

LASALLE HOTEL PROPERTIES  
Form 10-Q  
July 23, 2008  
Table of Contents

**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 June 30, 2008

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-14045

**LASALLE HOTEL PROPERTIES**

(Exact name of registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction)  
**36-4219376**  
(IRS Employer)  
**Identification No.)**  
**of incorporation or organization)**  
**3 Bethesda Metro Center, Suite 1200**  
**Bethesda, Maryland**  
(Address of principal executive offices)  
**20814**  
(Zip Code)  
**(301) 941-1500**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. 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 Exchange Act. Check one:

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

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

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<b>Class</b>	<b>Outstanding at July 23, 2008</b>
Common Shares of Beneficial Interest (\$0.01 par value)	40,449,343
8 <sup>3</sup> / <sub>8</sub> % Series B Cumulative Redeemable Preferred Shares ( \$0.01 par value)	1,100,000
7 <sup>1</sup> / <sub>2</sub> % Series D Cumulative Redeemable Preferred Shares ( \$0.01 par value)	3,170,000
8% Series E Cumulative Redeemable Preferred Shares (\$0.01 par value)	3,500,000
7 <sup>1</sup> / <sub>4</sub> % Series G Cumulative Redeemable Preferred Shares ( \$0.01 par value)	4,000,000

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I</b>	
<b><u>Financial Information</u></b>	
Item 1. <u>Financial Statements</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	46
Item 4. <u>Controls and Procedures</u>	46
<b>PART II</b>	
<b><u>Other Information</u></b>	
Item 1. <u>Legal Proceedings</u>	46
Item 1A. <u>Risk Factors</u>	46
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	48
Item 3. <u>Defaults Upon Senior Securities</u>	48
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	48
Item 5. <u>Other Information</u>	48
Item 6. <u>Exhibits</u>	48
<u>Signatures</u>	49

**Table of Contents****PART I. Financial Information****Item 1. Financial Statements****LASALLE HOTEL PROPERTIES****Consolidated Balance Sheets***(Dollars in thousands, except per share data)*

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	<b>(unaudited)</b>	
<b>Assets:</b>		
Investment in hotel properties, net	\$ 1,994,261	\$ 1,885,423
Property under development	58,910	111,236
Cash and cash equivalents	8,810	26,050
Restricted cash reserves (Note 5)	9,381	11,929
Rent receivable	1,761	3,075
Hotel receivables (net of allowance for doubtful accounts of approximately \$668 and \$722, respectively)	42,448	26,151
Deferred financing costs, net	3,303	3,441
Deferred tax asset	16,325	15,117
Prepaid expenses and other assets	55,161	28,898
<b>Total assets</b>	<b>\$ 2,190,360</b>	<b>\$ 2,111,320</b>
<b>Liabilities and Shareholders Equity:</b>		
Borrowings under credit facilities (Note 4)	\$ 177,517	\$ 70,416
Bonds payable (Note 4)	42,500	42,500
Mortgage loans (including unamortized premium of \$450 and \$590, respectively) (Note 4)	745,949	762,904
Accounts payable and accrued expenses	96,022	85,308
Advance deposits	17,323	7,265
Accrued interest	3,636	3,926
Distributions payable	12,518	12,466
<b>Total liabilities</b>	<b>1,095,465</b>	<b>984,785</b>
Minority interest in consolidated entities (Note 3)	2,639	
Minority interest of common units in Operating Partnership (redemption value of \$2,602 and \$3,303, respectively) (Notes 1 and 6)	695	747
Minority interest of preferred units in Operating Partnership (redemption value of \$86,181) (Notes 1 and 6)	87,482	87,652
Commitments and contingencies (Note 5)		
<b>Shareholders Equity:</b>		
Preferred shares, \$.01 par value, (liquidation preference \$294,250), 40,000,000 shares authorized and 11,770,000 shares issued and outstanding (Note 6)	118	118
Common shares of beneficial interest, \$.01 par value, 200,000,000 shares authorized; 40,449,772 shares issued and 40,449,343 outstanding, and 40,140,230 shares issued and outstanding, respectively (Note 6)	404	401
Treasury shares, at cost	(15)	
Additional paid-in capital, net of offering costs of \$42,679	1,129,971	1,128,708
Distributions in excess of retained earnings	(126,399)	(91,091)
<b>Total shareholders equity</b>	<b>1,004,079</b>	<b>1,038,136</b>

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Total liabilities and shareholders' equity	\$ 2,190,360	\$ 2,111,320
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The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****LASALLE HOTEL PROPERTIES****Consolidated Statements of Operations***(Dollars in thousands, except per share data)**(unaudited)*

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Hotel operating revenues:				
Room revenue	\$ 127,203	\$ 114,944	\$ 207,701	\$ 195,659
Food and beverage revenue	52,222	48,372	84,762	83,526
Other operating department revenue	14,318	13,017	23,889	22,355
Total hotel operating revenues	193,743	176,333	316,352	301,540
Participating lease revenue	5,057	7,143	10,564	12,660
Other income	2,496	1,240	4,040	2,438
<b>Total revenues</b>	<b>201,296</b>	<b>184,716</b>	<b>330,956</b>	<b>316,638</b>
<b>Expenses:</b>				
Hotel operating expenses:				
Room	27,361	24,054	48,848	44,895
Food and beverage	33,530	31,050	58,216	57,199
Other direct	6,640	6,316	11,328	11,143
Other indirect	46,575	44,336	86,086	82,797
Total hotel operating expenses	114,106	105,756	204,478	196,034
Depreciation and amortization	26,819	22,945	51,560	45,085
Real estate taxes, personal property taxes and insurance	9,865	8,299	18,666	16,445
Ground rent (Note 5)	1,997	1,728	3,545	3,169
General and administrative	4,170	3,488	7,828	7,398
Other expenses	682	658	1,504	1,233
<b>Total operating expenses</b>	<b>157,639</b>	<b>142,874</b>	<b>287,581</b>	<b>269,364</b>
<b>Operating income</b>	<b>43,657</b>	<b>41,842</b>	<b>43,375</b>	<b>47,274</b>
Interest income	26	199	109	1,023
Interest expense	(12,362)	(11,868)	(23,831)	(23,311)
Income before income tax (expense) benefit, minority interest, equity in earnings of joint venture and discontinued operations	31,321	30,173	19,653	24,986
Income tax (expense) benefit (Note 9)	(3,738)	(3,632)	117	(251)
Minority interest in loss of consolidated entities (Note 3)	4	5	5	5
Minority interest of common units in Operating Partnership (Notes 1 and 6)	(72)	(69)	(53)	(143)
Minority interest of preferred units in Operating Partnership (Notes 1 and 6)	(1,346)	(1,531)	(2,759)	(3,057)
Equity in earnings of joint venture	27	27	27	27
<b>Income from continuing operations</b>	<b>26,169</b>	<b>24,968</b>	<b>16,963</b>	<b>21,562</b>

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Discontinued operations:				
Income from operations of properties disposed of, including gain on disposal of assets		16		30,341
Minority interest, net of tax				(1)
Income tax benefit				73
<b>Net income from discontinued operations</b>		<b>16</b>		<b>30,413</b>
Net income	26,169	24,984	16,963	51,975
Distributions to preferred shareholders	(5,624)	(5,624)	(11,248)	(13,095)
Issuance costs of redeemed preferred shares (Note 6)				(3,868)
<b>Net income applicable to common shareholders</b>	<b>\$ 20,545</b>	<b>\$ 19,360</b>	<b>\$ 5,715</b>	<b>\$ 35,012</b>

**Table of Contents****LASALLE HOTEL PROPERTIES****Consolidated Statements of Operations - Continued***(Dollars in thousands, except per share data)**(unaudited)*

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
<b>Earnings per Common Share - Basic:</b>				
Net income applicable to common shareholders before discontinued operations and after dividends on unvested restricted shares	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.11
Discontinued operations				0.76
Net income applicable to common shareholders after dividends on unvested restricted shares	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.87
<b>Earnings per Common Share - Diluted:</b>				
Net income applicable to common shareholders before discontinued operations	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.11
Discontinued operations				0.76
Net income applicable to common shareholders	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.87
<b>Weighted average number of common shares outstanding:</b>				
Basic	39,919,144	39,854,720	39,919,144	39,849,367
Diluted	39,978,272	40,133,572	39,994,301	40,132,087

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

**Table of Contents****LASALLE HOTEL PROPERTIES****Consolidated Statements of Cash Flows***(Dollars in thousands, except per share data)**(unaudited)*

	<b>For the six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 16,963	\$ 51,975
Adjustments to reconcile net income to net cash flow provided by operating activities:		
Depreciation and amortization	51,560	45,136
Amortization of deferred financing costs and mortgage premiums	536	590
Minority interest in Operating Partnership	2,812	3,201
Minority interest in consolidated entities	(5)	
Gain on sale of hotel property		(30,278)
Deferred compensation	2,054	1,766
Allowance for doubtful accounts	(54)	136
Changes in assets and liabilities:		
Restricted cash reserves, net	(382)	(1,037)
Rent receivable	1,314	(2,134)
Hotel receivables	(16,243)	(10,919)
Deferred tax asset	(1,208)	(483)
Prepaid expenses and other assets	(26,658)	(13,866)
Accounts payable and accrued expenses	10,548	6,655
Advance deposits	10,058	5,589
Accrued interest	(290)	(146)
Net cash flow provided by operating activities	51,005	56,185
<b>Cash flows from investing activities:</b>		
Improvements and additions to properties	(55,917)	(60,061)
Acquisition of property	(51,469)	
Purchase of office furniture and equipment	(23)	(11)
Payment of deferred lease fees		(129)
Restricted cash reserves, net	2,930	4,457
Proceeds from sale of investment in hotel property		71,465
Net cash flow (used in) provided by investing activities	(104,479)	15,721
<b>Cash flows from financing activities:</b>		
Borrowings under credit facilities	249,499	101,959
Repayments under credit facilities	(142,398)	(74,959)
Repayments of mortgage loans	(16,815)	(2,070)
Payment of deferred financing costs	(538)	(1,071)
Contributions from minority investor	2,644	
Purchase of treasury shares	(955)	(1,038)
Proceeds from exercise of stock options		247
Redemption of preferred shares		(99,797)
Distributions-preferred shares/units	(14,177)	(17,544)
Distributions-common shares/units	(41,026)	(36,183)

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Net cash flow provided by (used in) financing activities	36,234	(130,456)
Net change in cash and cash equivalents	(17,240)	(58,550)
Cash and cash equivalents, beginning of period	26,050	63,026
Cash and cash equivalents, end of period	\$ 8,810	\$ 4,476

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

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**Table of Contents**

**LASALLE HOTEL PROPERTIES**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except per share data)*

*(unaudited)*

**1. Organization**

LaSalle Hotel Properties (the Company), a Maryland real estate investment trust (REIT), buys, owns, redevelops and leases upscale and luxury full-service hotels located in convention, resort and major urban business markets. The Company is a self-administered and self-managed REIT as defined in the Internal Revenue Code of 1986, as amended (the Code). As a REIT, the Company generally is not subject to federal corporate income tax on that portion of its net income that is currently distributed to shareholders.

As of June 30, 2008, the Company owned interests in 31 hotels with approximately 8,500 suites/rooms located in 11 states and the District of Columbia. Each hotel is leased under a participating lease that provides for rental payments equal to the greater of (i) a base rent or (ii) a participating rent based on hotel revenues. An independent hotel operator manages each hotel. One of the hotels is leased to an unaffiliated lessee (an affiliate of whom also operates this hotel) and 30 of the hotels are leased to the Company's taxable-REIT subsidiary, LaSalle Hotel Lessee, Inc. (LHL), or a wholly-owned subsidiary of LHL (see Note 8), including one hotel which transitioned from a lease with an unaffiliated lessee to a new lease with LHL as of June 1, 2008. Lease revenue from LHL and its wholly-owned subsidiaries is eliminated in consolidation. Additionally, the Company owned a 95% joint venture interest in a property under development (see Note 3).

Substantially all of the Company's assets are held by, and all of its operations are conducted through, LaSalle Hotel Operating Partnership, L.P. (the Operating Partnership). The Company is the sole general partner of the Operating Partnership. The Company owned 99.7% of the common units of the Operating Partnership at June 30, 2008. The remaining 0.3% was held by limited partners who held 103,530 limited partnership common units at June 30, 2008. A limited partner owns 2,348,888 Series C Preferred Units of limited interest in the Operating Partnership. In addition, a limited partner owns 1,098,348 Series F Preferred Units of limited interest in the Operating Partnership. See Note 6 for additional disclosures on common and preferred operating partnership units.

**2. Summary of Significant Accounting Policies**

The accompanying unaudited interim consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and in conformity with the rules and regulations of the Securities and Exchange Commission (SEC) applicable to interim financial information. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations of the SEC. These unaudited consolidated financial statements, in the opinion of management, include all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations, and consolidated statements of cash flows for the periods presented. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 due to seasonal and other factors. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. Certain prior period amounts have been reclassified to conform to the current period presentation.

**Basis of Presentation**

The consolidated financial statements include the accounts of the Company, the Operating Partnership, LHL and their subsidiaries in which they have a controlling interest, including joint ventures. All significant intercompany balances and transactions have been eliminated.

**Use of Estimates**

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and the amounts of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.



## **Table of Contents**

Substantially all of the Company's revenues and expenses are generated by the operations of the individual hotels. The Company records revenues and expenses that are estimated by the hotel operators to produce quarterly financial statements because the management contracts do not require the hotel operators to submit actual results within a time frame that permits the Company to use actual results when preparing its quarterly reports on Form 10-Q for filing by the deadline prescribed by the SEC. Generally, the Company records actual revenue and expense amounts for the first two months of each quarter and revenue and expense estimates for the last month of each quarter. Each quarter, the Company reviews the estimated revenue and expense amounts provided by the hotel operators for reasonableness based upon historical results for prior periods and internal Company forecasts. The Company records any differences between recorded estimated amounts and actual amounts in the following quarter; historically these differences have not been material. The Company believes the aggregate estimate of quarterly revenues and expenses recorded on the Company's consolidated statements of operations are fairly stated.

## **Stock-Based Compensation**

From time to time, the Company awards nonvested shares under the 1998 Share Option and Incentive Plan ( 1998 Plan ) as compensation to trustees, executive officers and employees. The shares vest over three to nine years. The Company recognizes compensation expense for nonvested shares on a straight-line basis over the vesting period based upon the fair market value of the shares on the date of issuance, adjusted for estimated forfeitures. Effective January 1, 2006, the Company adopted SFAS No. 123R (revised 2004), Share-Based Payment which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated statements of operations based on their fair values. No options have been granted since 2002. Accordingly, there were no option-related costs for 2008 and 2007 since the options were fully vested by then.

## **Recently Issued Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( FAS 157 ). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurements. This guidance was issued to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Adoption on January 1, 2008 did not have a material effect on the Company. The Company has deferred the application of FAS 157 related to non-financial assets and liabilities.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( FAS 159 ). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of the guidance is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. Adoption on January 1, 2008 did not have a material effect on the Company since the Company did not elect to measure any financial assets or liabilities at fair value.

In December 2007, the FASB issued revised SFAS No. 141, Business Combinations ( FAS 141(R) ). FAS 141(R) establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquirer; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The objective of the guidance is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. FAS 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Adoption on January 1, 2009 will impact the Company's accounting for future acquisitions and related transaction costs.

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**Table of Contents**

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ( FAS 160 ). FAS 160 establishes accounting and reporting standards that require the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently; when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value; and entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The objective of the guidance is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. FAS 160 is effective for fiscal years beginning on or after December 15, 2008. Management is currently evaluating the impact FAS 160 will have on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( FAS 161 ). FAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. The objective of the guidance is to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for; and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FAS 161 is effective for fiscal years beginning after November 15, 2008. Management is currently evaluating the impact FAS 161 will have on the Company's consolidated financial statements.

**3. Properties**

**Joint Ventures**

On March 18, 2008, the Company, through Modern Magic Hotel LLC, a joint venture in which the Company holds a 95% controlling interest, acquired floors 2 through 13 and a portion of the first floor of the existing 52-story IBM Building located at 330 N. Wabash Avenue in downtown Chicago, IL for \$46,000 plus acquisition costs. The joint venture has developed plans to convert the existing vacant floors to a super luxury hotel. Since the Company holds a controlling interest, the accounts of the joint venture have been included in the consolidated financial statements. Initial acquisition and subsequent costs are included in property under development in the accompanying consolidated balance sheet. The 5% interest of the outside partner is included in minority interest in consolidated entities in the accompanying consolidated balance sheet.

On April 17, 2008, the Company entered into a joint venture arrangement with LaSalle Investment Management ( LIM ), a leading global real estate investment manager, to seek domestic hotel investments in high barrier-to-entry urban and resort markets in the U.S. The two companies plan to invest up to \$250,000 of equity in the joint venture. With anticipated leverage, this will result in investments of up to \$700,000. The Company, through the Operating Partnership, will own a 15.0% equity interest in the joint venture and have the opportunity to earn additional capital gains, based upon achieving specific return thresholds based on the joint venture's equity investment. The Company will receive additional income for providing acquisition, asset management, project redevelopment oversight and financing services. The anticipated acquisition period is up to three years with the joint venture having a total life of up to seven years. The Company will continue to have the ability to acquire hotels on a wholly-owned basis throughout the life of the joint venture. During the joint venture's three-year acquisition period, prospective acquisitions will be allocated between the Company and the joint venture on the following basis: (i) the Company will have first right of acquisition to any asset with an acquisition price below \$75,000, (ii) the joint venture will have first right of acquisition to any asset with an acquisition price above \$175,000, and (iii) any asset with an acquisition price between \$75,000 and \$175,000 will be offered on a rotational basis with the first acquisition allocated to the joint venture. The Company accounts for its investment in this joint venture under the equity method of accounting. As of June 30, 2008 there were no acquisitions through the joint venture.

**Table of Contents**

**Discontinued Operations**

Effective January 10, 2007, the Company entered into a contract to sell the LaGuardia Airport Marriott ( LaGuardia ). The asset was classified as held for sale at that time, and accordingly, depreciation was suspended. The Company sold LaGuardia on January 26, 2007 and recognized a gain of \$30,401, of which \$16 and \$30,278 was recognized in the three and six months ended June 30, 2007, respectively. LaGuardia's activity, including the gain on sale, is recorded in discontinued operations in the accompanying consolidated statements of operations. The Company utilized the sale of the hotel as the disposition property in the reverse 1031 exchange established in conjunction with the Hotel Solamar acquisition in August 2006. As a result, the Company's gain was deferred for tax purposes. For the three and six months ended June 30, 2008, LaGuardia had zero revenues. For the three and six months ended June 30, 2007, LaGuardia had total revenues of zero and \$1,988, respectively. For the three and six months ended June 30, 2008, LaGuardia had zero operating income before income tax benefit and minority interest. For the three and six months ended June 30, 2008 and 2007, LaGuardia had operating income before income tax benefit and minority interest of zero and \$63, respectively. At June 30, 2008, the Company had no assets or liabilities related to the sale of LaGuardia.

**Table of Contents****4. Long-Term Debt**

Debt at June 30, 2008 and December 31, 2007 consisted of the following:

Debt	Interest Rate	Maturity Date	Balance Outstanding at	
			June 30, 2008	December 31, 2007
<b>Credit facilities</b>				
Senior Unsecured Credit Facility	Floating <sup>(a)</sup>	April 2011 <sup>(a)</sup>	\$ 169,000	\$ 56,000
LHL Unsecured Credit Facility	Floating <sup>(b)</sup>	April 2011 <sup>(b)</sup>	8,517	14,416
Total borrowings under credit facilities			177,517	70,416
<b>Massport bonds</b>				
Harborside Hyatt Conference Center & Hotel (taxable) <sup>(c)</sup>	Floating <sup>(c)</sup>	March 2018	5,400	5,400
Harborside Hyatt Conference Center & Hotel (tax exempt) <sup>(c)</sup>	Floating <sup>(c)</sup>	March 2018	37,100	37,100
Total bonds payable			42,500	42,500
<b>Mortgage loans</b>				
Le Parc Suite Hotel	7.78%	May 2008 <sup>(d)</sup>		14,860
Gild Hall	Floating <sup>(e)</sup>	November 2008 <sup>(e)</sup>	20,000	20,000
Sheraton Bloomington Hotel Minneapolis South and Westin City Center Dallas	8.10%	July 2009	39,086	39,661
San Diego Paradise Point Resort	5.25%	February 2009	58,978	59,729
Hilton Alexandria Old Town	4.98%	September 2009	31,635	32,032
Le Montrose Suite Hotel	8.08%	July 2010	13,267	13,392
Hilton San Diego Gaslamp Quarter	5.35%	June 2012	59,600	59,600
Hotel Solamar	5.49%	December 2013	60,900	60,900
Hotel Deca	6.28%	August 2014	10,253	10,360
Westin Copley Place	5.28%	August 2015	210,000	210,000
Westin Michigan Avenue	5.75%	April 2016	140,000	140,000
Indianapolis Marriott Downtown	5.99%	July 2016	101,780	101,780
Mortgage loans			745,499	762,314
Unamortized loan premium <sup>(f)</sup>			450	590
Total mortgage loans			745,949	762,904
Total debt			\$ 965,966	\$ 875,820

- (a) Borrowings bear interest at floating rates equal to, at the Company's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. At June 30, 2008, the rates applicable to the Company's outstanding LIBOR borrowings of \$83,000 and \$86,000 were 3.29% and 3.28%, respectively. At December 31, 2007, the rates applicable to the Company's outstanding LIBOR borrowings of \$29,000 and \$27,000 were 6.00% and 5.91%, respectively. The Company has the option to extend the credit facility's maturity date to April 2012.
- (b) Borrowings bear interest at floating rates equal to, at LHL's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. At June 30, 2008 and December 31, 2007, the rates applicable to LHL's outstanding LIBOR borrowings were 3.18% and 5.90%, respectively. LHL has the option to extend the credit facility's maturity date to April 2012.
- (c) The Massport bonds are secured by letters of credit issued by the Royal Bank of Scotland that expire in 2009. The Royal Bank of Scotland letters of credit are secured by the Harborside Hyatt Conference Center & Hotel. The bonds bear interest based on weekly floating rates.

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The interest rates at June 30, 2008 were 2.75% and 1.62% for the \$5,400 and \$37,100 bonds, respectively. The interest rates at December 31, 2007 were 4.95% and 3.49% for the \$5,400 and \$37,100 bonds, respectively. The Company also incurs an annual letter of credit fee, which was reduced from 1.35% to 1.10% in February 2008.

- (d) The Company repaid the mortgage loan through borrowings on its credit facilities upon maturity.
- (e) Mortgage debt bears interest at LIBOR plus 0.75%. The interest rates at June 30, 2008 and December 31, 2007 were 3.23% and 5.65%, respectively. The Company has the option to extend the maturity date for two consecutive one-year periods and a final 13-month period. The Company intends to exercise its first extension option upon initial maturity.
- (f) Mortgage debt includes unamortized loan premiums on the mortgage loans on Le Parc Suite Hotel and Hotel Deca of zero and \$450, respectively, as of June 30, 2008, and \$107 and \$483, respectively, as of December 31, 2007.

The Company incurred interest expense of \$12,362 and \$23,831 for the three and six months ended June 30, 2008, respectively, and \$11,868 and \$23,311 for the three and six months ended June 30, 2007, respectively.

**Table of Contents**

Included in interest expense is amortization of deferred financing fees of \$333 and \$676 for the three and six months ended June 30, 2008, respectively, and \$208 and \$775 for the three and six months ended June 30, 2007, respectively. Interest was capitalized in the amounts of \$682 and \$2,072 for the three and six months ended June 30, 2008, respectively, and \$832 and \$1,621 for the three and six months ended June 30, 2007, respectively.

As of June 30, 2008, the Company was current on all loan payments and in compliance with all debt covenants under the mortgages.

**Credit Facilities**

The Company has a senior unsecured credit facility from a syndicate of banks that provides for a maximum borrowing of up to \$450,000. On January 14, 2008, the Company amended the credit facility to increase the maximum borrowing from \$300,000 to \$450,000. On April 13, 2007, the Company amended the credit facility to extend the credit facility's maturity date to April 13, 2011 with a one-year extension option and to reduce the applicable margin pricing by a range of 0.8% to 1.0%. The senior unsecured credit facility contains certain financial covenants relating to debt service coverage, net worth and total funded indebtedness. It also contains financial covenants that, assuming no defaults, allow the Company to make shareholder distributions. Borrowings under the credit facility bear interest at floating rates equal to, at the Company's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. As of June 30, 2008, the Company was in compliance with all debt covenants and was not otherwise in default under the credit facility. The weighted average interest rate for borrowings under the senior unsecured credit facility was 3.4% and 3.7% for the three and six months ended June 30, 2008, respectively, and 6.1% and 6.2% for the three and six months ended June 30, 2007, respectively. The Company did not have any Adjusted Base Rate borrowings outstanding at June 30, 2008. Additionally, the Company is required to pay a variable unused commitment fee determined from a ratings or leverage based pricing matrix, currently set at 0.125% of the unused portion of the senior unsecured credit facility. The Company incurred unused commitment fees of \$83 and \$188 for the three and six months ended June 30, 2008, respectively, and \$89 and \$231 for the three and six months ended June 30, 2007, respectively. At June 30, 2008 and December 31, 2007, the Company had \$169,000 and \$56,000, respectively, of outstanding borrowings under the senior unsecured credit facility.

LHL has a \$25,000 unsecured revolving credit facility to be used for working capital and general lessee corporate purposes. On April 13, 2007, LHL amended the credit facility to extend the credit facility's maturity date to April 13, 2011 with a one-year extension option and to reduce the applicable margin pricing by a range of 0.8% to 1.0%. Borrowings under the LHL credit facility bear interest at floating rates equal to, at LHL's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. As of June 30, 2008, LHL was in compliance with all debt covenants and was not otherwise in default under the credit facility. The weighted average interest rate for borrowings under the LHL credit facility was 3.3% and 4.0% for the three and six months ended June 30, 2008, respectively, and 6.2% and 6.3% for the three and six months ended June 30, 2007, respectively. LHL did not have any Adjusted Base Rate borrowings outstanding at June 30, 2008. Additionally, LHL is required to pay a variable unused commitment fee determined from a ratings or leverage based pricing matrix, currently set at 0.125% of the unused portion of the LHL credit facility. LHL incurred unused commitment fees of \$5 and \$9 for the three and six months ended June 30, 2008, respectively, and \$4 and \$14 for the three and six months ended June 30, 2007, respectively. At June 30, 2008 and December 31, 2007, LHL had \$8,517 and \$14,416, respectively, of outstanding borrowings under the LHL credit facility.

**5. Commitments and Contingencies**

**Ground and Air Rights Leases**

Five of the Company's hotels, San Diego Paradise Point Resort, Harborside Hyatt Conference Center & Hotel, Indianapolis Marriott Downtown, Hilton San Diego Resort and Hotel Solamar, and the parking lot at Sheraton Bloomington Hotel Minneapolis South, are subject to ground leases under non-cancelable operating leases expiring from October 2014 to December 2102. The lease on the parking lot at the Sheraton Bloomington Hotel Minneapolis South expires in 2014, but the Company has an option to extend for 7 years to 2021. None of the remaining leases expire prior to 2020. The Westin Copley Place is subject to a long term air rights lease which expires on December 14, 2077 and requires no payments through maturity. In addition, one of the two golf courses, the Pines, at Seaview

## **Table of Contents**

Resort and Spa is subject to a ground lease, which expires on December 31, 2012 and may be renewed for 15 successive periods of 10 years. The ground leases related to the Pines golf course and the Indianapolis Marriott Downtown require future ground rent of one dollar per year. Total ground lease expense was \$1,997 and \$3,545 for the three and six months ended June 30, 2008, respectively, and \$1,728 and \$3,169 for the three and six months ended June 30, 2007, respectively.

### **Reserve Funds**

Certain of the Company's agreements with its hotel managers, franchisors and lenders have provisions for the Company to provide funds, generally 3.0% to 5.5% of hotel revenues, sufficient to cover the cost of (a) certain non-routine repairs and maintenance to the hotels; and (b) replacements and renewals to the hotels' furniture, fixtures, and equipment. Certain agreements require that the Company reserve cash. As of June 30, 2008, \$3,565 was available in restricted cash reserves for future capital expenditures.

### **Restricted Cash Reserves**

At June 30, 2008, the Company held \$9,381 in restricted cash reserves. Included in such amounts are (i) \$3,565 of reserve funds relating to the hotels with leases or operating agreements requiring the Company to maintain restricted cash to fund future capital expenditures, (ii) \$5,799 deposited in mortgage escrow accounts pursuant to mortgage obligations to pre-fund a portion of certain hotel expenses and debt payments, and (iii) \$17 of tenant security deposits held in cash accounts per leases.

### **Litigation**

The nature of the operations of the hotels exposes the hotels to the risk of claims and litigation in the normal course of their business. Although the outcome of these matters cannot be determined, management does not expect the ultimate resolution of these matters to have a material adverse effect on the financial position, operations or liquidity of the hotels.

The Company has engaged Starwood Hotels & Resorts Worldwide, Inc. to manage and operate its Dallas hotel under the Westin brand affiliation. Meridien Hotels, Inc. (Meridien) affiliates had been operating the Dallas property as a wrongful holdover tenant, until the Westin brand conversion occurred on July 14, 2003 under court order.

On December 20, 2002, affiliates of Meridien abandoned the Company's New Orleans hotel. The Company entered into a lease with a wholly-owned subsidiary of LHL and an interim management agreement with Interstate Hotels & Resorts, Inc., and re-named the hotel the New Orleans Grande Hotel. The New Orleans property thereafter was sold on April 21, 2003 for \$92,500.

In connection with the termination of the Meridien affiliates at these hotels, the Company is currently in litigation with Meridien and related affiliates. The Company understands that Lehman Brothers is now the real party in interest after having acquired a controlling stake in the Meridien entities that are parties to the Dallas and New Orleans lawsuits. The Company believes its sole potential obligation in connection with the termination of the leases is to pay fair market value of the leases at the date of termination if any.

With respect to the Dallas hotel, the Company has obtained a judgment from the court that Meridien defaulted and that Meridien is not entitled to the payment of fair market value. The Company's damage claims against Meridien went to trial in March 2005, and a final judgment was entered for the Company in the amount of \$3,903, plus post-judgment interest. Both parties cross-appealed, and on February 11, 2008 the Texas Court of Appeals affirmed the lower court's ruling that Meridien defaulted and is not entitled to payment of fair market value. The appellate court also affirmed the award of damages in the amount of holdover rent, but reduced the amount of the final judgment entered for the Company by approximately \$1,390. The Company has asked the Court of Appeals to reconsider its rulings in two respects: (i) whether Meridien Hotels, Inc. should be jointly and severally liable for the payment of the judgment; and (ii) whether the Company is entitled to pre-judgment interest on the amount of holdover rent that was not timely paid by Meridien during its wrongful holdover. On May 28, 2008, the Court of Appeals modified its prior decision to provide for an award of pre-judgment interest to the Company, entered a new

**Table of Contents**

judgement, and remanded to the trial court to determine the amount of pre-judgement interest to be awarded to the Company. Meridien did not timely file an objection to the Court's decision, and the Company anticipates that the trial court will issue a new scheduling order to resolve and otherwise act on its mandate to award pre-judgement interest to the Company.

With respect to the New Orleans hotel, arbitration of the fair market value of the New Orleans lease commenced in October 2002. On December 19, 2002, the arbitration panel determined that Meridien was entitled to an award of \$5,700, subject to adjustment (reduction) by the courts to account for Meridien's holdover. In order to dispute the arbitration decision, the Company was required to post a \$7,800 surety bond, which was secured by \$5,900 of restricted cash. The Company successfully challenged the award on appeal, and the dispute was remanded to the trial court. Meridien's request for rehearing was denied on March 31, 2004, and Meridien did not petition to the Louisiana Supreme Court. In June 2004, the \$7,800 surety bond was released and the \$5,900 restricted cash securing it was returned to the Company. The issue of default by the lessee and the Company's wrongful holdover claim, as well as Meridien's damage claims arising from the termination of its leasehold, among other claims, went to trial in February 2005. On June 9, 2005, the trial court issued its judgment denying the Company's default claim as well as Meridien's fraud claim, and re-determined fair market value of the lease to be \$8,572, plus interest. On July 18, 2005, the Company posted a \$8,633 surety bond, which was secured by \$8,980 of restricted cash. On May 26, 2006, the trial court entered judgment awarding Meridien attorney's fees of \$4,130. The Company has noticed an appeal from the trial court's judgment. On July 11, 2006, the Company posted a \$4,174 bond which is collateralized by a letter of credit. On August 15, 2006, the Company replaced the restricted cash collateral on the \$8,633 bond and obtained a new \$12,807 letter of credit which serves as collateral for the \$8,633 bond and the \$4,174 bond. The Louisiana court of appeals heard argument on the Company's appeal from the trial court's judgment on April 3, 2007, and issued its decision on April 16, 2008. The Appeals Court vacated the trial court's determination and award of fair market value, affirmed the trial court's judgment that Meridien was not in default of the lease, reduced Meridien's attorney's fee award to \$2,753, and ordered that the matter be sent back to arbitration for a recalculation of fair market value. The Company unsuccessfully petitioned the Court of Appeals for a rehearing, and is considering its options. Pending final resolution of the Company's default claims, Meridien has demanded arbitration of fair market value, and the Company has answered that demand. The Company applied for a writ of certiorari to the Supreme Court of Louisiana, asking for review of the appellate court's decision on the default and wrongful injunction issues. Pending the Supreme Court of Louisiana's response to that application, the trial court stayed the FMV arbitration.

In 2002, the Company recognized a net \$2,520 contingent lease termination expense and reversed previously deferred assets and liabilities related to the termination of both the New Orleans property and Dallas property leases and recorded a corresponding contingent liability included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. The Company believes, however, it is owed holdover rent per the lease terms due to Meridien's failure to vacate the properties as required under the leases. The contingent lease termination expense was, therefore, net of the holdover rent the Company believes it is entitled to for both properties. In 2003, the Company adjusted this liability by additional holdover rent of \$827 that it believes it is entitled to for the Dallas property. These amounts were recorded as other income in the Company's December 31, 2003 consolidated statement of operations. The contingent lease termination expense recognized cumulatively since 2002 is comprised of:

Expense Recognized For the Year Ended	Estimated Arbitration Award	Legal Fees Related to Litigation	Holdover Rent	Expected Reimbursement of Legal fees	Net Contingent Lease Termination Expense
December 31, 2002 <sup>(1)</sup>	\$ 5,749	\$ 2,610	\$ (4,844)	\$ (995)	\$ 2,520
December 31, 2003					
December 31, 2004		1,350		(500)	850
December 31, 2005		1,000			1,000
December 31, 2006		800			800
December 31, 2007					
June 30, 2008 <sup>(2)</sup>					
Cumulative Expense Recognized as of June 30, 2008	\$ 5,749	\$ 5,760	\$ (4,844)	\$ (1,495)	\$ 5,170

(1) Recognized in quarter ended December 31, 2002.

(2) Recognized in six months ended June 30, 2008.



**Table of Contents**

In September 2004 and June 2005, after evaluating the ongoing Meridien litigation, the Company accrued additional net legal fees of \$850 and \$1,000, respectively, due to litigation timeline changes. In September 2006, after further evaluation of the ongoing Meridien litigation, the Company accrued an additional \$800 in legal fees due to timeline changes in order to conclude this matter. As a result, the net contingent lease termination liability has a balance of \$1,503 as of June 30, 2008, which is included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. Based on the claims the Company has against Meridien, the Company is and will continue to challenge Meridien's claim that it is entitled to the payment of fair market value, and will continue to seek reimbursement of legal fees and damages. These amounts may exceed or otherwise may be used to offset any amounts potentially owed to Meridien, and therefore, ultimately may offset or otherwise reduce any contingent lease termination expense. Additionally, the Company cannot provide any assurances that the holdover rents or any damages will be collectible from Meridien or that the amounts due will not be greater than the recorded contingent lease termination expense.

The Company maintained a lien on Meridien's security deposit on both disputed properties with an aggregate value of \$3,300, in accordance with the lease agreements. The security deposits were liquidated in May 2003 with the proceeds used to partially satisfy Meridien's outstanding obligations. The judgment entered by the Dallas Court already incorporates a set-off in the amount of \$989 attributable to the security deposit for the Dallas property.

The Company does not believe that the amount of any fees or damages it may be required to pay on any of the litigation related to Meridien will have a material adverse effect on the Company's financial condition or results of operations, taken as a whole. The Company's management has discussed this contingency and the related accounting treatment with the audit committee of its Board of Trustees.

The Company accrues for future legal fees related to contingent liabilities based upon management's estimate. The Company is not presently subject to any other material litigation nor, to the Company's knowledge, is any other litigation threatened against the Company, other than routine actions for negligence or other claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance and all of which collectively are not expected to have a material adverse effect on the liquidity, results of operations or business or financial condition of the Company.

**Table of Contents****6. Shareholders' Equity and Minority Interest  
Stock Purchase Rights**

In connection with the acquisition of the initial hotels, the Company granted 1,280,569 rights to purchase common shares of beneficial interest at the exercise price of \$18.00 per share. The Company recorded these rights in shareholders' equity at their fair value on the date of grant. All rights had a one-year vesting period and a 10-year term. On April 28, 2008, the remaining outstanding 160,986 exercisable rights expired, resulting in no outstanding exercisable rights as of June 30, 2008.

**Common Shares of Beneficial Interest**

On January 1, 2008, executives and employees of the Company surrendered 29,945 common shares of beneficial interest to the Company to pay taxes at the time restricted shares vested. The Company re-issued 3,515 treasury shares as compensation to the Board of Trustees.

On January 1, 2008, the Company issued an aggregate of 8,817 common shares of beneficial interest, including 5,302 deferred shares to the independent members of its Board of Trustees for their 2007 compensation. These common shares were issued under the 1998 Plan.

On May 31, 2008 and June 25, 2008, the Company granted 175,000 and 162,500 restricted common shares of beneficial interest, respectively, to the Company's executives. The restricted shares granted vest over three to nine years, starting June 30, 2011. These common shares of beneficial interest were issued under the 1998 Plan.

During the quarter ended June 30, 2008, the Company received 1,957 common shares of beneficial interest related to the forfeiture of restricted shares due to employee resignations. The Company re-issued 27,958 treasury shares related to the issuance of restricted common shares of beneficial interest in May 2008. At June 30, 2008, there were 429 common shares of beneficial interest in treasury.

**Common Operating Partnership Units**

As of June 30, 2008, the Operating Partnership had 103,530 common units outstanding, representing a 0.3% partnership interest held by the limited partners. As of June 30, 2008, approximately \$2,602 of cash or the equivalent value in common shares, at our option, would be paid to the limited partners of the Operating Partnership if the partnership was terminated. The approximate value of \$2,602 is equivalent to the units outstanding valued at the Company's June 30, 2008 closing share price of \$25.13, which would be equal to the value provided to the limited partners upon liquidation of the Operating Partnership.

**Common Dividends**

The Company paid the following dividends on common shares/units during the six months ended June 30, 2008:

Dividend per	For the	Declared	Record Date	Payable
Share/Unit	Month			Date
\$0.17	31-Dec-2007	15-Oct-2007	31-Dec-2007	15-Jan-2008
\$0.17	31-Jan-2008	15-Jan-2008	31-Jan-2008	15-Feb-2008
\$0.17	29-Feb-2008	15-Jan-2008	29-Feb-2008	14-Mar-2008
\$0.17	31-Mar-2008	15-Jan-2008	31-Mar-2008	15-Apr-2008
\$0.17	30-Apr-2008	15-Apr-2008	30-Apr-2008	15-May-2008
\$0.17	31-May-2008	15-Apr-2008	30-May-2008	13-Jun-2008

**Table of Contents****Treasury Shares**

Treasury shares are accounted for under the cost method. In January 2008, the Company repurchased 29,945 common shares of beneficial interest related to executives and employees surrendering shares to pay taxes at the time restricted shares vested. The Company re-issued 3,515 treasury shares as compensation to the Board of Trustees for 2007. During the quarter ended June 30, 2008, the Company received 1,957 common shares of beneficial interest related to the forfeiture of restricted shares due to employee resignations. The Company re-issued 27,958 treasury shares related to the issuance of restricted common shares of beneficial interest in May 2008.

At June 30, 2008, there were 429 common shares of beneficial interest in treasury.

**Preferred Shares**

On March 6, 2007, the Company redeemed all 3,991,900 outstanding 10.25% Series A Cumulative Redeemable Preferred Shares (the Series A Preferred Shares) for \$99,797 (\$25.00 per share) plus accrued distributions through March 6, 2007 of \$1,847. The fair value of the Series A Preferred Shares exceeded the carrying value of the Series A Preferred by \$3,868, the amount of offering costs related to the Series A Preferred Shares, which is included in the determination of net income applicable to common shareholders for the six months ended June 30, 2007.

The Series B Preferred Shares, Series C Preferred Shares (if and when issued), Series D Preferred Shares, Series E Preferred Shares, and Series G Preferred Shares (collectively, the Preferred Shares) rank senior to the common shares of beneficial interest and on parity with each other with respect to payment of distributions; the Company will not pay any distributions, or set aside any funds for the payment of distributions, on its common shares of beneficial interest unless it has also paid (or set aside for payment) the full cumulative distributions on the Preferred Shares for the current and all past dividend periods. The outstanding Preferred Shares do not have any maturity date, and are not subject to mandatory redemption. The difference between the carrying value and the redemption amount of the Preferred Shares are the offering costs. In addition, the Company is not required to set aside funds to redeem the Preferred Shares. The Company may not optionally redeem the Series B Preferred Shares, Series D Preferred Shares, Series E Preferred Shares or Series G Preferred Shares, prior to September 30, 2008, August 24, 2010, February 8, 2011 and November 17, 2011, respectively, except in limited circumstances relating to the Company's continuing qualification as a REIT or as discussed below. The Company may not optionally redeem the Series C Preferred Shares, if and when issued, prior to January 1, 2021 except in limited circumstances relating to the Company's continuing qualification as a REIT and during the period from January 1, 2016 to and including December 31, 2016 upon giving notice as specified. After those dates, the Company may, at its option, redeem the Preferred Shares, in whole or from time to time in part, by payment of \$25.00 per share, plus any accumulated, accrued and unpaid distributions to and including the date of redemption. Accordingly, the Preferred Shares will remain outstanding indefinitely unless the Company decides to redeem them.

The following Preferred Shares were outstanding as of June 30, 2008:

Security Type	Number of Shares
8 <sup>3</sup> / <sub>8</sub> % Series B Preferred Shares	1,100,000
7 <sup>1</sup> / <sub>2</sub> % Series D Preferred Shares	3,170,000
8% Series E Preferred Shares	3,500,000
7 <sup>1</sup> / <sub>4</sub> % Series G Preferred Shares	4,000,000

**Preferred Operating Partnership Units**

The Series C Preferred Units have no stated maturity date or mandatory redemption. The Series C Preferred Units are redeemable for Series C Preferred Shares (liquidation preference \$25.00 per share), \$.01 par value per share, of the Company or cash at the Company's election. As of June 30, 2008, the redemption value of the Series C Preferred Units was \$58,722 based on the redemption price of \$25.00 per unit. The Company is not required to set aside funds to redeem the Series C Preferred Units and the Company may not optionally redeem the Series C Preferred Units prior to January 1, 2021, except the Company may redeem the Series C Preferred Units during the period from January 1, 2016 to and including December 31, 2016 upon giving notice as specified.

**Table of Contents**

The Series F Preferred Units issued by the Operating Partnership are not redeemable by the Operating Partnership prior to November 17, 2016. On or after this date, the Operating Partnership, at its option, may redeem the Series F Preferred Units, in whole or in part from time to time, for cash, at a redemption price \$25.00 per unit, plus any accumulated, accrued and unpaid distributions to and including the date of redemption. As of June 30, 2008, the redemption value of the Series F Preferred Units was \$27,459 based on the redemption price of \$25.00 per unit. Any Series F Preferred Unitholder may require the Operating Partnership to redeem the Series F Preferred Units held by that unitholder. The Company, as the sole general partner of the Operating Partnership, may, at its election, satisfy the unitholders' redemption right by paying cash or common shares of the Company.

The following Preferred Units were outstanding as of June 30, 2008:

Unit Type	Number of Units
7 1/4% Series C Preferred Units	2,348,888
Variable Series F Preferred Units	1,098,348

**Preferred Dividends**

The Company paid the following dividends on preferred shares/units during the six months ended June 30, 2008:

Share/ Unit	Security Type	Dividend per Share/Unit	For the Quarter Ended	Record Date	Payable Date
Share	8 3/8% Series B	\$ 0.52	31-Dec-2007	1-Jan-2008	15-Jan-2008
Share	8 3/8% Series B	\$ 0.52	31-Mar-2008	1-Apr-2008	15-Apr-2008
Unit	7 1/4% Series C	\$ 0.45	31-Dec-2007	1-Jan-2008	15-Jan-2008
Unit	7 1/4% Series C	\$ 0.45	31-Mar-2008	1-Apr-2008	15-Apr-2008
Share	7 1/2% Series D	\$ 0.47	31-Dec-2007	1-Jan-2008	15-Jan-2008
Share	7 1/2% Series D	\$ 0.47	31-Mar-2008	1-Apr-2008	15-Apr-2008
Share	8 % Series E	\$ 0.50	31-Dec-2007	1-Jan-2008	15-Jan-2008
Share	8 % Series E	\$ 0.50	31-Mar-2008	1-Apr-2008	15-Apr-2008
Unit	Variable Series F	\$ 0.41	31-Dec-2007	1-Jan-2008	15-Jan-2008
Unit	Variable Series F	\$ 0.32	31-Mar-2008	1-Apr-2008	15-Apr-2008
Share	7 1/4% Series G	\$ 0.45	31-Dec-2007	1-Jan-2008	15-Jan-2008
Share	7 1/4% Series G	\$ 0.45	31-Mar-2008	1-Apr-2008	15-Apr-2008

**7. Share Option and Incentive Plan**

In April 1998, the Board of Trustees adopted and the shareholders approved the 1998 Plan that is currently administered by the Compensation Committee of the Board of Trustees. The Company's employees and the hotel operators and their employees generally are eligible to participate in the 1998 Plan.

The 1998 Plan authorizes, among other things: (i) the grant of share options that qualify as incentive options under the Code, (ii) the grant of share options that do not so qualify, (iii) the grant of share options in lieu of cash for trustees' fees, (iv) grants of common shares of beneficial interest in lieu of cash compensation, and (v) the making of loans to acquire common shares of beneficial interest in lieu of compensation. The exercise price of share options is determined by the Compensation Committee of the Board of Trustees, but may not be less than 100% of the fair market value of the common shares of beneficial interest on the date of grant. Options under the 1998 Plan vest over a period determined by the Compensation Committee of the Board of Trustees, which is generally a three to four year period. The duration of each option is also determined by the Compensation Committee; however, the

**Table of Contents**

duration of each option shall not exceed 10 years from date of grant. There were no unvested stock options outstanding as of June 30, 2008. There are 2,800,000 common shares of beneficial interest authorized for issuance under the 1998 Plan. At June 30, 2008, there were 516,478 common shares available for future grant under the 1998 Plan.

**Service Condition Nonvested Share Awards**

From time to time, the Company awards nonvested shares under the 1998 Plan to members of the Board of Trustees, executives, and employees. The nonvested shares generally vest over three to nine years based on continued employment. The Company measures compensation costs for the nonvested shares based upon the fair market value of its common stock at the date of grant. Compensation costs are recognized on a straight-line basis over the vesting period and are included in general and administrative expense in the accompanying consolidated statements of operations.

A summary of the Company's nonvested shares as of June 30, 2008 is as follows:

	Number of Shares	Weighted - Average Grant Date Fair Value
Nonvested at January 1, 2008	285,280	\$ 37.82
Granted	337,500	29.61
Vested	(90,624)	34.75
Forfeited	(1,957)	35.62
Nonvested at June 30, 2008	530,199	\$ 33.13

As of June 30, 2008 and December 31, 2007, there were \$15,474 and \$7,391, respectively, of total unrecognized compensation costs related to nonvested share awards granted under the 1998 Plan. As of June 30, 2008 and December 31, 2007, these costs were expected to be recognized over a weighted average period of 3.8 and 1.7 years, respectively. The total fair value of shares vested during the three and six months ended June 30, 2008 was zero and \$2,891, respectively, and during the three and six months ended June 30, 2007 was \$47 and \$3,182, respectively. The compensation costs (net of estimated forfeitures) for the 1998 Plan that have been included in general and administrative expenses in the accompanying consolidated statements of operations were \$914 and \$1,746 for the three and six months ended June 30, 2008, respectively, and \$804 and \$1,611 for the three and six months ended June 30, 2007, respectively.

**Long-Term Performance-Based Share Awards**

On December 17, 2007 and December 20, 2006, the Company's Board of Trustees granted 45,376 and 31,490 performance-based awards of nonvested shares to executives, respectively. The actual amounts of the awards will be determined on January 1, 2011 and January 1, 2010, respectively, and will depend on the total return of the Company's common shares over a three-year period beginning with the closing price of the Company's common stock on December 31, 2007 and December 31, 2006, respectively, and ending with the closing price of the Company's common stock on December 31, 2010 and December 31, 2009, respectively. Forty percent of the awards will be based on the Company's total return compared to the total return of the companies in the NAREIT Equity Index. Total return is as calculated by the NAREIT Equity Index and is the increase in the market price of a company's common shares plus dividends declared thereon and assuming such dividends are reinvested. Forty percent of the awards will be based on the Company's total return compared to the total return of six companies in a designated peer group of the Company. The final 20% of the awards will be based on the amount of the Company's total return compared to a Board-established total return goal. The actual amounts of the awards will range from 0% to 200% of the target amounts, depending on the performance analysis described immediately above.

After the actual amounts of the awards are determined (or earned) on January 1, 2011 and January 1, 2010, the earned shares will be issued and outstanding with a portion subject to further vesting. For the December 17, 2007 grant, one-third of the earned amounts will vest immediately on January 1, 2011 and the remaining two-thirds will vest in equal amounts on January 1, 2012 and January 1, 2013. For the December 20, 2006 grant, one-third of the earned amounts will vest immediately on January 1, 2010 and the remaining two-thirds will vest in equal amounts

**Table of Contents**

on January 1, 2011 and January 1, 2012. Dividends will be deemed to have accrued on all of the earned shares, including those shares subject to further vesting, from December 31, 2007 and December 31, 2006, until the determination dates, January 1, 2011 and January 1, 2010. Such accrued dividends will be paid to the awardees on or about January 1, 2011 and January 1, 2010. Thereafter, the awardees are entitled to receive dividends as declared and paid on the earned shares and to vote the shares, including those shares subject to further vesting. The fair values were determined by a third party valuation expert using a Monte Carlo valuation method. Assumptions used in the valuations consisted of the following:

**Capital Market Assumptions**

Factors associated with the underlying performance of the Company's stock price and shareholder returns over the term of the performance awards including total stock return volatility and risk-free interest.

Factors associated with the relative performance of the Company's stock price and shareholder returns when compared to those companies which compose the index including beta as a means to breakdown total volatility into market-related and company specific volatilities.

The valuation has been performed in a risk-neutral framework, so no assumption has been made with respect to an equity risk premium.

**Employee Behavioral Assumptions**

As termination of employment results in forfeiture of the award, demographic assumptions have not been used. The assumptions used were as follows for each performance measure:

	Target Amounts	2007 Grant NAREIT Index	Peer Companies	Target Amounts	2006 Grant NAREIT Index	Peer Companies
Volatility	25.8%	25.8%	25.8%	24.4%	24.4%	24.4%
Interest rates	3.07%	3.07%	3.07%	4.74%	4.74%	4.74%
Dividend yield	N/A	N/A	N/A	1.32%	1.32%	1.32%
Stock beta	N/A	1.123	1.004	N/A	.947	.967
Fair value of components of award	\$ 28.69	\$ 35.22	\$ 35.39	\$ 43.29	\$ 51.47	\$ 50.72
Weighting of total award	20%	40%	40%	20%	40%	40%

On May 31, 2008 and June 25, 2008, the Company's Board of Trustees granted 125,000 and 87,500 performance-based awards of nonvested shares to executives, respectively. The actual amounts of the reward with respect to 62,500 shares will be determined on July 1, 2011 and will depend on the Company's total return over a three-year measuring period beginning with the per-share closing price for the Company's common shares on June 30, 2008 and ending with the per-share closing price of the Company's common shares on June 30, 2011. The actual amounts of the reward with respect to 75,000 shares will be determined on July 1, 2014 and depend on the Company's total return over a three-year measuring period beginning with the per-share closing price for the Company's common shares on June 30, 2011 and ending with the per-share closing price of the Company's common shares on June 30, 2014. The actual amounts of the reward with respect to 75,000 shares will be determined on July 1, 2017 and will depend on the Company's total return over a three-year measuring period beginning with the per-share closing price for the Company's common shares on June 30, 2014 and ending with the per-share closing price of the Company's common shares on June 30, 2017. Forty percent of the awards will be based on the Company's total return compared to the total return of the companies in the NAREIT Equity Index. Total return is as calculated by the NAREIT Equity Index and is the increase in the market price of a company's common shares plus dividends declared thereon and assuming such dividends are reinvested. Forty percent of the awards will be based on the Company's total return compared to the total return of companies in a designated peer group of the Company and included in the NAREIT Equity Index. The final 20% of the awards will be based on the amount of the Company's total return compared to a Board-established total return goal. The actual amounts of the awards will range from 0% to 200% of the target amounts, depending on the performance analysis described immediately above, and none of the performance shares is outstanding until issued in accordance with award agreement based on performance. After the

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actual amounts of the awards are determined (or earned) on July 1, 2011, July 1, 2014 and July 1, 2017, the earned shares will be issued and outstanding with a portion subject to further vesting.

**Table of Contents**

Dividends will be deemed to have accrued on all of the earned shares, including those shares subject to further vesting, from June 30, 2008 until the determination dates, July 1, 2011, July 1, 2014 and July 1, 2017. Such accrued dividends will be paid to the awardees on or about July 1, 2011, July 1, 2014 and July 1, 2017. Thereafter, the awardees are entitled to receive dividends as declared and paid on the earned shares and to vote the shares, including those shares subject to further vesting. As of June 30, 2008, the fair values have not been determined by a third party valuation expert.

A summary of the Company's long-term performance-based share awards as of June 30, 2008 is as follows:

	Number of Shares	Weighted- Average Grant Date Fair Value
Nonvested at January 1, 2008	76,866	\$ 40.35
Granted		
Vested		
Forfeited		
Nonvested at June 30, 2008	76,866	\$ 40.35

As of June 30, 2008 and December 31, 2007, there were \$2,461 and \$2,769, respectively, of total unrecognized compensation costs related to long-term performance-based share awards granted under the 1998 Plan. As of June 30, 2008 and December 31, 2007, these costs were expected to be recognized over a weighted average period of 3.3 and 3.7 years, respectively. No long-term performance-based share awards were vested as of June 30, 2008 and December 31, 2007. The compensation costs related to long-term performance-based share awards that have been included in general and administrative expenses in the accompanying consolidated statements of operations were \$154 and \$308 for the three and six months ended June 30, 2008, respectively, and \$77 and \$155 for the three and six months ended June 30, 2007, respectively. The 2008 grants are not included in either the share table above or compensation expense since they are effective July 1, 2008.

**8. LHL**

A significant portion of the Company's revenue is derived from operating revenues generated by the hotels leased by LHL.

Other indirect hotel operating expenses, including indirect operating expenses related to discontinued operations, consist of the following expenses incurred by the hotels leased by LHL:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
General and administrative	\$ 14,057	\$ 12,203	\$ 26,863	\$ 23,685
Sales and marketing	11,332	10,189	21,211	19,431
Repairs and maintenance	6,234	6,235	12,032	12,269
Utilities and insurance	5,907	6,095	11,830	12,793
Management and incentive fees	7,279	7,376	10,864	11,445
Franchise fees	1,381	1,717	2,562	3,065
Other expenses	385	521	724	769
Total other indirect expenses	46,575	44,336	86,086	83,457
Other indirect hotel operating expenses related to discontinued operations				(660)
Total other indirect expenses related to continuing operations	\$ 46,575	\$ 44,336	\$ 86,086	\$ 82,797

As of June 30, 2008, LHL leases the following 30 hotels owned by the Company:

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Seaview Resort and Spa	Hilton San Diego Gaslamp Quarter
Harborside Hyatt Conference Center & Hotel	The Grafton on Sunset
Hotel Viking	Onyx Hotel
Topaz Hotel	Westin Copley Place
Hotel Rouge	Hotel Deca
Hotel Madera	Hilton San Diego Resort and Spa
Hotel Helix	Donovan House
The Liaison Capitol Hill	Le Parc Suite Hotel
Sheraton Bloomington Hotel Minneapolis South	Westin Michigan Avenue
Lansdowne Resort	Hotel Sax Chicago
Westin City Center Dallas	Alexis Hotel
Hotel George	Hotel Solamar
Indianapolis Marriott Downtown	Gild Hall
Hilton Alexandria Old Town	Hotel Amarano Burbank
Chaminade Resort and Conference Center	San Diego Paradise Point Resort

The remaining hotel in which the Company owns an interest, Le Montrose Suite Hotel, is leased directly to an affiliate of the current hotel operator.

For each of calendar years 2004 through 2007, the Company notified Marriott International ( Marriott ) that it was terminating the management agreement at the Seaview Resort and Spa due to Marriott's failure to meet certain hotel operating performance thresholds as defined in the management agreement. Pursuant to the management agreement, Marriott had the right to avoid termination by making cure payments within 60 days of notification. Through June 30, 2008, Marriott made cure payments totaling \$12,315 for the calendar years 2004 through 2007 to avoid termination. Marriott may recoup these amounts in the event certain future operating thresholds are attained.

**Table of Contents**

Through June 30, 2008, Marriott has recouped a total of \$2,821 for the calendar years 2004 through 2007. The remaining amount may still be recouped; therefore, the Company recorded a deferred liability of \$9,494 and \$6,371 as of June 30, 2008 and December 31, 2007, respectively, which is included in accounts payable and accrued expenses on the accompanying consolidated balance sheets. The following is a reconciliation of the cure payments and deferred liability as of and for the six months ended June 30, 2008 and the years ended December 31, 2007, 2006 and 2005:

Year Ended December 31,	Notification Date	Performance Year	Cure Payment		Recoup Amount	Deferred Liability Balance
			Date	Amount		
2005	March 11, 2005	2004	April 28, 2005	\$ 2,394	\$ (1,540)	\$ 854
2006	March 9, 2006	2005	May 2, 2006	3,715	(280)	\$ 4,289
2007	February 22, 2007	2006	April 5, 2007	3,083	(1,001)	\$ 6,371
2008*	February 26, 2008	2007	April 10, 2008	3,123		\$ 9,494
				As of June 30, 2008	\$ 12,315	\$ (2,821)

\* Six months ended June 30, 2008.

**9. Income Taxes**

For the six months ended June 30, 2008, income tax benefit of \$117 was comprised of a net state and local tax expense of \$557 on the Company's and Operating Partnership's income, and federal, state and local tax benefit of \$674 on LHL's loss of \$3,805 before income tax benefit. For the three months ended June 30, 2008, income tax expense of \$3,738 was comprised of a net state and local tax expense of \$181 on the Company's and Operating Partnership's income and federal, state and local tax expense of \$3,557 on LHL's income of \$7,554 before income tax expense.

The Company has estimated its income tax benefit using a combined federal and state rate of 29.8%. As of June 30, 2008, the Company had a deferred tax asset of \$16,325 primarily due to current and past years' tax net operating losses. These loss carryforwards will expire in 2022 through 2027 if not utilized by then. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax asset and has determined that no valuation allowance is required. Reversal of the deferred tax asset in the subsequent years cannot be reasonably estimated.

**10. Earnings Per Common Share**

The limited partners' outstanding common limited partnership units in the Operating Partnership (which may be converted to common shares of beneficial interest) have been excluded from the diluted earnings per share calculation as there would be no effect on the amounts since the limited partners' share of income would also be added back to net income. The computation of basic and diluted earnings per common share is presented below (dollars in thousands except per share data):

**Table of Contents**

	For the three months ended		For the six months ended	
	2008	June 30, 2007	2008	June 30, 2007
<b>Numerator:</b>				
Net income applicable to common shareholders before discontinued operations and dividends on unvested restricted shares	\$ 20,545	\$ 19,344	\$ 5,715	\$ 4,599
Discontinued operations		16		30,413
Net income applicable to common shareholders before dividends on unvested restricted shares	20,545	19,360	5,715	35,012
Dividends paid on unvested restricted shares	(156)	(127)	(255)	(232)
Net income applicable to common shareholders, after dividends on unvested restricted shares	\$ 20,389	\$ 19,233	\$ 5,460	\$ 34,780
<b>Denominator:</b>				
Weighted average number of common shares - basic	39,919,144	39,854,720	39,919,144	39,849,367
Effect of dilutive securities:				
Unvested restricted shares	(58,214)	82,006	(62,164)	82,710
Stock options and compensation-related shares	117,342	196,846	137,321	200,010
Weighted average number of common shares - diluted	39,978,272	40,133,572	39,994,301	40,132,087
<b>Basic Earnings Per Common Share:</b>				
Net income applicable to common shareholders per weighted average common share before discontinued operations and after dividends on unvested restricted shares	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.11
Discontinued operations				0.76
Net income applicable to common shareholders per weighted average common share, after dividends on unvested restricted shares	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.87
<b>Diluted Earnings Per Common Share:</b>				
Net income applicable to common shareholders per weighted average common share before discontinued operations	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.11
Discontinued operations				0.76
Net income applicable to common shareholders per weighted average common share	\$ 0.51	\$ 0.48	\$ 0.14	\$ 0.87

**Table of Contents****11. Supplemental Information to Statements of Cash Flows**

	For the six months ended June 30,	
	2008	2007
Interest paid, net of capitalized interest	\$ 23,445	\$ 22,682
Interest capitalized	\$ 2,072	\$ 1,621
Income taxes paid, net of refunds	\$ 792	\$ 828
Distributions payable (common shares)	\$ 6,894	\$ 6,835
Distributions payable (preferred shares)	\$ 5,624	\$ 5,624
Accrued capital expenditures	\$ 4,837	\$ 7,810
Issuance of common shares for board of trustees compensation	\$ 153	\$ 165
Repurchase of common shares (treasury)	\$ (955)	\$ (1,038)
In conjunction with the sale of hotel property, the Company disposed of the following assets and liabilities:		
Proceeds on sale, net of closing costs	\$	\$ (67,069)
Other assets		(5,598)
Liabilities		1,202
Sale of hotel property	\$	\$ (71,465)
In conjunction with the property acquisition, the Company assumed the following assets and liabilities:		
Property under development	\$ 52,910	\$
Liabilities		(1,441)
Acquisition of property	\$ 51,469	\$

**12. Subsequent Events**

On July 15, 2008, the Company declared monthly distributions on common shares of the Company and on common units of the Operating Partnership in the amount of \$0.175 per common share of beneficial interest/unit for each of the months of July, August and September 2008.

The Company paid the following common and preferred dividends subsequent to June 30, 2008:

Security Type	Share/ Unit	Dividend per Share/Unit	For the Month/Quarter Ended		Declared	Record Date	Payable Date
Common	Share/Unit	\$ 0.17	Month	30-Jun-2008	15-Apr-2008	30-Jun-2008	15-Jul-2008
8 <sup>3</sup> / <sub>8</sub> % Series B Preferred	Share	\$ 0.52	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008
7 <sup>1</sup> / <sub>4</sub> % Series C Preferred	Unit	\$ 0.45	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008
7 <sup>1</sup> / <sub>2</sub> % Series D Preferred	Share	\$ 0.47	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008
8% Series E Preferred	Share	\$ 0.50	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008
Variable Series F Preferred	Unit	\$ 0.26	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008

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7 1/4% Series G Preferred	Share	\$	0.45	Quarter	30-Jun-2008	n/a	1-Jul-2008	15-Jul-2008
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On July 21, 2008 in connection with the Company's previously announced succession plan, the board of trustees increased the number of trustees constituting the full board of trustees to eight, and appointed Michael D. Barnello, our President and Chief Operating Officer, as a trustee effective immediately (initially to the class of trustees whose terms expire in 2009) to serve until his successor is duly elected and qualified.

Also on July 21, 2008, Julio E. Morales was named Chief Accounting Officer of the Company effective immediately. Mr. Morales, 47, has been with the Company since June 2000 and has acted as Controller of the Company since that time. Mr. Morales will continue to have responsibility for the day-to-day accounting functions of the Company and will continue to report to Hans S. Weger, the Company's Executive Vice President and Chief Financial Officer.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following should be read in conjunction with the consolidated financial statements and notes thereto appearing in Item 1 of this report.

## **Table of Contents**

### **Forward-Looking Statements**

This report, together with other statements and information publicly disseminated by the Company, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe the Company's future plans, strategies and expectations, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. Forward-looking statements in this report include, among others, statements about the Company's business strategy, including its acquisition and development strategies, industry trends, estimated revenues and expenses, ability to realize deferred tax assets, expected liquidity needs and sources (including capital expenditures and the ability to obtain financing or raise capital), and anticipated outcomes and consequences of pending litigation. You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond the Company's control and which could materially affect actual results, performances or achievements. Factors that may cause actual results to differ materially from current expectations include, but are not limited to:

the availability and terms of financing and capital and the general volatility of securities markets;

the Company's dependence on third-party managers of its hotels, including its inability to implement strategic business decisions directly;

risks associated with the hotel industry, including competition, increases in wages, potential unionization, energy costs and other operating costs, actual or threatened terrorist attacks, any type of flu or disease-related pandemic, downturns in general and local economic conditions;

risks associated with the real estate industry, including environmental contamination and costs of complying with the Americans with Disabilities Act and similar laws;

interest rate increases;

the possible failure of the Company to qualify as a REIT and the risk of changes in laws affecting REITs;

the possibility of uninsured losses; and

the risk factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, as updated elsewhere in this report.

Accordingly, there is no assurance that the Company's expectations will be realized. Except as otherwise required by the federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

### **Overview**

The Company intends to acquire upscale and luxury full-service hotels in convention, resort and major urban markets where the Company perceives strong demand growth or significant barriers to entry. The Company measures hotel performance by evaluating financial metrics such as room revenue per available room ( RevPAR ), funds from operations ( FFO ) and earnings before interest, taxes, depreciation and amortization

( EBITDA ).

The Company evaluates the hotels in its portfolio and potential acquisitions using the measures discussed above to determine each portfolio hotel's contribution or acquisition hotel's potential contribution toward reaching the Company's goal of maintaining a reliable stream of income and moderate growth to shareholders. The Company invests in capital improvements throughout the portfolio to continue to increase the competitiveness of its hotels and improve their financial performance. The Company actively seeks to acquire new hotel properties that meet its investment criteria. Currently, due to the dislocation between buyers and sellers, it is difficult to acquire hotels that fit our stringent investment criteria at prices that are generally acceptable to sellers.

**Table of Contents**

In the second quarter of 2008, the economy continued to weaken under the weight of the housing recession, financial market turmoil, growing unemployment and a financially strapped consumer. Due to the economic weakness, the lodging industry is experiencing slowing growth with leisure customers leading the downward trend. In general, leisure markets were soft while urban markets fared better during the quarter due to the larger amount of utilization by business travelers, the benefit from a weak dollar that improved international travel to the U.S., and the long term nature of convention business which is generally located in urban markets. The Company's performance significantly outpaced the industry, primarily as a result of the ramp up from our numerous redevelopments, repositioning and renovation projects. Group room nights were up 8.8% in quarter compared to the same quarter last year, a result of the implementation of a general strategy to add group room nights through increased group sales personnel.

For the second quarter of 2008, the Company had net income applicable to common shareholders of \$20.5 million or \$0.51 per diluted share. FFO was \$47.4 million, or \$1.18 per diluted share and EBITDA was \$70.5 million. RevPAR for the hotel portfolio was \$174.38, which is an increase of 5.3% compared to the prior year period. Average daily rate increased 2.6% to \$214.38 and occupancy increased by 2.6% to 81.3%. The Company's hotel portfolio EBITDA increased 7.5% and hotel portfolio EBITDA margins increased 69 basis points due to a 5.3% increase in RevPAR, ramp up from our numerous redevelopments, repositioning and renovation projects, and reductions in property maintenance expense, energy costs and lower incentive management fees.

Please refer to *Non-GAAP Financial Measures* for a detailed discussion of the Company's use of FFO, EBITDA, and Hotel EBITDA and a reconciliation of FFO, EBITDA, and Hotel EBITDA to net income, a GAAP measurement.

**Critical Accounting Estimates**

A significant portion of the Company's revenues and expenses are generated by the operations of the individual hotels. The Company records revenues and expenses that are estimated by the hotel operators to produce quarterly financial statements since the management contracts do not require the hotel operators to submit actual results within a time frame that permits the Company to use actual results when preparing its quarterly reports on Form 10-Q for filing with the SEC by the filing deadline prescribed by the SEC. Generally, the Company records actual revenue and expense amounts for the first two months of each quarter and revenue and expense estimates for the last month of each quarter. Each quarter, the Company reviews the estimated revenue and expense amounts provided by the hotel operators for reasonableness based upon historical results for prior periods and internal Company forecasts. The Company records any differences between recorded estimated amounts and actual amounts in the following quarter; historically these differences have not been material. The Company believes the aggregate estimate of quarterly revenues and expenses recorded on the Company's consolidated statements of operations are fairly stated.

See the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for further discussion of critical accounting estimates.

The Company's management has discussed the policy of using estimated hotel operating revenues and expenses and the contingent lease liability with the audit committee of its Board of Trustees. The audit committee has reviewed the Company's disclosure relating to the estimates in this Management's Discussion and Analysis of Financial Conditions and Results of Operations section.

**Comparison of the Three Months Ended June 30, 2008 to the Three Months Ended June 30, 2007**

Industry travel levels declined marginally in the quarter compared to prior year levels. On a year-over-year basis, overall industry supply growth substantially exceeded demand in the quarter. For the industry, April's results were positively impacted by the Easter Holiday shift to the first quarter of 2008 vs. the second quarter of 2007, but the quarter was largely impacted by overall economic weakness. For the Company, the quarter's favorable results were primarily a result of the ramp up from our numerous redevelopments, repositioning and renovation projects. Occupancies at properties leased to LHL increased 2.7% from the prior year and ADR increased 2.7% over the prior year resulting in a RevPAR increase of 5.5% over the prior year.

*Hotel Operating Revenues*

Hotel operating revenues from the hotels leased to LHL (30 hotels as of June 30, 2008), including room revenue, food and beverage revenue, and other operating department revenue (which includes golf, telephone, parking and other ancillary revenues) increased \$17.4 million, from \$176.3 million in 2007 to \$193.7 million in 2008. This increase includes amounts that are not comparable year-over-year as follows:

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\$5.2 million increase in room, food and beverage, and other revenue from San Diego Paradise Point Resort due to the transition to a new lease with LHL as of June 1, 2008; and

**Table of Contents**

\$2.5 million increase in room, food and beverage, and other revenue from Donovan House re-opening on March 28, 2008 after completion of a comprehensive renovation and repositioning project.

The remaining increase is primarily due to the following:

\$2.2 million increase in room, food and beverage, and other revenue from Westin Copley Place due to improved hotel facilities as a result of restaurant, meeting facilities and ballroom renovations;

\$2.0 million increase in room, food and beverage revenue from Hotel Sax Chicago due to hotel, lounge, and meeting facilities renovations completed in 2007;

\$1.8 million increase in room, food and beverage, and other revenue from The Hilton San Diego Resort and Spa due to improved hotel facilities as a result of renovations;

\$1.6 million increase in room, food and beverage, and other revenue from Alexis Hotel due to improved hotel facilities as a result of renovations;

\$1.1 million increase in room, golf and other ancillary revenue at Lansdowne Resort due to an increase in RevPAR, primarily attributable to the new golf course that opened in May 2007, improved hotel facilities as a result of renovations, a larger spa, and improved group business;

\$0.7 million increase in food and beverage revenue from Sheraton Bloomington Hotel Minneapolis South due to improved group business; and

\$0.6 million increase in room, food and beverage, and other revenue from Hotel Viking due to an increase in RevPAR primarily attributable to improved hotel facilities as a result of renovations.

The above increases are partially offset by the following decreases:

\$1.4 million decrease in room, food and beverage, golf and other revenue from Seaview Resort and Spa due to a decrease in occupancy; and

\$0.7 million decrease in room, food and beverage revenues from Indianapolis Marriott Downtown due to the cancellation of US Grand Prix Formula One Race which was originally scheduled for June 2008 and weaker group business.

The remaining increase of \$1.8 million is primarily attributable to the 2.7% increase in occupancy and the 2.7% increase in ADR across the portfolio.

*Participating Lease Revenue*

Participating lease revenue from hotels leased to third party lessees (one hotel as of June 30, 2008) decreased \$2.0 million, from \$7.1 million in 2007 to \$5.1 million in 2008. The decrease is primarily due to the transition of San Diego Paradise Point Resort to a new lease with LHL as of June 1, 2008, offset by an increase of \$0.2 million from Le Montrose Suite Hotel due to an increase in RevPAR primarily attributable to an increase in ADR. Participating lease revenue includes (i) base rent and (ii) participating rent based on fixed percentages of hotel revenues pursuant to the respective participating leases.

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### *Other Income*

Other income increased \$1.3 million from \$1.2 million in 2007 to \$2.5 million in 2008. This increase is primarily due to the following:

\$0.7 million recognized in the 2008 period from a settlement of outstanding liabilities with respect to the acquisition of Westin Michigan Avenue property in March 2006; and

\$0.2 million from a settlement of outstanding liabilities due to the transition of San Diego Paradise Point Resort to a new lease with LHL as of June 1, 2008.

## **Table of Contents**

The remaining increase of \$0.4 million is primarily due to the income from retail leases at the Hotel Sax Chicago and a cumulative adjustment for tenant personal property tax reimbursement of San Diego Paradise Point Resort.

### *Hotel Operating Expenses*

Hotel operating expenses increased \$8.3 million from \$105.8 million in 2007 to \$114.1 million in 2008. This increase includes amounts that are not comparable year-over-year as follows :

\$2.7 million increase in room, food and beverage, other operating department and indirect expense from San Diego Paradise Point Resort due to the transition to a new lease with LHL as of June 1, 2008; and

\$2.5 million increase in room, food and beverage, other operating department and indirect expense from Donovan House re-opening on March 28, 2008 after completion of a comprehensive renovation and repositioning project.

The remaining increase is primarily due to the following:

\$1.4 million increase in room, food and beverage, other operating department and indirect expense from Hotel Sax Chicago due to hotel, lounge, and meeting facilities renovations completed in 2007, which increased occupancy and in turn increased service costs;

\$1.3 million increase in room, food and beverage, other operating department and indirect expense from The Hilton San Diego Resort and Spa due to improved hotel facilities as a result of renovations, which increased occupancy and in turn increased service costs; and

\$0.8 million increase in room, food and beverage, and indirect expense from Westin Copley Place due to improved hotel facilities and ballroom renovations, which increased occupancy and in turn increased service costs.

The above increases are partially offset by the \$0.8 million decrease in incentive management fees from Westin Michigan Avenue primarily due to the hotel renovation.

The remaining increase of \$0.4 million is primarily attributed to higher operating costs from an increase in occupancy of 2.7%.

### *Depreciation and Amortization*

Depreciation and amortization expense increased \$3.9 million from \$22.9 million in 2007 to \$26.8 million in 2008. This increase includes an amount that is not comparable year-over-year of \$1.2 million from Donovan House which re-opened on March 28, 2008 after completion of a comprehensive renovation and repositioning project. The remaining increase of \$2.7 million is primarily due to building and land improvements and purchases of furniture, fixtures and equipment across the hotel portfolio during 2008 and 2007.

### *Real Estate Taxes, Personal Property Taxes and Insurance*

Real estate taxes, personal property taxes, and insurance expenses increased \$1.6 million from \$8.3 million in 2007 to \$9.9 million in 2008. This increase includes an amount that is not comparable year-over-year of \$0.3 million from Donovan House which re-opened on March 28, 2008 after completion of a comprehensive renovation and repositioning project. The remaining increase of \$1.3 million is a result of an increase in real estate and personal property taxes of \$1.4 million primarily from increases in assessments and rates at certain of the hotel properties, including an increase of \$0.8 million from Indianapolis Marriott Downtown due to an increase in assessment, offset by a decrease in insurance premiums of \$0.1 million.

### *Ground Rent*

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Ground rent increased \$0.3 million from \$1.7 million in 2007 to \$2.0 million in 2008. Certain hotels are subject to ground rent under operating leases which call for either fixed or variable payments based on the hotel's performance. The increase is due to performance at the applicable hotels being slightly better in the 2008 period than the 2007 period.

**Table of Contents**

*General and Administrative Expenses*

General and administrative expense increased \$0.7 million from \$3.5 million in 2007 to \$4.2 million in 2008 primarily as a result of an increase in compensation costs and legal fees.

*Other Expenses*

Other expenses had no change from 2007 to 2008, with \$0.7 million in both periods. Other expenses primarily include expenses related to the renaming and repositioning of hotels and retail lease expenses.

*Interest Income*

Interest income decreased \$0.2 million from \$0.2 million in 2007 to zero in 2008 primarily due to decreases in cash balances and interest rates in the 2008 period.

*Interest Expense*

Interest expense increased by \$0.5 million from \$11.9 million in 2007 to \$12.4 million in 2008 due to an increase in the Company's weighted average debt and a decrease in capitalized interest, partly offset by a decrease in the weighted average interest rate. The Company's weighted average debt outstanding related to continuing operations increased from \$847.8 million in 2007 to \$973.6 million in 2008, which includes increases from:

additional borrowing to purchase a controlling interest in the joint venture that acquired the 330 N. Wabash Avenue property in March 2008; and

additional borrowings under the Company's credit facility to finance other capital improvements during 2008.  
The above borrowings are offset by paydowns on outstanding debt from operating cash flows.

The Company's weighted average interest rate given the impact of adding back capitalized interest to the Company's interest expense decreased from 5.7% in 2007 to 5.1% in 2008. The Company's weighted average interest rate excluding the impact of capitalized interest decreased from 5.3% in 2007 to 4.8% in 2008. Capitalized interest decreased \$0.1 million, from \$0.8 million in 2007 to \$0.7 million in 2008, primarily due to the completion of the renovation of the Donovan House in March 2008, partly offset by the redevelopment of the 330 N. Wabash Avenue property as a super luxury hotel during 2008.

*Income Taxes*

Income tax expense increased \$0.1 million from \$3.6 million in 2007 to \$3.7 million in 2008. For the three months ended June 30, 2008, the Company and Operating Partnership incurred state and local income tax expense of \$0.2 million. LHL's net income before income tax expense decreased \$0.8 million from \$8.4 million in 2007 to \$7.6 million in 2008. Accordingly, for the three months ended June 30, 2008, LHL recorded a federal income tax expense of \$2.7 million (using an estimated tax rate of 35.7%). Also, in 2008, LHL recorded a current state and local tax expense of \$0.1 million and a deferred state and local tax expense of \$0.7 million (using an estimated tax rate of 9.2%). The following table summarizes the income tax expense (dollars in thousands):

	<b>For the three months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Company and Operating Partnership state and local tax expense	\$ 181	\$ 257
LHL federal, state and local tax expense	3,557	3,375

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Total tax expense	3,738	3,632
Less: LHL federal, state and local tax expense related to discontinued operations		
Total tax expense from continuing operations	\$ 3,738	\$ 3,632

**Table of Contents**

As of June 30, 2008, the Company had a deferred tax asset of \$16.3 million primarily due to current and past years tax net operating losses. These loss carryforwards will expire in 2022 through 2027 if not utilized by then. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax asset and has determined that no valuation allowance is required.

*Minority Interest*

Minority interest in consolidated entities represents the outside equity interest in the 330 N. Wabash Avenue property which is included in the consolidated financial statements of the Company since the Company holds a controlling interest.

Minority interest of common units in the Operating Partnership represents the common unit limited partners proportionate share of the equity in the Operating Partnership. Income is allocated to common units minority interest based on the weighted average percentage ownership throughout the year. At June 30, 2008, the limited partners held 0.3% of the common units of the Operating Partnership.

The minority interest of preferred units in the Operating Partnership represents the allocation of income of the Operating Partnership to the preferred units held by third parties. The decrease in minority interest of preferred units in the Operating Partnership from \$1.5 million in 2007 to \$1.3 million in 2008 is a result of a lower LIBOR rate used in calculating the dividend rate of the Series F Preferred Units.

*Discontinued Operations*

Net income from discontinued operations decreased from an immaterial amount in 2007 to zero in 2008. Net income from discontinued operations is a result of the sale of the LaGuardia in January 2007. The following table summarizes net income from discontinued operations for 2008 and 2007 (dollars in thousands):

	<b>For the three months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Net lease income from LaGuardia Airport Marriott	\$	\$
Net operating income from LaGuardia Airport Marriott		
Gain on sale of LaGuardia Airport Marriott		16
Minority interest expense related to LaGuardia Airport Marriott		
Income tax expense related to LaGuardia Airport Marriott		
Net income from discontinued operations	\$	\$ 16

*Distributions to Preferred Shareholders*

Distributions to preferred shareholders remained unchanged from 2007 to 2008, with \$5.6 million in both periods since there were no additional equity offerings or redemptions affecting either period.

**Table of Contents**

**Comparison of the Six Months Ended June 30, 2008 to the Six Months Ended June 30, 2007**

Industry travel levels remained soft due to a marginal reduction in demand from both business and leisure travel. On a year-over-year basis, overall industry demand for hotel rooms fell well short of supply growth. With respect to the Company's hotels, occupancies at properties leased to LHL were up an average of 0.5% for the six months ended June 30, 2008, ADR was up an average of 2.4% resulting in a RevPAR increase of 2.9%. The six months ended June 30, 2008 was negatively impacted by the numerous redevelopments, repositioning and renovation projects during the first quarter, but benefited from the ramp up of those assets during the second quarter.

*Hotel Operating Revenues*

Hotel operating revenues from the hotels leased to LHL (30 hotels as of June 30, 2008), including room revenue, food and beverage revenue, and other operating department revenue (which includes golf, telephone, parking and other ancillary revenues) increased \$14.9 million, from \$301.5 million in 2007 to \$316.4 million in 2008. This increase includes amounts that are not comparable year-over-year as follows:

\$5.2 million increase in room, food and beverage, and other revenue from San Diego Paradise Point Resort due to the transition to a new lease with LHL as of June 1, 2008; and

\$2.5 million increase in room, food and beverage, and other revenue from Donovan House re-opening on March 28, 2008 after completion of a comprehensive renovation and repositioning project.

The remaining increase is primarily due to the following:

\$3.2 million increase in room, food and beverage, and other revenue from Alexis Hotel (\$1.9 million) and Hotel Viking (\$1.3 million) due to improved hotel facilities as a result of renovations;

\$3.1 million increase in room, food and beverage revenue from Hotel Sax Chicago due to hotel, lounge, and meeting facilities renovations completed in 2007;

\$1.9 million increase in room and other revenue from The Hilton San Diego Resort and Spa due to improved hotel facilities as a result of renovations;

\$1.8 million increase in room revenue from Westin Copley Place primarily due to an increase in occupancy;

\$1.7 million increase in room, golf and other ancillary revenue at Lansdowne Resort due to the new golf course that opened in May 2007, improved hotel facilities as a result of renovations, a larger spa, and improved group business;

\$1.0 million increase in room, food and beverage, and other revenue from Hilton San Diego Gaslamp Quarter primarily due to an increase in occupancy;

\$0.8 million increase in room, food and beverage, and other revenue from Hilton Alexandria Old Town primarily due to an increase in occupancy and improved food and beverage sales; and

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\$0.7 million increase in room, food and beverage revenue from Le Parc Suite Hotel due to an increase in RevPAR primarily attributable to increases in occupancy and ADR.

The above increases are partially offset by the following decreases:

\$2.1 million decrease in room, food and beverage, and other revenue from The Liaison Capitol Hill due to an extensive hotel and restaurant renovation;

\$2.0 million decrease in room, food and beverage, golf and other revenue from Seaview Resort and Spa due to a decline in occupancy;

\$1.3 million decrease in room, food and beverage revenue from Indianapolis Marriott Downtown due to the cancellation of US Grand Prix Formula One Race which was originally scheduled for June 2008 and weaker group business;

\$1.1 million decrease in room, food and beverage, and other revenue from Gild Hall due to the hotel renovation;

\$1.0 million decrease in food and beverage, and other revenue from Westin Copley Place due to disruption from ballroom renovations; and

\$0.9 million decrease in room, food and beverage, and other revenue from Hotel Solamar due to a decrease in ADR.

## **Table of Contents**

The remaining increase of \$1.4 million is primarily due to a 2.9% increase in RevPAR, attributable to a 0.5% increase in occupancy and a 2.4% increase in ADR across the portfolio.

### *Participating Lease Revenue*

Participating lease revenue from hotels leased to third party lessees (one hotel as of June 30, 2008) decreased \$2.1 million, from \$12.7 million in 2007 to \$10.6 million in 2008. The decrease is primarily due to the transition of San Diego Paradise Point Resort to a new lease with LHL as of June 1, 2008, offset by an increase of \$0.4 million from Le Montrose Suite Hotel due to an increase in RevPAR primarily attributable to an increase in ADR. Participating lease revenue includes (i) base rent and (ii) participating rent based on fixed percentages of hotel revenues pursuant to the respective participating leases.

### *Other Income*

Other income increased \$1.6 million from \$2.4 million in 2007 to \$4.0 million in 2008. This increase is primarily due to the following:

\$0.7 million recognized in 2008 from a settlement of outstanding liabilities with respect to the acquisition of Westin Michigan Avenue property in March 2006; and

\$0.2 million from a settlement of outstanding liabilities due to the transition of San Diego Paradise Point Resort to a new lease with LHL as of June 1, 2008.

The remaining increase of \$0.7 million is primarily due to the income from retail leases at the Hotel Sax Chicago and a cumulative adjustment for tenant personal property tax reimbursements of San Diego Paradise Point Resort and Le Montrose Suite Hotel.

### *Hotel Operating Expenses*

Hotel operating expenses increased \$8.5 million from \$196.0 million in 2007 to \$204.5 million in 2008. This increase includes amounts that are not comparable year-over-year as follows:

\$2.8 million increase in room, food and beverage, other operating department and indirect expense from Donovan House re-opening on March 28, 2008 after completion of a comprehensive renovation and repositioning project; and

\$2.7 million increase in room, food and beverage, other operating department and indirect expense from San Diego Paradise Point Resort due to the transition to a new lease with LHL as of June 1, 2008.

The remaining increase is primarily due to the following:

\$2.6 million increase in room, food and beverage, other operating department and indirect expense from Hotel Sax Chicago due to hotel, lounge, and meeting facilities renovations completed in 2007, which increased occupancy and in turn increased service costs;

\$1.1 million increase in room, other operating department and indirect expense from The Hilton San Diego Resort and Spa due to improved hotel facilities as a result of renovations, which increased occupancy and in turn increased service costs;

\$0.7 million increase in room, food and beverage, other operating department and indirect expense from Hotel Viking due to improved hotel facilities as a result of renovations, which increased occupancy and in turn increased service costs;

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\$0.7 million increase in room, food and beverage, and indirect expense from Lansdowne Resort due the new golf course that opened in May 2007, improved hotel facilities as a result of renovations, and a larger spa, which increased occupancy and in turn increased service costs; and

\$0.7 million increase in room expense from Westin Copley Place due to increased occupancy, which in turn increased service costs.

## **Table of Contents**

The above increases are partially offset by the following decreases:

\$1.0 million decrease in incentive management fees from Westin Michigan Avenue due to the hotel renovation;

\$0.9 million decrease in room, food and beverage, other operating department and indirect expense from Seaview Resort and Spa due to decreased occupancy, which in turn decreased service costs;

\$0.8 million decrease in room, food and beverage, other operating department and indirect expense from Chaminade Resort and Conference Center due to the property being closed during a renovation and repositioning project, which was completed January 31, 2008; and

\$0.8 million decrease in food and beverage, other operating department and indirect expense from Westin Copley Place due to disruption from ballroom renovations.

The remaining increase of \$0.7 million is primarily attributed to higher operating costs from an increase in occupancy of 0.5% across the portfolio.

### *Depreciation and Amortization*

Depreciation and amortization expense increased \$6.5 million from \$45.1 million in 2007 to \$51.6 million in 2008. This increase includes an amount that is not comparable year-over-year of \$1.2 million from Donovan House which re-opened on March 28, 2008 after completion of a comprehensive renovation and repositioning project. The remaining increase of \$5.3 million is primarily due to building and land improvements and purchases of furniture, fixtures and equipment across the hotel portfolio during 2008 and 2007.

### *Real Estate Taxes, Personal Property Taxes and Insurance*

Real estate taxes, personal property taxes, and insurance expenses increased \$2.3 million from \$16.4 million in 2007 to \$18.7 million in 2008. This increase includes an amount that is not comparable year-over-year of \$0.3 million from Donovan House which re-opened on March 28, 2008 after completion of a comprehensive renovation and repositioning project. The remaining increase of \$2.0 million is a result of an increase in real estate and personal property taxes of \$2.3 million primarily from increases in assessments and rates at certain of the hotel properties, including an increase of \$0.8 million from Indianapolis Marriott Downtown due to an increase in assessment, offset by a decrease in insurance premiums of \$0.3 million.

### *Ground Rent*

Ground rent increased \$0.3 million from \$3.2 million in 2007 to \$3.5 million in 2008. Certain hotels are subject to ground rent under operating leases which call for either fixed or variable payments based on the hotel's performance. The increase is due to performance at the applicable hotels being slightly better in the 2008 period than the 2007 period.

### *General and Administrative Expenses*

General and administrative expense increased \$0.4 million from \$7.4 million in 2007 to \$7.8 million in 2008 primarily as a result of an increase in compensation costs and legal fees.

### *Other Expenses*

Other expenses increased \$0.3 million from \$1.2 million in 2007 to \$1.5 million in 2008 primarily due to expenses related to the renaming and repositioning of Hotel Sax Chicago and Donovan House.

### *Interest Income*

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Interest income decreased \$0.9 million from \$1.0 million in 2007 to \$0.1 million in 2008 primarily due to short term cash investments in the 2007 period from the proceeds of an underwritten public offering of 4,000,000 shares of 7.25% Series G Cumulative Preferred Shares in November 2006 and the sale of LaGuardia in January 2007, and decreases in cash balances and interest rates in the 2008 period.

**Table of Contents**

*Interest Expense*

Interest expense increased by \$0.5 million from \$23.3 million in 2007 to \$23.8 million in 2008 due to an increase in the Company's weighted average debt, partly offset by a decrease in the weighted average interest rate and an increase in capitalized interest. The Company's weighted average debt outstanding related to continuing operations increased from \$832.1 million in 2007 to \$937.5 million in 2008, which includes increases from:

redemption of the Series A Preferred Shares in March 2007;

additional borrowing to purchase a controlling interest in the joint venture that acquired the 330 N. Wabash Avenue property in March 2008; and

additional borrowings under the Company's credit facility to finance other capital improvements during 2008.

The above borrowings are offset by paydowns on outstanding debt from proceeds from:

the sale of LaGuardia in January 2007; and

operating cash flows.

The Company's weighted average interest rate given the impact of adding back capitalized interest to the Company's interest expense decreased from 5.7% in 2007 to 5.3% in 2008. The Company's weighted average interest rate excluding the impact of capitalized interest decreased from 5.3% in 2007 to 4.8% in 2008. Capitalized interest increased \$0.5 million, from \$1.6 million in 2007 to \$2.1 million in 2008, primarily due to the redevelopment of the 330 N. Wabash Avenue property as a super luxury hotel during 2008, partly offset by the completion of the Donovan House renovation in March 2008.

*Income Taxes*

Income taxes decreased \$0.4 million from an income tax expense of \$0.3 million in 2007 to an income benefit of \$0.1 million in 2008. For the six months ended June 30, 2008, the Company and Operating Partnership incurred state and local income tax expense of \$0.6 million. LHL's net loss before income tax benefit increased \$3.0 million from \$0.8 million in 2007 to \$3.8 million in 2008. Accordingly, for the six months ended June 30, 2008, LHL recorded federal income tax benefit of \$0.9 million (using an estimated tax rate of 23.7%). Also, in 2008, LHL recorded a current state and local tax expense of \$0.4 million and a deferred state and local tax benefit of \$0.2 million (using an estimated tax rate of 6.1%). The following table summarizes the income tax (benefit) expense (dollars in thousands):

	<b>For the six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Company and Operating Partnership state and local tax expense	\$ 557	\$ 337
LHL federal, state and local tax benefit	(674)	(159)
<b>Total tax (benefit) expense</b>	<b>(117)</b>	<b>178</b>
Less: LHL federal, state and local tax expense related to discontinued operations		73
<b>Total tax (benefit) expense from continuing operations</b>	<b>\$ (117)</b>	<b>\$ 251</b>

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As of June 30, 2008, the Company had a deferred tax asset of \$16.3 million primarily due to current and past years' tax net operating losses. These loss carryforwards will expire in 2022 through 2027 if not utilized by then. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax asset and has determined that no valuation allowance is required.

**Table of Contents***Minority Interest*

Minority interest in consolidated entities represents the outside equity interest in the 330 N. Wabash Avenue property which is included in the consolidated financial statements of the Company since the Company holds a controlling interest.

Minority interest of common units in the Operating Partnership represents the common unit limited partners' proportionate share of the equity in the Operating Partnership. Income is allocated to common units minority interest based on the weighted average percentage ownership throughout the year. At June 30, 2008, the limited partners held 0.3% of the common units of the Operating Partnership.

The minority interest of preferred units in the Operating Partnership represents the allocation of income of the Operating Partnership to the preferred units held by third parties. The decrease in minority interest of preferred units in the Operating Partnership from \$3.1 million in 2007 to \$2.8 million in 2008 is a result of a lower LIBOR rate used in calculating the dividend rate of the Series F Preferred Units.

*Discontinued Operations*

Net income from discontinued operations decreased \$30.4 million from \$30.4 million in 2007 to zero in 2008. Net income from discontinued operations is a result of the sale of the LaGuardia in January 2007. The following table summarizes net income from discontinued operations for 2008 and 2007 (dollars in thousands):

	<b>For the six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Net lease income from LaGuardia Airport Marriott	\$	\$ 240
Net operating loss from LaGuardia Airport Marriott		(177)
Gain on sale of LaGuardia Airport Marriott		30,278
Minority interest expense related to LaGuardia Airport Marriott		(1)
Income tax benefit related to LaGuardia Airport Marriott		73
 Net income from discontinued operations	 \$	 \$ 30,413

*Distributions to Preferred Shareholders*

Distributions to preferred shareholders decreased \$1.9 million, from \$13.1 million in 2007 to \$11.2 million in 2008 due to the redemption of the Series A Preferred Shares on March 6, 2007.

**Non-GAAP Financial Measures***Funds From Operations and EBITDA*

The Company considers the non-GAAP measures of FFO and EBITDA to be key supplemental measures of the Company's performance and should be considered along with, but not as alternatives to, net income as a measure of the Company's operating performance. Historical cost accounting for real estate assets 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, most real estate industry investors consider FFO and EBITDA to be helpful in evaluating a real estate company's operations.

The White Paper on FFO approved by NAREIT in April 2002 defines FFO as net income or loss (computed in accordance with GAAP), excluding gains or losses from sales of properties and items classified by GAAP as extraordinary, plus real estate-related depreciation and amortization (excluding amortization of deferred finance costs) and after comparable adjustments for the Company's portion of these items related to unconsolidated entities and joint ventures. The Company computes FFO consistent with standards established by NAREIT, which may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently than the Company.



**Table of Contents**

With respect to FFO, the Company believes that excluding the effect of extraordinary items, real estate-related depreciation and amortization, and the portion of these items related to unconsolidated entities, all of which are based on historical cost accounting and which may be of limited significance in evaluating current performance, can facilitate comparisons of operating performance between periods and between REITs, even though FFO does not represent an amount that accrues directly to common shareholders. However, FFO may not be helpful when comparing the Company to non-REITs.

With respect to EBITDA, the Company believes that excluding the effect of non-operating expenses and non-cash charges, and the portion of these items related to unconsolidated entities, all of which are also based on historical cost accounting and may be of limited significance in evaluating current performance, can help eliminate the accounting effects of depreciation and amortization, and financing decisions and facilitate comparisons of core operating profitability between periods and between REITs, even though EBITDA also does not represent an amount that accrues directly to common shareholders.

With respect to Hotel EBITDA, the company believes that excluding the effect of corporate-level expenses, non-cash items, and the portion of these items related to unconsolidated entities, provides a more complete understanding of the operating results over which individual hotels and operators have direct control. We believe property-level results provide investors with supplemental information on the ongoing operational performance of our hotels and effectiveness of the third party management companies operating our business on a property-level basis.

Neither FFO, EBITDA, nor Hotel EBITDA represents cash generated from operating activities determined by GAAP and should not be considered as alternatives to net income, cash flow from operations or any other operating performance measure prescribed by GAAP. Neither FFO, EBITDA nor Hotel EBITDA is a measure of the Company's liquidity, nor is FFO, EBITDA or Hotel EBITDA indicative of funds available to fund the Company's cash needs, including its ability to make cash distributions. Neither measurement reflects cash expenditures for long-term assets and other items that have been and will be incurred. FFO, EBITDA and Hotel EBITDA may include funds that may not be available for management's discretionary use due to functional requirements to conserve funds for capital expenditures, property acquisitions, and other commitments and uncertainties. To compensate for this, management considers the impact of these excluded items to the extent they are material to operating decisions or the evaluation of the Company's operating performance.

The following is a reconciliation between net income applicable to common shareholders and FFO for the three and six months ended June 30, 2008 and 2007 (dollars in thousands, except share data):

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
<b>Funds From Operations (FFO):</b>				
Net income applicable to common shareholders	\$ 20,545	\$ 19,360	\$ 5,715	\$ 35,012
Depreciation	26,595	22,722	51,163	44,738
Amortization of deferred lease costs	181	122	304	246
Minority interest:				
Minority interest in consolidated entities	(4)		(5)	
Minority interest of common units in Operating Partnership	72	69	53	143
Minority interest in discontinued operations				1
Less: Net gain on sale of property disposed of		(16)		(30,278)
<b>FFO</b>	<b>\$ 47,389</b>	<b>\$ 42,257</b>	<b>\$ 57,230</b>	<b>\$ 49,862</b>
<b>Weighted average number of common shares and units outstanding:</b>				
Basic	40,022,674	39,958,250	40,022,674	39,952,897
Diluted	40,081,802	40,237,102	40,097,831	40,235,617

**Table of Contents**

The following is a reconciliation between net income applicable to common shareholders and EBITDA for the three and six months ended June 30, 2008 and 2007 (dollars in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
<b>Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA):</b>				
Net income applicable to common shareholders	\$ 20,545	\$ 19,360	\$ 5,715	\$ 35,012
Interest expense	12,362	11,868	23,831	23,311
Income tax expense (benefit):				
Income tax expense (benefit)	3,738	3,632	(117)	251
Income tax (benefit) from discontinued operations				(73)
Depreciation and amortization	26,819	22,945	51,560	45,136
Minority interest:				
Minority interest in consolidated entities	(4)		(5)	
Minority interest of common units in Operating Partnership	72	69	53	143
Minority interest of preferred units in Operating Partnership	1,346	1,531	2,759	3,057
Minority interest in discontinued operations				1
Distributions to preferred shareholders	5,624	5,624	11,248	16,963
<b>EBITDA</b>	<b>\$ 70,502</b>	<b>\$ 65,029</b>	<b>\$ 95,044</b>	<b>\$ 123,801</b>
Corporate expense	5,340	4,524	10,251	9,389
Interest and other income	(2,522)	(1,466)	(4,149)	(3,488)
Participating lease adjustments (net)	538	400	431	458
Hotel level adjustments (net)	(779)	(476)	(554)	(135)
Income from operations of property disposed of, including gain on sale		(16)		(30,392)
<b>Hotel EBITDA</b>	<b>\$ 73,079</b>	<b>\$ 67,995</b>	<b>\$ 100,023</b>	<b>\$ 99,633</b>

Hotel EBITDA includes the operating data for all properties leased to LHL and to third parties for the three and six months ended June 30, 2008 and 2007 excluding the Donovan House. Chaminade Resort is excluded from January (closed for renovations) in the six months ended June 30, 2008 and 2007.

**Off-Balance Sheet Arrangements***Tax Indemnification Agreement*

Pursuant to the acquisition of the Westin Copley Place, the Company entered into a Tax Reporting and Protection Agreement (the "Tax Agreement") with Transwest Copley Square LLC (formerly SCG Copley Square LLC). Under the Tax Agreement, the Company is required, among other things, to indemnify Transwest Copley Square LLC (and its affiliates) for certain income tax liabilities that such entities would incur if the Westin Copley Place was transferred by the Company in a taxable transaction or if the Company fails to maintain a certain level of indebtedness with respect to the Westin Copley Place or its operations. The obligations of the Company under the Tax Protection Agreement (i) do not apply in the case of a foreclosure of the Westin Copley Place, if certain specified requirements are met, (ii) are limited to \$20.0 million (although a limitation of \$10.0 million is applicable to certain specified transactions), and (iii) terminates on the earlier of the tenth anniversary of the Company's acquisition of the Westin Copley Place or January 1, 2016. The Company believes that the likelihood that the Company will be required to pay under this Tax Agreement is remote, and therefore, a liability has not been recorded.

## **Table of Contents**

### *Reserve Funds*

Certain of the Company's agreements with its hotel managers, franchisors and lenders have provisions for the Company to provide funds, generally 3.0% to 5.5% of hotel revenues, sufficient to cover the cost of (a) certain non-routine repairs and maintenance to the hotels; and (b) replacements and renewals to the hotels' furniture, fixtures and equipment. Certain agreements require that the Company reserve cash. As of June 30, 2008, \$3.6 million was available in restricted cash reserves for future capital expenditures.

The Company has no other off-balance sheet arrangements.

### **Liquidity and Capital Resources**

The Company's principal source of cash to meet its cash requirements, including distributions to shareholders, is its pro rata share of operating cash flow from hotels leased by LHL and the Operating Partnership's cash flow from the participating leases with third parties. The Company's senior unsecured credit facility contains certain financial covenants relating to debt service coverage, net worth and total funded indebtedness and contains financial covenants that, assuming no continuing defaults, allow the Company to make shareholder distributions. There are currently no other contractual or other arrangements limiting payment of distributions by the Operating Partnership. Similarly, LHL is a wholly owned subsidiary of the Operating Partnership. Payments to the Operating Partnership are required pursuant to the terms of the lease agreements between LHL and the Operating Partnership relating to the properties owned by the Operating Partnership and leased by LHL. Except for the security deposit required under the participating lease for one hotel not leased by LHL, the lessees' obligations under the participating leases are unsecured and the lessees' abilities to make rent payments to the Operating Partnership, and the Company's liquidity, including its ability to make distributions to shareholders, are dependent on the lessees' abilities to generate sufficient cash flow from the operations of the hotels.

**Table of Contents**

Debt at June 30, 2008 and December 31, 2007 consisted of the following:

Debt	Interest Rate	Maturity Date	Balance Outstanding at June 30, 2008	December 31, 2007
<b>Credit facilities</b>				
Senior Unsecured Credit Facility	Floating <sup>(a)</sup>	April 2011 <sup>(a)</sup>	\$ 169,000	\$ 56,000
LHL Unsecured Credit Facility	Floating <sup>(b)</sup>	April 2011 <sup>(b)</sup>	8,517	14,416
Total borrowings under credit facilities			177,517	70,416
<b>Massport bonds</b>				
Harborside Hyatt Conference Center & Hotel (taxable) <sup>(c)</sup>	Floating <sup>(c)</sup>	March 2018	5,400	5,400
Harborside Hyatt Conference Center & Hotel (tax exempt) <sup>(c)</sup>	Floating <sup>(c)</sup>	March 2018	37,100	37,100
Total bonds payable			42,500	42,500
<b>Mortgage loans</b>				
Le Parc Suite Hotel	7.78%	May 2008 <sup>(d)</sup>		14,860
Gild Hall	Floating <sup>(e)</sup>	November 2008 <sup>(e)</sup>	20,000	20,000
Sheraton Bloomington Hotel Minneapolis South and Westin City Center Dallas	8.10%	July 2009	39,086	39,661
San Diego Paradise Point Resort	5.25%	February 2009	58,978	59,729
Hilton Alexandria Old Town	4.98%	September 2009	31,635	32,032
Le Montrose Suite Hotel	8.08%	July 2010	13,267	13,392
Hilton San Diego Gaslamp Quarter	5.35%	June 2012	59,600	59,600
Hotel Solamar	5.49%	December 2013	60,900	60,900
Hotel Deca	6.28%	August 2014	10,253	10,360
Westin Copley Place	5.28%	August 2015	210,000	210,000
Westin Michigan Avenue	5.75%	April 2016	140,000	140,000
Indianapolis Marriott Downtown	5.99%	July 2016	101,780	101,780
Mortgage loans			745,499	762,314
Unamortized loan premium <sup>(f)</sup>			450	590
Total mortgage loans			745,949	762,904
<b>Total debt</b>			<b>\$ 965,966</b>	<b>\$ 875,820</b>

- (a) Borrowings bear interest at floating rates equal to, at the Company's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. At June 30, 2008, the rates applicable to the Company's outstanding LIBOR borrowings of \$83,000 and \$86,000 were 3.29% and 3.28%, respectively. At December 31, 2007, the rates applicable to the Company's outstanding LIBOR borrowings of \$29,000 and \$27,000 were 6.00% and 5.91%, respectively. The Company has the option to extend the credit facility's maturity date to April 2012.
- (b) Borrowings bear interest at floating rates equal to, at LHL's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. At June 30, 2008 and December 31, 2007, the rates applicable to LHL's outstanding LIBOR borrowings were 3.18% and 5.90%, respectively. LHL has the option to extend the credit facility's maturity date to April 2012.
- (c) The Massport bonds are secured by letters of credit issued by the Royal Bank of Scotland that expire in 2009. The Royal Bank of Scotland letters of credit are secured by the Harborside Hyatt Conference Center & Hotel. The bonds bear interest based on weekly floating rates. The interest rates at June 30, 2008 were 2.75% and 1.62% for the \$5,400 and \$37,100 bonds, respectively. The interest rates at December 31, 2007 were 4.95% and 3.49% for the \$5,400 and \$37,100 bonds, respectively. The Company also incurs an annual letter of credit fee, which was reduced from 1.35% to 1.10% in February 2008.

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- (d) The Company repaid the mortgage loan through borrowings on its credit facilities upon maturity.
- (e) Mortgage debt bears interest at LIBOR plus 0.75%. The interest rates at June 30, 2008 and December 31, 2007 were 3.23% and 5.65%, respectively. The Company has the option to extend the maturity date for two consecutive one-year periods and a final 13-month period. The Company intends to exercise its first extension option upon initial maturity.
- (f) Mortgage debt includes unamortized loan premiums on the mortgage loans on Le Parc Suite Hotel and Hotel Deca of zero and \$450, respectively, as of June 30, 2008, and \$107 and \$483, respectively, as of December 31, 2007.

The Company incurred interest expense of \$12.4 million and \$23.8 million for the three and six months ended June 30, 2008, respectively, and \$11.9 million and \$23.3 million for the three and six months ended June 30, 2007, respectively. Included in interest expense is the amortization of deferred financing fees of \$0.3 million and \$0.7

**Table of Contents**

million for the three and six months ended June 30, 2008, respectively, and \$0.2 million and \$0.8 million for the three and six months ended June 30, 2007, respectively. Interest was capitalized in the amounts of \$0.7 million and \$2.1 million for the three and six months ended June 30, 2008, respectively, and \$0.8 million and \$1.6 million for the three and six months ended June 30, 2007, respectively.

As of June 30, 2008, the Company was current on all loan payments and in compliance with all debt covenants under the mortgages.

*Credit Facilities*

The Company has a senior unsecured credit facility from a syndicate of banks that provides for a maximum borrowing of up to \$450.0 million. On January 14, 2008, the Company amended the credit facility to increase the maximum borrowing from \$300.0 million to \$450.0 million. On April 13, 2007, the Company amended the credit facility to extend the credit facility's maturity date to April 13, 2011 with a one-year extension option and to reduce the applicable margin pricing by a range of 0.8% to 1.0%. The senior unsecured credit facility contains certain financial covenants relating to debt service coverage, net worth and total funded indebtedness. It also contains financial covenants that, assuming no defaults, allow the Company to make shareholder distributions. Borrowings under the credit facility bear interest at floating rates equal to, at the Company's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. As of June 30, 2008, the Company was in compliance with all debt covenants and was not otherwise in default under the credit facility. The weighted average interest rate for the borrowings under the senior unsecured credit facility was 3.4% and 3.7% for the three and six months ended June 30, 2008, respectively, and 6.1% and 6.2% for the three and six months ended June 30, 2007, respectively. The Company did not have any Adjusted Base Rate borrowings outstanding at June 30, 2008. Additionally, the Company is required to pay a variable unused commitment fee determined from a ratings or leverage based pricing matrix, currently set at 0.125% of the unused portion of the senior unsecured credit facility. The Company incurred unused commitment fees of \$0.1 million and \$0.2 million for the three and six months ended June 30, 2008, respectively, and \$0.1 million and \$0.2 million for the three and six months ended June 30, 2007, respectively. At June 30, 2008 and December 31, 2007, the Company had \$169.0 million and \$56.0 million, respectively, of outstanding borrowings under the senior unsecured credit facility.

LHL has a \$25.0 million unsecured revolving credit facility to be used for working capital and general lessee corporate purposes. On April 13, 2007, LHL amended the credit facility to extend the credit facility maturity date to April 13, 2011 with a one-year extension option and to reduce the applicable margin pricing by a range of 0.8% to 1.0%. Borrowings under the LHL credit facility bear interest at floating rates equal to, at LHL's option, either (i) LIBOR plus an applicable margin, or (ii) an Adjusted Base Rate plus an applicable margin. As of June 30, 2008, LHL was in compliance with all debt covenants and was not otherwise in default under the credit facility. The weighted average interest rate for borrowings under the LHL credit facility was 3.3% and 4.0% for the three and six months ended June 30, 2008, respectively, and 6.2% and 6.3% for the three and six months ended June 30, 2007, respectively. LHL did not have any Adjusted Base Rate borrowings outstanding at June 30, 2008. Additionally, LHL is required to pay a variable unused commitment fee determined from a ratings or leverage based pricing matrix, currently set at 0.125% of the unused portion of the LHL credit facility. LHL incurred unused commitment fees of an immaterial amount for the three and six months ended June 30, 2008 and 2007. At June 30, 2008 and December 31, 2007, LHL had \$8.5 million and \$14.4 million, respectively, of outstanding borrowings under the LHL credit facility.

**Sources and Uses of Cash**

At June 30, 2008, the Company had \$8.8 million of cash and cash equivalents and \$9.4 million of restricted cash reserves. Additionally, the Company had \$267.6 million available under the senior unsecured credit facility and \$16.5 million available under the LHL credit facility.

Net cash provided by operating activities was \$51.0 million for the six months ended June 30, 2008 primarily due to the operations of hotels leased by LHL and participating lease revenues from hotels leased to third parties, which were partially offset by payments for real estate taxes, personal property taxes, insurance and ground rent.

## **Table of Contents**

Net cash used in investing activities was \$104.5 million for the six months ended June 30, 2008 primarily due to the purchase of the 330 N. Wabash Avenue property and outflows for improvements and additions at the hotels, partially offset by proceeds from restricted cash reserves.

Net cash provided by financing activities was \$36.2 million for the six months ended June 30, 2008 primarily due to borrowings under credit facilities and contributions from a minority investor, partially offset by repayments under credit facilities, payment of distributions to the common shareholders and unitholders, payment of distributions to preferred shareholders and unitholders and mortgage loan repayments.

The Company has considered its short-term (one year or less) liquidity needs and the adequacy of its estimated cash flow from operations and other expected liquidity sources to meet these needs. The Company believes that its principal short-term liquidity needs are to fund normal recurring expenses, debt service requirements, distributions on the preferred shares and the minimum distribution required to maintain the Company's REIT qualification under the Code. The Company anticipates that these needs will be met through cash flows provided by operating activities, borrowings under the senior unsecured credit facility and equity issuances available under the shelf registration. The Company also considers capital improvements and property acquisitions as short-term needs that will be funded either with cash flows provided by operating activities, utilizing availability under the senior unsecured credit facility, the issuance of other indebtedness, or the issuance of additional equity securities.

The Company expects to meet long-term (greater than one year) liquidity requirements such as property acquisitions, scheduled debt maturities, major renovations, expansions and other nonrecurring capital improvements utilizing availability under the senior unsecured credit facility, estimated cash flows from operations, the issuance of long-term unsecured and secured indebtedness and the issuance of additional equity securities. The Company expects to acquire or develop additional hotel properties only as suitable opportunities arise, and the Company will not undertake acquisition or development of properties unless stringent acquisition and development criteria have been achieved.

## **Reserve Funds**

The Company is obligated to maintain reserve funds for capital expenditures at the hotels (including the periodic replacement or refurbishment of furniture, fixtures and equipment) as determined pursuant to the operating agreements. Please refer to Off-Balance Sheet Arrangements for a discussion of the Reserve Funds.

**Table of Contents**

**Contractual Obligation**

The following is a summary of the Company's obligations and commitments as of June 30, 2008 (dollars in thousands):

Contractual Obligations	Total	Amount of Commitment Expiration Per Period			
	Amounts Committed	Less than 1 year	1 to 3 years	4 to 5 years	Over 5 years
Mortgage loans <sup>(1)</sup>	\$ 983,022	\$ 122,515	\$ 149,884	\$ 129,153	\$ 581,470
Borrowings under credit facilities <sup>(2)</sup>	183,420	5,903	177,517		
Ground rent <sup>(3)</sup>	194,402	4,717	9,455	9,484	170,746
Massport bonds <sup>(1)</sup>	49,952	750	1,499	1,499	46,204
Purchase commitments <sup>(4)</sup>					
Purchase orders and letters of commitment	38,748	38,748			
<b>Total obligations and commitments</b>	<b>\$ 1,449,544</b>	<b>\$ 172,633</b>	<b>\$ 338,355</b>	<b>\$ 140,136</b>	<b>\$ 798,420</b>

<sup>(1)</sup> Amounts include principal and interest. Interest expense on fixed rate debt is computed based on the fixed interest rate of the debt. Interest expense on the variable rate debt is calculated based on the rate at June 30, 2008.

<sup>(2)</sup> Amounts include principal and interest. Interest expense is calculated based on the variable rate at June 30, 2008. It is assumed that the outstanding debt at June 30, 2008 will be repaid upon maturity with interest-only payments until then.

<sup>(3)</sup> Amounts calculated based on the annual minimum future ground lease payments that extend through the term of the lease. Rents may be subject to adjustments based on future interest rates and hotel performance.

<sup>(4)</sup> As of June 30, 2008, purchase orders and letters of commitment totaling approximately \$38.7 million had been issued for renovations at the properties. The Company has committed to these projects and anticipates making similar arrangements with the existing properties or any future properties that it may acquire.

**The Hotels**

On January 31, 2008, the Chaminade Resort and Conference Center re-opened after completion of renovations relating to an ongoing repositioning project. On March 28, 2008, the Donovan House re-opened after completion of a comprehensive renovation and repositioning project.

For each of calendar years 2004 through 2007, the Company notified Marriott International (Marriott) that it was terminating the management agreement at the Seaview Resort and Spa due to Marriott's failure to meet certain hotel operating performance thresholds as defined in the management agreement. Pursuant to the management agreement, Marriott had the right to avoid termination by making cure payments within 60 days of notification. Through June 30, 2008, Marriott made cure payments totaling \$12.3 million for the calendar years 2004 through 2007 to avoid termination. Marriott may recoup these amounts in the event certain future operating thresholds are attained. Through June 30, 2008, Marriott has recouped a total of \$2.8 million for the calendar years 2004 through 2007. The remaining amount may still be recouped; therefore, the Company recorded a deferred liability of \$9.5 million and \$6.4 million as of June 30, 2008 and December 31, 2007, respectively, which is included in accounts payable and accrued expenses on the accompanying consolidated balance sheets. The following is a reconciliation of the cure payments and deferred liability as of and for the six months ended June 30, 2008 and the years ended December 31, 2007, 2006 and 2005 (dollars in thousands):

Year Ended	Notification Date	Performance Year	Cure Payment		Deferred Liability Balance
			Date	Amount	
December 31, 2005	March 11, 2005	2004	April 28, 2005	\$ 2,394	\$ (1,540)
2006	March 9, 2006	2005	May 2, 2006	3,715	(280)
2007	February 22, 2007	2006	April 5, 2007	3,083	(1,001)
2008*	February 26, 2008	2007	April 10, 2008	3,123	\$ 9,494

As of June 30, 2008 \$ 12,315 \$ (2,821)

\* Six months ended June 30, 2008.

**Table of Contents**

The following table sets forth historical comparative information with respect to occupancy, average daily rate (ADR) and room revenue per available room (RevPAR) for the total hotel portfolio for the three and six months ended June 30, 2008 and 2007. ADR is calculated as the quotient of room revenue divided by the number of rooms sold, and RevPAR is calculated as the product of occupancy and ADR.

	For the three months ended			For the six months ended		
	2008	June 30, 2007	Variance	2008	June 30, 2007	Variance
<b>Total Portfolio</b>						
Occupancy	81.3%	79.3%	2.6%	73.0%	72.8%	0.3%
ADR	\$ 214.38	\$ 208.99	2.6%	\$ 200.58	\$ 196.07	2.3%
RevPAR	\$ 174.38	\$ 165.63	5.3%	\$ 146.42	\$ 142.71	2.6%

**Joint Ventures**

On March 18, 2008, the Company, through Modern Magic Hotel LLC, a joint venture in which the Company holds a 95% controlling interest, acquired floors 2 through 13 and a portion of the first floor of the existing 52-story IBM Building located at 330 N. Wabash Avenue in downtown Chicago, IL for \$46.0 million plus acquisition costs. The joint venture has developed plans to convert the existing vacant floors to a super luxury hotel. Since the Company holds a controlling interest, the accounts of the joint venture have been included in the consolidated financial statements.

On April 17, 2008, the Company entered into a joint venture arrangement with LaSalle Investment Management (LIM), a leading global real estate investment manager, to seek domestic hotel investments in high barrier-to-entry urban and resort markets in the U.S. The two companies plan to invest up to \$250.0 million of equity in the joint venture. With anticipated leverage, this will result in investments of up to \$700.0 million. The Company, through the Operating Partnership, will own a 15.0% equity interest in the joint venture and have the opportunity to earn a promote, or incentive fee, based upon achieving specific return thresholds based on each partner's equity investment. The Company will receive additional income for providing acquisition, asset management, project redevelopment oversight and financing services. The anticipated acquisition period is up to three years with the joint venture having a total life of up to seven years. The Company will continue to have the ability to acquire hotels on a wholly-owned basis throughout the life of the joint venture. During the joint venture's three-year acquisition period, prospective acquisitions will be allocated between the Company and the joint venture on the following basis: (i) the Company will have first right of acquisition to any asset with an acquisition price below \$75.0 million, (ii) the joint venture will have first right of acquisition to any asset with an acquisition price above \$175.0 million, and (iii) any asset with an acquisition price between \$75.0 million and \$175.0 million will be offered on a rotational basis with the first acquisition allocated to the joint venture. The Company accounts for its investment in this joint venture under the equity method of accounting. As of June 30, 2008, there were no acquisitions through the joint venture.

**Inflation**

The Company's revenues come primarily from its pro rata share of the Operating Partnership's cash flow from the participating leases and the LHL hotel operating revenues, thus the Company's revenues will vary based on changes in the underlying hotels' revenues. Therefore, the Company relies entirely on the performance of the hotels and the lessees' abilities to increase revenues to keep pace with inflation. The hotel operators can change room rates quickly, but competitive pressures may limit the lessees' and hotel operators' abilities to raise rates faster than inflation or even at the same rate.

The Company's expenses (primarily real estate taxes, property and casualty insurance, administrative expenses and LHL hotel operating expenses) are subject to inflation. These expenses are expected to grow with the general rate of inflation, except for energy costs, property and casualty insurance, liability insurance, property tax rates, employee benefits, and some wages, which are expected to increase at rates higher than inflation, and except for instances in which the properties are subject to periodic real estate tax reassessments.

**Seasonality**

The Company's hotels' operations historically have been seasonal. Taken together, the hotels maintain higher occupancy rates during the second and third quarters. These seasonality patterns can be expected to cause fluctuations in the Company's quarterly lease revenue under the participating leases with third-party lessees and hotel operating revenue from LHL.



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**Table of Contents**

**Legal Proceedings**

The nature of the operations of the hotels exposes the hotels to the risk of claims and litigation in the normal course of their business. Although the outcome of these matters cannot be determined, management does not expect the ultimate resolution of these matters to have a material adverse effect on the financial position, operations or liquidity of the hotels.

The Company has engaged Starwood Hotels & Resorts Worldwide, Inc. to manage and operate its Dallas hotel under the Westin brand affiliation. Meridien Hotels, Inc. ( Meridien ) affiliates had been operating the Dallas property as a wrongful holdover tenant, until the Westin brand conversion occurred on July 14, 2003 under court order.

On December 20, 2002, affiliates of Meridien abandoned the Company's New Orleans hotel. The Company entered into a lease with a wholly-owned subsidiary of LHL and an interim management agreement with Interstate Hotels & Resorts, Inc., and re-named the hotel the New Orleans Grande Hotel. The New Orleans property thereafter was sold on April 21, 2003 for \$92.5 million.

In connection with the termination of the Meridien affiliates at these hotels, the Company is currently in litigation with Meridien and related affiliates. The Company understands that Lehman Brothers is now the real party in interest after having acquired a controlling stake in the Meridien entities that are parties to the Dallas and New Orleans lawsuits. The Company believes its sole potential obligation in connection with the termination of the leases is to pay fair market value of the leases at the date of termination, if any.

With respect to the Dallas hotel, the Company has obtained a judgment from the court that Meridien defaulted and that Meridien is not entitled to the payment of fair market value. The Company's damage claims against Meridien went to trial in March 2005, and a final judgment was entered for the Company in the amount of \$3.9 million, plus post-judgment interest. Both parties cross-appealed, and on February 11, 2008 the Texas Court of Appeals affirmed the lower court's ruling that Meridien defaulted and is not entitled to payment of fair market value. The appellate court also affirmed the award of damages in the amount of holdover rent, but reduced the amount of the final judgment entered for the Company by approximately \$1.4 million. The Company has asked the Court of Appeals to reconsider its rulings in two respects: (i) whether Meridien Hotels, Inc. should be jointly and severally liable for the payment of the judgment; and (ii) whether the Company is entitled to pre-judgment interest on the amount of holdover rent that was not timely paid by Meridien during its wrongful holdover. On May 28, 2008, the Court of Appeals modified its prior decision to provide for an award of pre-judgment interest to the Company, entered a new Judgment, and remanded to the trial court to determine the amount of pre-judgment interest to be awarded to the Company. Meridien did not timely file an objection to the Court's decision, and the Company anticipates that the trial court will issue a new scheduling order to resolve and otherwise act on its mandate to award pre-judgment interest to the Company.

With respect to the New Orleans hotel, arbitration of the fair market value of the New Orleans lease commenced in October 2002. On December 19, 2002, the arbitration panel determined that Meridien was entitled to an award of \$5.7 million, subject to adjustment (reduction) by the courts to account for Meridien's holdover. In order to dispute the arbitration decision, the Company was required to post a \$7.8 million surety bond, which was secured by \$5.9 million of restricted cash. The Company successfully challenged the award on appeal, and the dispute was remanded to the trial court. Meridien's request for rehearing was denied on March 31, 2004, and Meridien did not petition to the Louisiana Supreme Court. In June 2004, the \$7.8 million surety bond was released and the \$5.9 million restricted cash securing it was returned to the Company. The issue of default by the lessee and the Company's wrongful holdover claim, as well as Meridien's damage claims arising from the termination of its leasehold, among other claims, went to trial in February 2005. On June 9, 2005, the trial court issued its judgment denying the Company's default claim as well as Meridien's fraud claim, and re-determined fair market value of the lease to be \$8.6 million, plus interest. On July 18, 2005, the Company posted a \$8.6 million surety bond, which was secured by \$9.0 million of restricted cash. On May 26, 2006, the trial court entered judgment awarding Meridien attorney's fees of \$4.1 million. The Company has noticed an appeal from the trial court's judgment. On July 11, 2006, the Company posted a \$4.2 million bond which is collateralized by a letter of credit. On August 15, 2006, the Company replaced the restricted cash collateral on the \$8.6 million bond and obtained a new \$12.8 million letter of credit which serves as collateral for the \$8.6 million bond and the \$4.2 million bond. The Louisiana court of appeals

**Table of Contents**

heard argument on the Company's appeal from the trial court's judgment on April 3, 2007, and issued its decision on April 16, 2008. The Appeals Court vacated the trial court's determination and award of fair market value, affirmed the trial court's judgment that Meridien was not in default of the lease, reduced Meridien's attorney's fee award to \$2.8 million, and ordered that the matter be sent back to arbitration for a recalculation of fair market value. The Company unsuccessfully petitioned the Court of Appeals for a rehearing, and is considering its options. Pending final resolution of the Company's default claims, Meridien has demanded arbitration of fair market value, and the Company has answered that demand. The Company applied for a writ of certiorari to the Supreme Court of Louisiana, asking for review of the appellate court's decision on the default and wrongful injunction issues. Pending the Supreme Court of Louisiana's response to that application, the trial court stayed the FMV arbitration.

In 2002, the Company recognized a net \$2.5 million contingent lease termination expense and reversed previously deferred assets and liabilities related to the termination of both the New Orleans property and Dallas property leases and recorded a corresponding contingent liability included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. The Company believes, however, it is owed holdover rent per the lease terms due to Meridien's failure to vacate the properties as required under the leases. The contingent lease termination expense was, therefore, net of the holdover rent the Company believes it is entitled to for both properties. In 2003, the Company adjusted this liability by additional holdover rent of \$0.8 million that it believes it is entitled to for the Dallas property. These amounts were recorded as other income in the Company's December 31, 2003 consolidated statement of operations. The contingent lease termination expense recognized cumulatively since 2002 is comprised of (dollars in thousands):

Expense Recognized For the Year Ended	Estimated Arbitration Award	Legal Fees Related to Litigation	Holdover Rent	Expected Reimbursement of Legal fees	Net Contingent Lease Termination Expense
December 31, 2002 <sup>(1)</sup>	\$ 5,749	\$ 2,610	\$ (4,844)	\$ (995)	\$ 2,520
December 31, 2003					
December 31, 2004		1,350		(500)	850
December 31, 2005		1,000			1,000
December 31, 2006		800			800
December 31, 2007					
June 30, 2008 <sup>(2)</sup>					
Cumulative Expense Recognized as of June 30, 2008	\$ 5,749	\$ 5,760	\$ (4,844)	\$ (1,495)	\$ 5,170

<sup>(1)</sup> Recognized in quarter ended December 31, 2002.

<sup>(2)</sup> Recognized in six months ended June 30, 2008.

In September 2004 and June 2005, after evaluating the ongoing Meridien litigation, the Company accrued additional net legal fees of \$0.9 million and \$1.0 million, respectively, due to litigation timeline changes. In September 2006, after further evaluation of the ongoing Meridien litigation, the Company accrued an additional \$0.8 million in legal fees due to timeline changes in order to conclude this matter. As a result, the net contingent lease termination liability has a balance of \$1.5 million as of June 30, 2008, which is included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. Based on the claims the Company has against Meridien, the Company is and will continue to challenge Meridien's claim that it is entitled to the payment of fair market value, and will continue to seek reimbursement of legal fees and damages. These amounts may exceed or otherwise may be used to offset any amounts potentially owed to Meridien, and therefore, ultimately may offset or otherwise reduce any contingent lease termination expense. Additionally, the Company cannot provide any assurances that the holdover rents or any damages will be collectible from Meridien or that the amounts due will not be greater than the recorded contingent lease termination expense.

The Company maintained a lien on Meridien's security deposit on both disputed properties with an aggregate value of \$3.3 million, in accordance with the lease agreements. The security deposits were liquidated in May 2003 with the proceeds used to partially satisfy Meridien's outstanding obligations. The judgment entered by the Dallas Court already incorporates a set-off in the amount of \$1.0 million attributable to the security deposit for the Dallas property.



## **Table of Contents**

The Company does not believe that the amount of any fees or damages it may be required to pay on any of the litigation related to Meridien will have a material adverse effect on the Company's financial condition or results of operations, taken as a whole. The Company's management has discussed this contingency and the related accounting treatment with the audit committee of its Board of Trustees.

The Company accrues for future legal fees related to contingent liabilities based upon management's estimate. The Company is not presently subject to any other material litigation nor, to the Company's knowledge, is any other litigation threatened against the Company, other than routine actions for negligence or other claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance and all of which collectively are not expected to have a material adverse effect on the liquidity, results of operations or business or financial condition of the Company.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company is exposed to market risk from changes in interest rates. We seek to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs by closely monitoring our variable rate debt and converting such debt to fixed rates when we deem such conversion advantageous. As of June 30, 2008, \$240.0 million of the Company's aggregate indebtedness (24.9% of total indebtedness) was subject to variable interest rates.

If market rates of interest on our variable rate long-term debt fluctuate by 0.25%, interest expense would increase or decrease, depending on rate movement, future earnings and cash flows, by approximately \$0.6 million annually. This assumes that the amount outstanding under the Company's variable rate debt remains at \$240.0 million, the balance at June 30, 2008.

### **Item 4. Controls and Procedures**

Based on the most recent evaluation, the Company's Chief Executive Officer and Chief Financial Officer believe the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of June 30, 2008. There were no changes to the Company's internal control over financial reporting during the second quarter ended June 30, 2008 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. Other Information**

### **Item 1. Legal Proceedings**

The Company and the Operating Partnership are subject to claims and actions in the ordinary course and, from time to time, to other litigation, including the Meridien litigation described elsewhere in this report and, with respect to the Meridien litigation previously reported in Part I of this report, is hereby incorporated by reference thereto in this Item 1 Part II. Some of these matters are expected to be covered by insurance. The ultimate resolution of these matters, in the opinion of the Company, is not expected to have a material adverse effect on the financial position, operations or liquidity of the Company and the Operating Partnership.

### **Item 1A. Risk Factors**

Other than with respect to the risk factors below, there have been no material changes from the risk factors disclosed in the "Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**Table of Contents**

*Our lenders may have suffered losses related to the weakening economy and may not be able to fund our borrowings.*

Our lenders, including the lenders participating in our \$450.0 million senior unsecured credit facility, may have suffered losses related to their lending and other financial relationships, especially because of the general weakening of the national economy and increased financial instability of many borrowers. As a result, lenders may become insolvent or tighten their lending standards, which could make it more difficult for us to borrow under our credit facility or to obtain other financing on favorable terms or at all. Our financial condition and results of operations would be adversely affected if we were unable to draw funds under our credit facility because of a lender default or to obtain other cost-effective financing.

**Table of Contents**

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

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

(a) On April 24, 2008, the Company held its Annual Meeting of Shareholders. The matters on which the shareholders voted, in person or by proxy were:

- (i) for the election of two Class I trustees of the Company to serve until the 2011 Annual Meeting of Shareholders and until their successors are duly elected and qualified; and
- (ii) the ratification of the appointment of the Company's independent registered public accountants for the year ending December 31, 2008.

The two nominees were elected and the ratification of the appointment of the independent registered public accountants was approved. The results of the voting were as follows:

Election of Trustees:

Trustee	Votes For	Votes Against	Votes Withheld
Jon E. Bortz	36,713,191	0	443,647
Donald A. Washburn	36,274,315	0	882,703

Ratification of Appointment of Independent Registered Public Accountants:

Votes For	Votes Against	Abstentions	Not Voted
37,050,038	91,456	15,073	2,957,233

(b) In addition, the following trustees' terms are continuing: Donald S. Perkins, Stuart L. Scott, Darryl Hartley-Leonard, Kelly L. Kuhn and William S. McCalmont.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(a) Exhibits.

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<b>Exhibit Number</b>	<b>Description of Exhibit</b>
10.1	Offer letter to Michael D. Barnello <sup>(1)</sup>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
32.2	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

<sup>(1)</sup> Previously filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on June 2, 2008 and incorporated herein by reference.

**Table of Contents**

SIGNATURES

Pursuant to the requirements 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.

**LASALLE HOTEL PROPERTIES**

Dated: July 23, 2008

BY: /s/ JULIO E. MORALES  
Julio E. Morales  
*Chief Accounting Officer (Principal Accounting Officer)*

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Offer letter to Michael D. Barnello <sup>(1)</sup>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
32.2	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

<sup>(1)</sup> Previously filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on June 2, 2008 and incorporated herein by reference.