the replacement of furniture, fixtures and equipment.

Financing Activities. During the three months ended March 31, 2010, we paid approximately \$0.3 million to reduce the balance on our credit facility due to a decline in the value of the collateral pool securing the facility.

Capital Expenditures

Since mid-2004, we have completed product improvement plans (PIPs) in connection with the licensing or re-licensing at eight of our nine properties. With the exception of a product improvement plan in connection with the re-licensing of the Holiday Inn Brownstone, whose franchise license expires in December 2011, we anticipate that capital expenditures for the replacement and refurbishment of furniture, fixtures and equipment over the next 12 to 24 months will be lower than historical norms for our properties and the industry. Historically, we have aimed to maintain overall capital expenditures at 4.0% of gross revenue. However, in light of the current slowdown of the economy and in the interest of preserving capital, we aim to restrict capital expenditures to the replacement of broken or damaged furniture and equipment and the acquisition of items mandated by our licensors that are necessary to maintain our brand affiliations. We anticipate that capital expenditures for the replacement and refurbishment of furniture, fixtures and equipment that are not related to a product improvement plan should total 1.5% to 2.0% of gross revenues during the next 12 to 24 months.

During the next 12 months, we expect capital expenditures, other than costs that we incur to make capital improvements required by our franchisors, will be funded by our replacement reserve accounts. With respect to four of our hotels, the reserve accounts are escrowed accounts with funds deposited monthly and reserved for capital improvements or expenditures. We deposit an amount equal to 4.0% of gross revenue for the Hilton Savannah DeSoto, the Hilton Wilmington Riverside and the Crowne Plaza Hampton Marina and 4.0% of room revenues for the Crowne Plaza Jacksonville Riverfront. Beginning in June 2010, we will deposit an amount equal to 3.0% of room revenues for our remaining properties. We intend to maintain overall capital expenditures at 4.0% of gross revenue.

Liquidity and Capital Resources

As of March 31, 2010, we had cash and cash equivalents of approximately \$3.4 million, of which approximately \$1.0 million was in restricted reserve accounts and real estate tax escrows. As of March 31, 2010, our revolving credit facility, under which we may borrow up to \$80.0 million, had an outstanding balance of approximately \$75.2 million. We expect that our cash on hand combined with our cash flow from our hotels should be adequate to fund continuing operations, recurring capital expenditures for the refurbishment and replacement of furniture, fixtures and equipment, as well as scheduled payments of principal and interest.

Our ability to maintain existing levels of debt on our credit facility is dependent on our ability to comply with the loan-to-value requirements of our credit agreement as well as various financial covenants. The loan-to-value requirements of our credit agreement as well as the leverage covenants contemplate valuations of our encumbered properties based on varied methodologies. Established properties that have not undergone renovation are valued at a multiple of their net operating income, as defined by our credit agreement. For encumbered properties that have undergone renovation, especially those for which we are employing a deep-turn strategy, the value of such properties is fixed during the construction and ramp-up phases, after which time such properties will be valued in a similar manner to other established properties. The ramp-up phase for our three recently renovated properties ended in April 2010. Also, beginning in April 2010, the maximum amount that we can borrow under the credit facility was reduced from 70.0% of the value of the encumbered properties to 65.0%. Other financial covenants relate to minimum levels of cash flow that ensure our ability to pay the interest due under the credit facility, minimum levels of expenditures to maintain the quality of the encumbered assets, existence of a hedge against rising interest rates on a substantial portion of the facility, as well as minimum levels of net worth. In addition, our credit agreement imposes limitations on our ability to incur additional debt.

Our recently renovated properties did not realize sufficient operating performance to allow the properties in our collateral pool to meet the loan-to-value requirements after March 2010, and without an amendment to our credit agreement we will be required to reduce the outstanding balance of the facility by making a payment ranging between \$25.5 million and \$26.5 million during the second quarter 2010. We will need to raise additional capital if such a payment is required. We are currently considering a number of alternatives to address this issue and are in discussions with the lenders under our credit facility with respect to a potential amendment to the facility which would not oblige the Company to immediately reduce its borrowings under the facility. We have recently agreed with our

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lenders to an extension of the time period for submitting the monthly borrowing base report regarding the value of the hotels in our borrowing base in light of the advanced stage of discussions regarding a potential amendment to the facility. In addition to a potential amendment to our credit agreement, we are evaluating potential sources of additional capital. Sources of additional capital to fund any required reductions in the amount outstanding on the credit facility may include a combination of some or all of the following:

The issuance of shares of preferred stock;

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The issuance of additional shares of our common stock;

The issuance of additional units in the operating partnership;

The incurrence by the subsidiaries of the operating partnership of mortgage indebtedness in connection with the refinancing of hotel properties;

The selective disposition of core or non-core assets; and

The sale or contribution of some of our wholly owned properties, development projects or development land to strategic joint ventures to be formed with unrelated investors, which would have the net effect of generating additional capital through such sale or contribution.

We are uncertain whether, when and under what terms such sources of capital will be available to us.

Should the current economic slowdown and weakness in the lodging industry intensify and further reduce our operating cash flows and financial performance or weaken our financial condition below the levels necessary to comply with the loan-to-value requirements or the financial covenants in our credit agreement, we may be required to make additional payments beyond those described above on all or a portion of the outstanding debt. Any such payment will require us to obtain additional capital, which may not be available to us on favorable terms, if at all.

Our mortgage on the Crowne Plaza Jacksonville Riverfront matures in July 2010. We intend to exercise our right to extend the loan an additional twelve months. The loan has a minimum loan-to-value requirement of 75.0% with the value of the property determined by independent appraisal or the property's financial performance. Currently, the loan-to-value ratio as calculated by either metric exceeds the minimum loan-to-value requirement. We may be required to reduce the mortgage balance by an amount ranging between \$1.5 million and \$3.0 million.

We believe that as the economy begins to recover, there will be numerous opportunities to acquire properties at attractive prices. However, with the constraints of the covenants in our credit agreement, we have limited, if any, ability to incur additional debt in order to take advantage of such opportunities. Given the potential for attractive acquisitions emerging from the current economic downturn, we intend to pursue additional equity financing in the future to enable us to take advantage of such opportunities. However, should additional equity financing not be available on acceptable terms, we may not be able to take advantage of such opportunities.

Beyond the funding of any required principal reduction on our existing indebtedness or acquisitions in the near-term, our medium and long-term capital needs will generally include the retirement of maturing mortgage debt, amounts outstanding under our secured credit facility, and obligations under our tax indemnity agreements, if any. We remain committed to maintaining a flexible capital structure. Accordingly, in addition to the sources described above with respect to our short-term liquidity, we expect to meet our long-term liquidity needs through a combination of those sources as well as the following:

The issuance by the operating partnership of the Company and/or their subsidiary entities of secured and unsecured debt securities to the extent permitted by our credit agreement; or

The incurrence by the subsidiaries of the operating partnership of mortgage indebtedness in connection with the acquisition or refinancing of hotel properties.

Dividend Policy

In December 2008, in the interest of capital preservation within the current economic environment, and based on the expectation that the U.S. economy, and in particular the lodging industry, would continue to face declining operating trends through 2009, we amended our dividend policy. In May 2009, we entered into a fourth amendment to our credit agreement which imposes additional restrictions on the timing of the payment and the amount of cash dividends but permits us to pay in the fourth quarter of a given fiscal year, or in the following quarter, that amount of cash dividends necessary to maintain our REIT status with respect to such year, provided that certain conditions are met before additional distributions can be made. We expect this will result in a reduction in the current level of dividend payments compared to the level of dividend payments we have made in recent years.

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

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Off-Balance Sheet Arrangements

Through a joint venture with a Carlyle subsidiary, we own a 25.0% indirect, non-controlling interest in an entity (the JV Owner) that acquired the 311-room Crowne Plaza Hollywood Beach Resort in Hollywood, Florida. We have the right to receive a pro rata share of operating surpluses and we have an obligation to fund our pro rata share of operating shortfalls. We also have the opportunity to earn an incentive participation in the net proceeds realized from the sale of the hotel based upon the achievement of certain overall investment returns, in addition to our pro rata share of net sale proceeds. The Crowne Plaza Hollywood Beach Resort is leased to another entity (the Joint Venture Lessee) in which we also own a 25.0% indirect, non-controlling interest.

Adjacent to the Crowne Plaza Hollywood Beach Resort is a three-acre hotel development site, which is leased by a joint venture entity. That entity, in which we also have a 25.0% indirect ownership interest, has an option to purchase the site, which is improved with a parking garage currently being used by the hotel. The purchase option expires in August 2011 and allows the site to be purchased at fair market value as determined by independent appraisal, but no less than \$5.0 million or more than \$10.0 million. The owner of the property is in bankruptcy proceedings and it is unclear what impact those proceedings will have on the lease.

The acquisition of the property was funded in part by a mortgage loan in the amount of \$57.6 million. The mortgage, which had an original two-year term maturing on August 1, 2009, was restructured on June 13, 2008 so that the first \$35.6 million bears interest at a rate of LIBOR plus additional interest of 0.98%. The remaining \$22.0 million bears a rate of LIBOR plus additional interest of 3.50%. Upon the restructure, a fourth entity, in which we own a 25.0% indirect non-controlling interest, purchased the \$22.0 million junior participation for \$19.0 million. The loan has been extended for one year and, subject to certain conditions, can be extended for two additional one-year periods. The JV Owner executed an interest rate cap agreement capping LIBOR at 6.25%, effectively limiting the interest rate on the mortgage to 8.19% through the current extended maturity date. Monthly interest-only payments are due throughout the term. The Crowne Plaza Hollywood Beach Resort secures the mortgage. We have provided limited guarantees to the lender with respect to this mortgage. The joint venture partners intend to seek an extension of the loan, and may, in connection therewith, modify certain of its terms.

Carlyle owns a 75.0% controlling interest in the JV Owner, the Joint Venture Lessee, the entity with the purchase option and the entity that holds the junior participation. Carlyle may elect to dispose of the Crowne Plaza Hollywood Beach without our consent. We account for our non-controlling 25.0% interest in all of these entities under the equity method of accounting.

Inflation

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

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

Seasonality

The operations of the properties have historically been seasonal. The months of March and April are traditionally strong, as is October. The periods from mid-November through mid-February are traditionally slow with the exception of the Crowne Plaza Jacksonville Hotel and the Crowne Plaza Tampa Westshore. The remaining months are generally good, but can be impacted by bad weather and can vary significantly.

Geographic Concentration

Our hotels are located in Florida, Georgia, Indiana, Maryland, North Carolina, Pennsylvania and Virginia.

Critical Accounting Policies

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

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Investment in Hotel Properties. Hotel properties are stated at cost, net of any impairment charges, and are depreciated using the straight-line method over an estimated useful life of 7-39 years for buildings and 3-10 years for furniture and equipment. In accordance with generally accepted accounting principles, the controlling interests in hotels comprising our accounting predecessor, MHI Hotels Services Group, and noncontrolling interests held by the controlling holders of our accounting predecessor in hotels

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acquired from third parties are recorded at historical cost basis. Noncontrolling interests in those entities that comprise our accounting predecessor and the interests in hotels, other than those held by the controlling members of our accounting predecessor, acquired from third parties are recorded at fair value at time of acquisition.

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

There were no charges for impairment recorded for the three months ended March 31, 2010 or 2009.

We estimate the fair market values of our properties through cash flow analysis taking into account each property's expected cash flow generated from operations, holding period and expected proceeds from ultimate disposition. These cash flow analyses are based upon significant management judgments and assumptions including revenues and operating costs, growth rates and economic conditions at the time of ultimate disposition. In projecting the expected cash flows from operations of the asset, we base our estimates on future projected net operating income before depreciation and eliminating non-recurring operating expenses, which is a non-GAAP operational measure, and deduct expected capital expenditure requirements. We then apply growth assumptions based on estimated changes in room rates and expenses and the demand for lodging at our properties, as impacted by local and national economic conditions and estimated or known future new hotel supply. The estimated proceeds from disposition are determined as a matter of management's business judgment based on a combination of anticipated cash flow in the year of disposition, terminal capitalization rate, ratio of selling price to gross hotel revenues and selling price per room.

If actual conditions differ from those in our assumptions, the actual results of each asset's operations and fair market value could be significantly different from the estimated results and value used in our analysis.

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

Income Taxes. We record a valuation allowance to reduce deferred tax assets to an amount that we believe is more likely than not to be realized. Because of expected future taxable income of our TRS Lessee, we have not recorded a valuation allowance to reduce our net deferred tax asset as of March 31, 2010. Should our estimate of future taxable income be less than expected, we would record an adjustment to the net deferred tax asset in the period such determination was made.

Recent Accounting Pronouncements

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

Forward Looking Statements

Information included and incorporated by reference in this Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and as such may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identified by our use of words, such as intend, plan, may, should, will, project, estimate, anticipate, believe, expect, continue, potential, opportunity, and similar expressions, whether in the negative or affirmative. All statements regarding our expected financial position, business and financing plans are forward-looking statements. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to:

National and local economic and business conditions, including the current economic downturn, that will affect occupancy rates at our hotels and the demand for hotel products and services;

risks associated with the hotel industry, including competition, increases in wages, energy costs and other operating costs;

the availability and terms of financing and capital and the general volatility of the securities markets, specifically, the impact of the current credit crisis which has severely constrained the availability of debt financing;

risks associated with the level of our indebtedness and our ability to meet covenants in our debt agreements;

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management and performance of our hotels;

risks associated with redevelopment and repositioning projects, including delays and cost overruns;

supply and demand for hotel rooms in our current and proposed market areas;

our ability to acquire additional properties and the risk that potential acquisitions may not perform in accordance with expectations; and

legislative/regulatory changes, including changes to laws governing taxation of real estate investment trusts.

Additional factors that could cause actual results to vary from our forward-looking statements are set forth under the Section titled Risk Factors in our Annual Report on Form 10-K and subsequent reports filed with the Securities and Exchange Commission.

These risks and uncertainties should be considered in evaluating any forward-looking statement contained in this report or incorporated by reference herein. All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are qualified by the cautionary statements in this section. We undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

To meet in part our long-term liquidity requirements, we will borrow funds at a combination of fixed and variable rates. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. Our credit agreement required us to hedge at least one-half of the maximum borrowing amount with an interest-rate swap, which we purchased on August 8, 2006 on a notional amount of \$30.0 million. As of March 31 2010, a derivative with a fair value of approximately \$0.2 million was included in accounts payable and other accrued liabilities. We expect that before the end of May 2010, we will be required by our lender to execute another interest-rate swap or other interest-rate hedge contract for the remainder of the term of the credit agreement. From time to time we may enter into other interest rate hedge contracts such as collars and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We do not intend to hold or issue these derivative contracts for trading or speculative purposes.

As of March 31, 2010, we had approximately \$63.6 million of fixed-rate debt and approximately \$88.8 million of variable-rate debt. The weighted-average interest rate on the fixed-rate debt was 6.66%. A change in market interest rates on the fixed portion of our debt would impact the fair value of the debt, but have no impact on interest incurred or cash flows. Our variable-rate debt is exposed to changes in interest rates, specifically the change in 30-day LIBOR, but would be limited to the effect on our mortgage on the Crowne Plaza Hampton Marina as well as the loan from the Carlyle Affiliate Lender and the gap between the balance on the credit facility and the \$30.0 million notional amount of the interest-rate swap purchased on August 8, 2006. Assuming that the amount outstanding on our mortgage on the Crowne Plaza Hampton Marina, the loan from the Carlyle Affiliate Lender and the amount outstanding under our credit facility remain at approximately \$88.8 million, the balance at March 31, 2010, the impact on our annual interest incurred and cash flows of a one percent change in 30-day LIBOR would be approximately \$588,000.

As of December 31, 2009, we had approximately \$63.7 million of fixed-rate debt and approximately \$89.1 million of variable-rate debt. The weighted average interest rate on the fixed-rate debt was 6.66%. A change in market interest rates on the fixed portion of our debt would impact the fair value of the debt, but have no impact on interest incurred or cash flows. Our variable-rate debt is exposed to changes in interest rates, specifically the change in 30-day LIBOR, but would be limited to the effect on the gap between the balance on the revolving credit facility and the \$30.0 million notional amount of the interest-rate swap executed August 8, 2006, as well as the balance of the mortgage on the Crowne Plaza Hampton Marina to the extent that 30-day LIBOR exceeds 2.00% as well as the loan from the Carlyle entity that is the other member of the joint venture entity that owns the Crowne Plaza Hollywood Beach Resort.

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Assuming that the amount outstanding under our credit facility remains at approximately \$75.5 million, the balance at December 31, 2009, the impact on our annual interest incurred and cash flows of a one percent change in interest rate would be approximately \$501,000.

Item 4T. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer of MHI Hospitality Corporation have evaluated the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as required by paragraph (b) of Rules 13a-15 and 15d-15 under the Exchange Act, and have concluded that as of the end of the period covered by this report, MHI Hospitality Corporation's disclosure controls and procedures were effective.

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As of March 31, 2010, there was no change in MHI Hospitality Corporation's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act during MHI Hospitality Corporation's last fiscal quarter that materially affected, or is reasonably likely to materially affect, MHI Hospitality Corporation's internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

We are not involved in any legal proceedings other than routine legal proceedings occurring in the ordinary course of business. We believe that these routine legal proceedings, in the aggregate, are not material to our financial condition and results of operations.

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our annual report on Form 10-K for the year ended December 31, 2009.

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

On March 22, 2010, Supreme Corp, a holder of units in the Operating Partnership, redeemed 368,168 units for an equivalent number of shares of the Company's common stock. The shares of common stock were issued to the unitholder pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933, as amended.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. [Removed and Reserved]

Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

Exhibit Number	Description of Exhibit
3.1	Articles of Amendment and Restatement of MHI Hospitality Corporation. ⁽¹⁾
3.2	Amended and Restated Bylaws of MHI Hospitality Corporation. ⁽²⁾
10.2A	Executive Employment Agreement between MHI Hospitality Corporation and Andrew M. Sims. ⁽³⁾
10.3A	Executive Employment Agreement between MHI Hospitality Corporation and William J. Zaiser. ⁽³⁾
31.1	Certification of President and Chief Executive Officer pursuant to Exchange Act Rules Rule 13(a)-14 and 15(d)-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules Rule 13(a)-14 and 15(d)-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	

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Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- (1) Incorporated by reference to the corresponding exhibit previously filed as an exhibit to the Registrant's Pre-Effective Amendment No. 1 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on October 20, 2004. (333-118873).
- (2) Incorporated by reference to the corresponding exhibit previously filed as an exhibit to the Registrant's Pre-Effective Amendment No. 5 to its Registration Statement on Form S-11 filed with the Securities and Exchange Commission on December 13, 2004. (333-118873).
- (3) Incorporated by reference to the corresponding exhibit previously filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 5, 2010.

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SIGNATURE

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

MHI HOSPITALITY CORPORATION

Date: May 14, 2010

By: /s/ ANDREW M. SIMS
Andrew M. Sims
President, Chief Executive Officer and Chairman of the Board

By: /s/ WILLIAM J. ZAISER
William J. Zaiser
Chief Financial Officer

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