

## Section 1: 10-Q (10-Q)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended September 30, 2019

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: 000-54263



**CAREY WATERMARK INVESTORS INCORPORATED**  
(Exact name of registrant as specified in its charter)

**Maryland**

(State of incorporation)

**26-2145060**

(I.R.S. Employer Identification No.)

**50 Rockefeller Plaza**

**New York, New York**

(Address of principal executive office)

**10020**

(Zip Code)

**Investor Relations (212) 492-8920**

**(212) 492-1100**

(Registrant's telephone numbers, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

Registrant has 142,681,934 shares of common stock, \$0.001 par value, outstanding at November 1, 2019.

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## INDEX

	<u>Page No.</u>
PART I — FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
<a href="#">Consolidated Balance Sheets</a>	<a href="#">2</a>
<a href="#">Consolidated Statements of Operations</a>	<a href="#">3</a>
<a href="#">Consolidated Statements of Comprehensive (Loss) Income</a>	<a href="#">4</a>
<a href="#">Consolidated Statements of Equity</a>	<a href="#">5</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">7</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">8</a>
Item 2. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	<a href="#">27</a>
Item 3. <a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	<a href="#">43</a>
Item 4. <a href="#">Controls and Procedures</a>	<a href="#">44</a>
PART II — OTHER INFORMATION	
Item 2. <a href="#">Unregistered Sales of Equity Securities</a>	<a href="#">45</a>
Item 6. <a href="#">Exhibits</a>	<a href="#">46</a>
<a href="#">Signatures</a>	<a href="#">47</a>

### **Forward-Looking Statements**

This Quarterly Report on Form 10-Q (this “Report”), including Management’s Discussion and Analysis of Financial Condition and Results of Operations, in Item 2 of Part I of this Report, contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. These statements are based on the current expectations of our management. Forward-looking statements in this Report include, among others, statements about the impact of hurricanes and other natural disasters on certain hotels, including the condition of the properties and cost estimates. In addition, on October 22, 2019, we announced that we have entered into a merger agreement with Carey Watermark Investors 2 Incorporated and an internalization agreement with our external advisor and subadvisor. These transactions are expected to close in the first quarter of 2020, although there can be no assurance that they will close in our expected timeframe or at all. It is important to note that our actual results could be materially different from those projected in such forward-looking statements. You should exercise caution in relying on forward-looking statements, as they involve known and unknown risks, uncertainties, and other factors that may materially affect our future results, performance, achievements or transactions. Information on factors that could impact actual results and cause them to differ from what is anticipated in the forward-looking statements contained herein is included in this Report as well as in our other filings with the Securities and Exchange Commission (“SEC”), including but not limited to those described in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the SEC on March 15, 2019 (the “2018 Annual Report”), and those that will be included in the joint proxy statement/prospectus that we expect to file with the SEC with regard to the proposed merger. Except as required by federal securities laws and the rules and regulations of the SEC, we do not undertake to revise or update any forward-looking statements.

All references to “Notes” throughout the document refer to the footnotes to the consolidated financial statements of the registrant in Part I, Item 1. Financial Statements (Unaudited).

**PART I — FINANCIAL INFORMATION**  
**Item 1. Financial Statements.**

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS (UNAUDITED)**  
*(in thousands, except share and per share amounts)*

	September 30, 2019	December 31, 2018
<b>Assets</b>		
Investments in real estate:		
Hotels, at cost	\$ 2,085,575	\$ 2,175,975
Accumulated depreciation	(295,974)	(266,323)
Net investments in hotels	1,789,601	1,909,652
Assets held for sale (Note 4)	15,203	—
Equity investments in real estate	106,890	112,715
Operating lease right-of-use assets	47,461	—
Cash and cash equivalents	78,831	66,593
Intangible assets, net	65,184	76,671
Restricted cash	61,443	54,537
Accounts receivable, net	22,091	36,884
Other assets	24,761	23,092
<b>Total assets</b> <sup>(a)</sup>	<b>\$ 2,211,465</b>	<b>\$ 2,280,144</b>
<b>Liabilities and Equity</b>		
Non-recourse debt, net, including debt attributable to Assets held for sale	\$ 1,274,847	\$ 1,326,014
WPC Credit Facility	35,000	41,637
Accounts payable, accrued expenses and other liabilities	107,047	128,955
Operating lease liabilities	71,540	—
Due to related parties and affiliates	3,040	6,258
Other liabilities held for sale (Note 4)	208	—
Distributions payable	20,171	19,898
<b>Total liabilities</b> <sup>(a)</sup>	<b>1,511,853</b>	<b>1,522,762</b>
Commitments and contingencies (Note 10)		
Common stock, \$0.001 par value; 300,000,000 shares authorized; 141,548,634 and 139,627,375 shares, respectively, issued and outstanding	142	140
Additional paid-in capital	1,195,949	1,174,887
Distributions and accumulated losses	(548,011)	(471,130)
Accumulated other comprehensive loss	(266)	(286)
<b>Total stockholders' equity</b>	<b>647,814</b>	<b>703,611</b>
Noncontrolling interests	51,798	53,771
<b>Total equity</b>	<b>699,612</b>	<b>757,382</b>
<b>Total liabilities and equity</b>	<b>\$ 2,211,465</b>	<b>\$ 2,280,144</b>

(a) See [Note 2](#) for details related to variable interest entities (“VIEs”).

See Notes to Consolidated Financial Statements.

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

*(in thousands, except share and per share amounts)*

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
<b>Revenues</b>				
Hotel Revenues				
Rooms	\$ 95,825	\$ 94,465	\$ 298,126	\$ 287,031
Food and beverage	38,481	34,943	127,126	118,564
Other operating revenue	13,997	12,752	40,483	34,057
Business interruption income	2,815	6,075	3,627	18,273
<b>Total Hotel Revenues</b>	<u>151,118</u>	<u>148,235</u>	<u>469,362</u>	<u>457,925</u>
<b>Expenses</b>				
Rooms	21,616	22,161	66,227	66,204
Food and beverage	27,696	27,056	86,866	84,083
Other hotel operating expenses	7,213	6,922	21,366	19,704
Property taxes, insurance, rent and other	17,052	14,640	55,539	45,906
Sales and marketing	14,492	14,066	43,672	43,381
General and administrative	13,859	13,247	41,624	39,739
Repairs and maintenance	4,920	4,956	15,013	14,866
Utilities	4,124	4,025	11,510	10,991
Management fees	3,484	4,502	12,971	13,963
Depreciation and amortization	19,102	18,642	57,845	57,615
<b>Total Hotel Operating Expenses</b>	<u>133,558</u>	<u>130,217</u>	<u>412,633</u>	<u>396,452</u>
Asset management fees to affiliate and other expenses	3,464	3,770	11,073	11,524
Corporate general and administrative expenses	3,052	2,839	9,211	8,555
Gain on hurricane-related property damage	(880)	(41)	(880)	(1,106)
Transaction costs	728	—	1,483	—
<b>Total Expenses</b>	<u>139,922</u>	<u>136,785</u>	<u>433,520</u>	<u>415,425</u>
Operating income before net gain (loss) on sale of real estate	11,196	11,450	35,842	42,500
Net gain (loss) on sale of real estate	5,881	(669)	5,881	31,260
<b>Operating Income</b>	<u>17,077</u>	<u>10,781</u>	<u>41,723</u>	<u>73,760</u>
Interest expense	(17,219)	(16,557)	(50,205)	(49,826)
Equity in (losses) earnings of equity method investments in real estate, net	(759)	(589)	101	(538)
Net loss on extinguishment of debt	—	(322)	(136)	(511)
Other income	355	140	605	508
<b>(Loss) income before income taxes</b>	<u>(546)</u>	<u>(6,547)</u>	<u>(7,912)</u>	<u>23,393</u>
Provision for income taxes	(1,030)	(986)	(2,133)	(3,516)
<b>Net (Loss) Income</b>	<u>(1,576)</u>	<u>(7,533)</u>	<u>(10,045)</u>	<u>19,877</u>
(Income) loss attributable to noncontrolling interests (inclusive of Available Cash Distributions to a related party of \$2,537, \$2,478, \$4,905 and \$3,450, respectively)	(878)	323	(6,474)	(5,180)
<b>Net (Loss) Income Attributable to CWI Stockholders</b>	<u>\$ (2,454)</u>	<u>\$ (7,210)</u>	<u>\$ (16,519)</u>	<u>\$ 14,697</u>
<b>Basic and Diluted (Loss) Income Per Share</b>	<u>\$ (0.02)</u>	<u>\$ (0.05)</u>	<u>\$ (0.12)</u>	<u>\$ 0.11</u>
<b>Basic and Diluted Weighted-Average Shares Outstanding</b>	<u>141,952,133</u>	<u>139,439,615</u>	<u>141,332,118</u>	<u>139,175,017</u>

See Notes to Consolidated Financial Statements.

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)**

*(in thousands)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Net (Loss) Income</b>	\$ (1,576)	\$ (7,533)	\$ (10,045)	\$ 19,877
<b>Other Comprehensive Income</b>				
Unrealized gain on derivative instruments	160	85	28	511
<b>Comprehensive (Loss) Income</b>	(1,416)	(7,448)	(10,017)	20,388
<b>Amounts Attributable to Noncontrolling Interests</b>				
Net (income) loss	(878)	323	(6,474)	(5,180)
Unrealized (gain) loss on derivative instruments	(6)	(1)	(8)	3
Comprehensive (income) loss attributable to noncontrolling interests	(884)	322	(6,482)	(5,177)
<b>Comprehensive (Loss) Income Attributable to CWI Stockholders</b>	<u>\$ (2,300)</u>	<u>\$ (7,126)</u>	<u>\$ (16,499)</u>	<u>\$ 15,211</u>

See Notes to Consolidated Financial Statements.

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)**

*(in thousands, except share and per share amounts)*

	CWI Stockholders							
	Shares	Common Stock	Additional Paid-In Capital	Distributions and Accumulated Losses	Accumulated Other Comprehensive (Loss) Income	Total CWI Stockholders' Equity	Noncontrolling Interests	Total Stockholders' Equity
<b>Balance at July 1, 2019</b>	141,040,038	\$ 141	\$1,190,111	\$ (525,386)	\$ (420)	\$ 664,446	\$ 54,688	\$ 719,134
Net (loss) income				(2,454)		(2,454)	878	(1,576)
Shares issued, net of offering costs	1,028,483	1	10,684			10,685		10,685
Shares issued to affiliates	342,920	—	3,562			3,562		3,562
Distributions to noncontrolling interests						—	(3,774)	(3,774)
Shares issued under share incentive plans			134			134		134
Distributions declared (\$0.1425 per share)				(20,171)		(20,171)		(20,171)
Other comprehensive income					154	154	6	160
Repurchase of shares	(862,807)	—	(8,542)			(8,542)		(8,542)
<b>Balance at September 30, 2019</b>	<u>141,548,634</u>	<u>\$ 142</u>	<u>\$1,195,949</u>	<u>\$ (548,011)</u>	<u>\$ (266)</u>	<u>\$ 647,814</u>	<u>\$ 51,798</u>	<u>\$ 699,612</u>
<b>Balance at July 1, 2018</b>	138,539,759	\$ 139	\$1,162,515	\$ (417,555)	\$ (26)	\$ 745,073	\$ 57,689	\$ 802,762
Net loss				(7,210)		(7,210)	(323)	(7,533)
Shares issued, net of offering costs	1,048,320	1	10,916			10,917		10,917
Shares issued to affiliates	339,550	—	3,534			3,534		3,534
Distributions to noncontrolling interests						—	(2,540)	(2,540)
Shares issued under share incentive plans			101			101		101
Distributions declared (\$0.1425 per share)				(19,827)		(19,827)		(19,827)
Other comprehensive income					85	85	1	86
Repurchase of shares	(787,680)	(1)	(7,808)			(7,809)		(7,809)
<b>Balance at September 30, 2018</b>	<u>139,139,949</u>	<u>\$ 139</u>	<u>\$1,169,258</u>	<u>\$ (444,592)</u>	<u>\$ 59</u>	<u>\$ 724,864</u>	<u>\$ 54,827</u>	<u>\$ 779,691</u>

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF EQUITY (UNAUDITED)**

(Continued)

(in thousands, except share and per share amounts)

	CWI Stockholders							
	Shares	Common Stock	Additional Paid-In Capital	Distributions and Accumulated Losses	Accumulated Other Comprehensive (Loss) Income	Total CWI Stockholders' Equity	Noncontrolling Interests	Total Stockholders' Equity
<b>Balance at January 1, 2019</b>	139,627,375	\$ 140	\$1,174,887	\$ (471,130)	\$ (286)	\$ 703,611	\$ 53,771	\$ 757,382
Net (loss) income				(16,519)		(16,519)	6,474	(10,045)
Shares issued, net of offering costs	3,109,275	3	32,299			32,302		32,302
Shares issued to affiliates	1,026,336	1	10,669			10,670		10,670
Contributions from noncontrolling interests						—	175	175
Distributions to noncontrolling interests						—	(8,630)	(8,630)
Shares issued under share incentive plans	24,975	—	226			226		226
Stock-based compensation to directors	20,206	—	210			210		210
Distributions declared (\$0.4275 per share)				(60,362)		(60,362)		(60,362)
Other comprehensive income					20	20	8	28
Repurchase of shares	(2,259,533)	(2)	(22,342)			(22,344)		(22,344)
<b>Balance at September 30, 2019</b>	<u>141,548,634</u>	<u>\$ 142</u>	<u>\$1,195,949</u>	<u>\$ (548,011)</u>	<u>\$ (266)</u>	<u>\$ 647,814</u>	<u>\$ 51,798</u>	<u>\$ 699,612</u>
<b>Balance at January 1, 2018</b>	137,826,503	\$ 138	\$1,153,652	\$ (399,884)	\$ (455)	\$ 753,451	\$ 54,437	\$ 807,888
Net income				14,697		14,697	5,180	19,877
Shares issued, net of offering costs	3,135,146	3	33,000			33,003		33,003
Shares issued to affiliates	1,016,974	1	10,717			10,718		10,718
Distributions to noncontrolling interests						—	(4,787)	(4,787)
Shares issued under share incentive plans	18,971	—	175			175		175
Stock-based compensation to directors	17,291	—	180			180		180
Distributions declared (\$0.4275 per share)				(59,405)		(59,405)		(59,405)
Other comprehensive income (loss)					514	514	(3)	511
Repurchase of shares	(2,874,936)	(3)	(28,466)			(28,469)		(28,469)
<b>Balance at September 30, 2018</b>	<u>139,139,949</u>	<u>\$ 139</u>	<u>\$1,169,258</u>	<u>\$ (444,592)</u>	<u>\$ 59</u>	<u>\$ 724,864</u>	<u>\$ 54,827</u>	<u>\$ 779,691</u>

See Notes to Consolidated Financial Statements.

**CAREY WATERMARK INVESTORS INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

*(in thousands)*

	Nine Months Ended September 30,	
	2019	2018
<b>Cash Flows — Operating Activities</b>		
Net (loss) income	\$ (10,045)	\$ 19,877
Adjustments to net (loss) income:		
Depreciation and amortization	57,845	57,615
Asset management fees to affiliates settled in shares	10,673	10,628
Net gain on sale of real estate (Note 4)	(5,881)	(31,260)
Business interruption income	(3,627)	(18,273)
Amortization of deferred financing costs and other	2,507	2,296
Gain on hurricane-related property damage	(880)	(1,106)
Amortization of stock-based compensation expense	560	455
Net loss on extinguishment of debt	136	511
Equity in (earnings) losses of equity method investments in real estate, net	(101)	538
Straight-line rent adjustments	—	4,316
Net changes in other operating assets and liabilities	12,341	6,396
Net decrease in operating lease right-of-use assets	4,978	—
Business interruption insurance proceeds	3,627	9,323
(Decrease) increase in due to related parties and affiliates	(3,393)	1,087
Distributions of earnings from equity method investments	2,888	2,802
Insurance proceeds for remediation work due to hurricane damage	2,773	4,031
Net increase in operating lease liabilities	1,142	—
Receipt of key money and other deferred incentive payments	500	58
Funding of hurricane/fire-related remediation work	(3)	(10,738)
<b>Net Cash Provided by Operating Activities</b>	<b>76,040</b>	<b>58,556</b>
<b>Cash Flows — Investing Activities</b>		
Proceeds from the sale of real estate investments (Note 4)	77,447	156,756
Capital expenditures	(29,991)	(60,311)
Hurricane-related property insurance proceeds	11,661	14,379
Distributions from equity investments in excess of cumulative equity income	6,421	12,893
Capital contributions to equity investments in real estate	(3,429)	(732)
Repayments of loan receivable	167	238
<b>Net Cash Provided by Investing Activities</b>	<b>62,276</b>	<b>123,223</b>
<b>Cash Flows — Financing Activities</b>		
Scheduled payments and prepayments of mortgage principal	(136,563)	(166,332)
Proceeds from mortgage financing	85,430	75,250
Distributions paid	(60,089)	(59,219)
Net proceeds from issuance of shares	32,301	33,003
Repurchase of shares	(22,312)	(28,464)
Repayment of WPC Credit Facility	(11,637)	(37,000)
Distributions to noncontrolling interests	(8,630)	(4,787)
Proceeds from WPC Credit Facility	5,000	10,000
Deferred financing costs	(2,323)	(1,959)
Other financing activities, net	(349)	(1,193)
<b>Net Cash Used in Financing Activities</b>	<b>(119,172)</b>	<b>(180,701)</b>
<b>Change in Cash and Cash Equivalents and Restricted Cash During the Period</b>		
Net increase in cash and cash equivalents and restricted cash	19,144	1,078
Cash and cash equivalents and restricted cash, beginning of period	121,130	132,376

Cash and cash equivalents and restricted cash, end of period

\$ 140,274 \$ 133,454

See Notes to Consolidated Financial Statements.

*CWI 9/30/2019 10-Q - 7*

**CAREY WATERMARK INVESTORS INCORPORATED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note 1. Business**

*Organization*

Carey Watermark Investors Incorporated (“CWI”) is a publicly-owned, non-traded real estate investment trust (“REIT”) that, together with its consolidated subsidiaries, invests in, manages and seeks to enhance the value of, interests in lodging and lodging-related properties in the United States. We conduct substantially all of our investment activities and own all of our assets through CWI OP, LP (the “Operating Partnership”). We are a general partner and a limited partner of, and own a 99.985% capital interest in, the Operating Partnership. Carey Watermark Holdings, LLC (“Carey Watermark Holdings”), which is owned indirectly by both W. P. Carey Inc. (“WPC”) and Watermark Capital Partners, LLC (“Watermark Capital Partners”), holds a special general partner interest in the Operating Partnership.

We are managed by Carey Lodging Advisors, LLC (our “Advisor”), an indirect subsidiary of WPC. Our Advisor manages our overall portfolio, including providing oversight and strategic guidance to the independent hotel operators that manage our hotels. CWA, LLC (the “Subadvisor”), a subsidiary of Watermark Capital Partners, provides services to our Advisor, primarily relating to acquiring, managing, financing and disposing of our hotels and overseeing the independent operators that manage the day-to-day operations of our hotels. In addition, the Subadvisor provides us with the services of Mr. Michael G. Medzigan, our Chief Executive Officer, subject to the approval of our independent directors.

We held ownership interests in 26 hotels at September 30, 2019, including 22 hotels that we consolidate (“Consolidated Hotels”) and four hotels that we record as equity investments (“Unconsolidated Hotels”).

*Public Offerings*

We raised \$575.8 million through our initial public offering, which ran from September 15, 2010 through September 15, 2013, and \$577.4 million through our follow-on offering, which ran from December 20, 2013 through December 31, 2014. We have fully invested the proceeds from both our initial public offering and follow-on offering. In addition, from inception through September 30, 2019, \$246.0 million of distributions were reinvested in our common stock through our distribution reinvestment plan (“DRIP”).

*Proposed Merger*

On October 22, 2019, we and Carey Watermark Investors 2 Incorporated (“CWI 2”) announced that we have entered into a definitive merger agreement under which we will merge in an all-stock transaction, with us surviving the merger as a wholly-owned subsidiary of CWI 2. The transaction is expected to close in the first quarter of 2020, subject to the approval of our stockholders and CWI 2’s stockholders, among other conditions. Following the close of the merger, the combined company will complete an internalization transaction with our Advisor and Subadvisor, as a result of which the combined company will become self-managed ([Note 13](#)).

**Note 2. Basis of Presentation**

*Basis of Presentation*

Our interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not necessarily include all information and footnotes necessary for a fair statement of our consolidated financial position, results of operations and cash flows in accordance with generally accepted accounting principles in the United States (“GAAP”).

In the opinion of management, the unaudited financial information for the interim periods presented in this Report reflects all normal and recurring adjustments necessary for a fair statement of financial position, results of operations and cash flows. Our interim consolidated financial statements should be read in conjunction with our audited consolidated financial statements and accompanying notes for the year ended December 31, 2018, which are included in our 2018 Annual Report, as certain disclosures that would substantially duplicate those contained in the audited consolidated financial statements have not been included in this Report. Operating results for interim periods are not necessarily indicative of operating results for an entire year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in our consolidated financial statements and the accompanying notes. Actual results could differ from those estimates.

### ***Basis of Consolidation***

Our consolidated financial statements reflect all of our accounts, including those of our controlled subsidiaries. The portions of equity in consolidated subsidiaries that are not attributable, directly or indirectly, to us are presented as noncontrolling interests. All significant intercompany accounts and transactions have been eliminated.

When we obtain an economic interest in an entity, we evaluate the entity to determine if it should be deemed a VIE, and, if so, whether we are the primary beneficiary and are therefore required to consolidate the entity. There have been no significant changes in our VIE policies from what was disclosed in the 2018 Annual Report.

At both September 30, 2019 and December 31, 2018, we considered five entities to be VIEs, four of which we consolidated as we are considered the primary beneficiary. The following table presents a summary of selected financial data of consolidated VIEs included in the consolidated balance sheets (in thousands):

	September 30, 2019	December 31, 2018
Net investments in hotels	\$ 495,142	\$ 497,637
Intangible assets, net	37,246	37,847
Total assets	568,256	576,430
Non-recourse debt, net	\$ 341,955	\$ 344,018
Total liabilities	374,810	373,700

### ***Reclassifications***

Certain prior period amounts have been reclassified to conform to the current period presentation. In accordance with the SEC's adoption of certain rule and form amendments on August 17, 2018, we moved Net gain (loss) on sale of real estate in the consolidated statements of operations to be included within Operating Income.

### ***Accounting Policy Update***

*Transaction Costs* — Transaction costs for the three and nine months ended September 30, 2019 are costs incurred in connection with the proposed merger with CWI 2 and related transactions, discussed in [Note 1](#) and [Note 13](#), and included legal, accounting, financial advisory and other transaction costs. These costs are expensed as incurred in the consolidated statements of operations.

### ***Out-of-Period Adjustment***

During the second quarter of 2019, we identified and recorded an out-of-period adjustment related to the accounting for income taxes. We concluded that this error was not material to our consolidated financial statements for any of the current or prior periods. The adjustment is reflected as a \$0.5 million decrease to our Provision for income taxes in the consolidated statements of operations for the nine months ended September 30, 2019.

**Restricted Cash**

The following table provides a reconciliation of cash and cash equivalents and restricted cash reported within the consolidated balance sheets to the consolidated statements of cash flows (in thousands):

	September 30, 2019	December 31, 2018
Cash and cash equivalents	\$ 78,831	\$ 66,593
Restricted cash	61,443	54,537
Total cash and cash equivalents and restricted cash	\$ 140,274	\$ 121,130

**Recent Accounting Pronouncements***Pronouncements Adopted as of September 30, 2019*

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, *Leases (Topic 842)*. ASU 2016-02 modifies the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract: the lessee and the lessor. ASU 2016-02 provides new guidelines that change the accounting for leasing arrangements for lessees, whereby their rights and obligations under substantially all leases, existing and new, are capitalized and recorded on the balance sheet. For lessors, however, the new standard remains generally consistent with existing guidance, but has been updated to align with certain changes to the lessee model and ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*.

We adopted this guidance for our interim and annual periods beginning January 1, 2019 using the modified retrospective method, applying the transition provisions at the beginning of the period of adoption rather than at the beginning of the earliest comparative period presented. We elected the package of practical expedients as permitted under the transition guidance, which allowed us to not reassess whether arrangements contain leases, lease classification and initial direct costs. The adoption of the lease standard did not result in a cumulative effect adjustment recognized in the opening balance of retained earnings as of January 1, 2019.

The most significant impact of the adoption of ASU 2016-02 was the recognition of operating lease right-of-use (“ROU”) assets and corresponding lease liabilities primarily related to our ground leases, and to a lesser extent, our parking garage and equipment leases, for which we were the lessee of \$52.6 million and \$70.5 million, respectively, on January 1, 2019, which included reclassifying below-market ground lease and parking garage lease intangible assets, above-market ground lease intangible liabilities and deferred rent as a component of the ROU asset (a net reclassification of \$17.9 million). See [Note 10](#) for additional disclosures of the presentation of these amounts in our consolidated balance sheet.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments under the lease. We determine if an arrangement contains a lease at contract inception and determine the classification of the lease at commencement. Operating lease ROU assets and lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. We do not include renewal options in the lease term when calculating the lease liability unless we are reasonably certain we will exercise the option. Variable lease payments are excluded from the ROU assets and lease liabilities and are recognized in the period in which the obligation for those payments is incurred. Our variable lease payments may consist of payments based on a percentage of revenue and increases as a result of Consumer Price Index (“CPI”) or other comparable indices. Lease expense for operating lease payments is recognized on a straight-line basis over the term of the lease.

The implicit rate within our operating leases is generally not determinable and, as a result, we use our incremental borrowing rate at the lease commencement date to determine the present value of lease payments. The determination of our incremental borrowing rate requires judgment. We determine our incremental borrowing rate for each lease using estimated baseline mortgage rates. These baseline rates are determined based on a review of current mortgage debt market activity for benchmark securities utilizing a yield curve. The rates are then adjusted for various factors, including level of collateralization and lease term.

In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. ASU 2017-12 makes more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess hedge effectiveness. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. We adopted this guidance for our interim and annual periods beginning January 1, 2019. The adoption of ASU 2017-12 did not have a material impact on our consolidated financial statements.

In June 2018, the FASB issued *ASU 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. ASU 2018-07 expands the scope of Topic 718 to include share-based payment transactions in exchange for goods and services from nonemployees, which will align the accounting for such payments to nonemployees with the existing requirements for share-based payments granted to employees (with certain exceptions). These share-based payments will now be measured at the grant-date fair value of the equity instrument issued. We adopted this guidance for our interim and annual periods beginning January 1, 2019. The adoption of this standard did not have a material impact on our consolidated financial statements.

### Note 3. Agreements and Transactions with Related Parties

#### *Agreements with Our Advisor and Affiliates*

We have an advisory agreement with our Advisor (the "Advisory Agreement") to perform certain services for us under a fee arrangement, including managing our overall business, our investments and certain administrative duties. The Advisory Agreement has a term of one year and may be renewed for successive one-year periods. Our Advisor also has a subadvisory agreement with the Subadvisor (the "Subadvisory Agreement") whereby our Advisor pays 20% of its fees earned under the Advisory Agreement to the Subadvisor in return for certain personnel services.

The following tables present a summary of fees we paid; expenses we reimbursed; and distributions we made to our Advisor, the Subadvisor and other affiliates, as described below, in accordance with the terms of those agreements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Amounts Included in the Consolidated Statements of Operations</b>				
Asset management fees	\$ 3,547	\$ 3,534	\$ 10,673	\$ 10,628
Available Cash Distributions	2,537	2,478	4,905	3,450
Personnel and overhead reimbursements	1,679	1,681	4,948	4,584
Interest expense	375	325	1,133	1,015
Disposition fees	—	110	—	300
	<u>\$ 8,138</u>	<u>\$ 8,128</u>	<u>\$ 21,659</u>	<u>\$ 19,977</u>

#### **Other Transaction Fees Incurred**

Capitalized loan refinancing fees	\$ 528	\$ —	\$ 528	\$ 653
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The following table presents a summary of the amounts included in Due to related parties and affiliates in the consolidated financial statements (in thousands):

	September 30, 2019	December 31, 2018
<b>Amounts Due to Related Parties and Affiliates</b>		
Reimbursable costs due to our Advisor	\$ 1,469	\$ 1,785
Other amounts due to our Advisor	1,172	1,184
Accrued interest on WPC Credit Facility	375	2,082
Due to other related parties and affiliates	24	1,207
	<u>\$ 3,040</u>	<u>\$ 6,258</u>

*Asset Management Fees, Disposition Fees and Loan Refinancing Fees*

We pay our Advisor an annual asset management fee equal to 0.5% of the aggregate average market value of our investments, as described in the Advisory Agreement. Our Advisor is also entitled to receive disposition fees of up to 1.5% of the contract sales price of a property, as well as a loan refinancing fee of up to 1.0% of the principal amount of a refinanced loan, if certain conditions described in the Advisory Agreement are met. If our Advisor elects to receive all or a portion of its fees in shares of our common stock, the number of shares issued is determined by dividing the dollar amount of fees by our most recently published estimated net asset value per share (“NAV”). For both the nine months ended September 30, 2019 and 2018, we settled \$10.7 million of asset management fees in shares of our common stock at our Advisor’s election. At September 30, 2019, our Advisor owned 5,301,305 shares (3.7%) of our outstanding common stock. Asset management fees are included in Asset management fees to affiliate and other expenses in the consolidated financial statements.

*Available Cash Distributions*

Carey Watermark Holdings’ special general partner interest entitles it to receive distributions of 10% of Available Cash (as defined in the limited partnership agreement of the Operating Partnership) (“Available Cash Distributions”) generated by the Operating Partnership, subject to certain limitations. In addition, in the event of the dissolution of the Operating Partnership, Carey Watermark Holdings will be entitled to receive distributions of up to 15% of net proceeds, provided certain return thresholds are met for the initial investors in the Operating Partnership. Available Cash Distributions are included in (Income) loss attributable to noncontrolling interests in the consolidated financial statements.

*Personnel and Overhead Reimbursements/Reimbursable Costs*

Under the terms of the Advisory Agreement, our Advisor generally allocates expenses of dedicated and shared resources, including the cost of personnel, rent and related office expenses, between us and CWI 2, based on total pro rata hotel revenues on a quarterly basis. CWI 2 is a publicly owned, non-traded REIT that is also advised by our Advisor and invests in lodging and lodging-related properties. Pursuant to the Subadvisory Agreement, after we reimburse our Advisor, it will subsequently reimburse the Subadvisor for personnel costs and other charges, including the services of our Chief Executive Officer, subject to the approval of our board of directors. These reimbursements are included in Corporate general and administrative expenses and Due to related parties and affiliates in the consolidated financial statements and are settled in cash. We have also granted restricted stock units to employees of the Subadvisor pursuant to our 2010 Equity Incentive Plan.

*Other Amounts Due to our Advisor*

This balance primarily represented asset management fees payable to our Advisor.

*Other Transactions with Affiliates*

*WPC Credit Facility*

On September 26, 2017, we entered into a secured credit facility (the “WPC Credit Facility”) with our Operating Partnership as borrower and WPC as lender. The WPC Credit Facility consists of (i) a bridge term loan of up to \$75.0 million (the “Bridge Loan”) for the purpose of acquiring an interest in the Ritz-Carlton Bacara, Santa Barbara Venture and (ii) a \$25.0 million revolving working capital facility (the “Working Capital Facility”) to be used for our working capital needs. The Bridge Loan was scheduled to mature on September 30, 2019; however, effective September 26, 2019, the Bridge Loan was extended on its existing terms to December 31, 2019, with the option to extend the maturity date to March 31, 2020 at our election. Effective as of the same date, the Working Capital Facility, which is currently scheduled to mature on December 31, 2019, also has the option to extend the maturity date to March 31, 2020 at our election. Upon exercise of the three-month extension, the interest rate for both loans would increase to the London Interbank Offered Rate (“LIBOR”) plus 3.0% from the current interest rate of LIBOR plus 1.0%. If the Advisory Agreement expires or is terminated, both the Bridge Loan and the Working Capital Facility would mature at that time. We serve as guarantor of the WPC Credit Facility and have pledged our unencumbered equity interests in certain properties as collateral, as further described in the pledge and security agreement entered into between the borrower and lender. At December 31, 2018, the outstanding balances under the Bridge Loan and Working Capital Facility were \$40.8 million and \$0.8 million, respectively. At September 30, 2019, the outstanding balance under the Bridge Loan was \$35.0 million. No balance was outstanding under the Working Capital Facility at September 30, 2019, with \$25.0 million available to be drawn at that date.

On October 28, 2019, we repaid \$5.0 million towards the Bridge Loan ([Note 13](#)).

The WPC Credit Facility includes various customary affirmative and negative covenants. We were in compliance with all applicable covenants at September 30, 2019.

#### Jointly Owned Investments

At September 30, 2019, we owned interests in three ventures with CWI 2: the Ritz-Carlton Key Biscayne, a Consolidated Hotel, and the Marriott Sawgrass Golf Resort & Spa and the Ritz-Carlton Bacara, Santa Barbara, both Unconsolidated Hotels. A third-party also owns an interest in the Ritz-Carlton Key Biscayne.

#### Note 4. Net Investments in Hotels

Net investments in hotels are summarized as follows (in thousands):

	September 30, 2019	December 31, 2018
Buildings	\$ 1,471,111	\$ 1,552,365
Land	337,344	355,082
Building and site improvements	158,079	149,323
Furniture, fixtures and equipment	103,232	108,907
Construction in progress	15,809	10,298
Hotels, at cost	2,085,575	2,175,975
Less: Accumulated depreciation	(295,974)	(266,323)
Net investments in hotels	\$ 1,789,601	\$ 1,909,652

During the nine months ended September 30, 2019 and 2018, we retired fully depreciated furniture, fixtures and equipment aggregating \$9.8 million and \$24.7 million, respectively.

Depreciation expense was \$18.7 million and \$18.3 million for the three months ended September 30, 2019 and 2018, respectively, and \$56.7 million and \$56.5 million for the nine months ended September 30, 2019 and 2018, respectively.

#### Hurricane-Related Disruption

Below is a summary of the items that comprised the gain recognized related to Hurricane Irma (in thousands):

	Three Months Ended September 30,	
	2019	2018
Net write-off of fixed assets	\$ 1,012	\$ 3,351
Remediation work performed <sup>(a)</sup>	—	(1,062)
Property damage insurance receivables	(1,892)	(2,330)
Gain on hurricane-related property damage	\$ (880)	\$ (41)

	Nine Months Ended September 30,	
	2019	2018
Net write-off of fixed assets	\$ 3,071	\$ 8,811
Remediation work performed	—	5,428
Property damage insurance receivables	(3,951)	(15,345)
Gain on hurricane-related property damage	\$ (880)	\$ (1,106)

(a) For the three months ended September 30, 2018, this represents a change in estimated costs for remediation work incurred.

As of September 30, 2019, we have received cumulative business interruption insurance proceeds related to Hurricane Irma of \$24.6 million. We recorded business interruption income related to Hurricane Irma in the consolidated statements of operations of \$2.8 million and \$5.8 million during the three months ended September 30, 2019 and 2018, respectively, and \$3.6 million and \$16.3 million during the nine months ended September 30, 2019 and 2018, respectively.

As the restoration work continues to be performed, the estimated total cost will change. Any changes to property damage estimates will be recorded in the periods in which they are determined and any additional remediation work will be recorded in the periods in which it is performed.

### **Property Dispositions**

#### *2019 Activity*

On September 17, 2019, we sold our 100% ownership interest in the Courtyard San Diego Mission Valley to an unaffiliated third party for a contractual sales price of \$79.0 million, with net proceeds after the repayment of the related mortgage loan of approximately \$33.6 million, including the release of \$1.4 million of restricted cash. We recognized a gain on sale of \$5.9 million during the third quarter of 2019 in connection with this transaction.

#### *2018 Activity*

On January 25, 2018, we sold our 100% ownership interest in the Marriott Boca Raton at Boca Center to an unaffiliated third party for a contractual sales price of \$76.0 million, with net proceeds after the repayment of the related mortgage loan of approximately \$35.4 million, including the release of \$1.4 million of restricted cash. We recognized a gain on sale of \$12.3 million during the first quarter of 2018 in connection with this transaction.

On February 5, 2018, we sold our 100% ownership interests in the Hampton Inn Memphis Beale Street and Hampton Inn Atlanta Downtown to an unaffiliated third party for a contractual sales price totaling \$63.0 million, with net proceeds after the repayment of the related mortgage loans of approximately \$31.8 million, including the release of \$2.0 million of restricted cash. We recognized a gain on sale totaling \$19.6 million during the first quarter of 2018 in connection with this transaction.

On September 27, 2018, we sold our 100% ownership interest in the Staybridge Suites Savannah Historic District to an unaffiliated third party for a contractual sales price of \$22.0 million, with net proceeds after the defeasance of the related mortgage loan of approximately \$6.7 million. We recognized a loss on sale of \$0.7 million during the third quarter of 2018 in connection with this transaction, as well as a \$0.3 million loss on extinguishment of debt in connection with the defeasance of the loan.

### **Assets and Liabilities Held for Sale**

At September 30, 2019, the Hilton Garden Inn New Orleans French Quarter/CBD was classified as held for sale. The hotel was subsequently sold on October 9, 2019 ([Note 13](#)). No properties were classified as held for sale as of December 31, 2018.

Below is a summary of our assets and liabilities held for sale (in thousands):

	<b>September 30, 2019</b>
Net investments in hotels	\$ 15,119
Other assets	84
<b>Assets held for sale</b>	<b>\$ 15,203</b>
Non-recourse debt, net attributable to Assets held for sale	\$ 14,630
Other liabilities held for sale	\$ 208

**Construction in Progress**

At September 30, 2019 and December 31, 2018, construction in progress, recorded at cost, was \$15.8 million and \$10.3 million, respectively, and related to planned renovations at certain of our hotels. Upon substantial completion of renovation work, costs are reclassified from construction in progress to buildings, building and site improvements and furniture, fixture and equipment, as applicable, and depreciation will commence.

We capitalize qualifying interest expense and certain other costs, such as property taxes, property insurance, utilities expense and hotel incremental labor costs, related to hotels undergoing major renovations. We capitalized \$0.7 million and \$1.1 million of such costs during the three months ended September 30, 2019 and 2018, respectively, and \$1.2 million and \$2.6 million during the nine months ended September 30, 2019 and 2018, respectively. At September 30, 2019 and December 31, 2018, accrued capital expenditures were \$2.2 million and \$5.5 million, respectively, representing non-cash investing activity.

**Note 5. Equity Investments in Real Estate**

At September 30, 2019, we owned equity interests in four Unconsolidated Hotels, two with unrelated third parties and two with CWI 2. We do not control the ventures that own these hotels, but we exercise significant influence over them. We account for these investments under the equity method of accounting (i.e., at cost, increased or decreased by our share of earnings or losses, less distributions, plus contributions and other adjustments required by equity method accounting, such as basis differences from acquisition costs paid to our Advisor that we incur and other-than-temporary impairment charges, if any).

Under the conventional approach of accounting for equity method investments, an investor applies its percentage ownership interest to the venture's net income or loss to determine the investor's share of the earnings or losses of the venture. This approach is inappropriate if the venture's capital structure gives different rights and priorities to its investors. We have priority returns on several of our equity method investments. Therefore, we follow the hypothetical liquidation at book value ("HLBV") method in determining our share of these ventures' earnings or losses for the reporting period, as this method better reflects our claim on the ventures' book value at the end of each reporting period. Earnings for our equity method investments are recognized in accordance with each respective investment agreement and, where applicable, based upon the allocation of the investment's net assets at book value as if the investment was hypothetically liquidated at the end of each reporting period.

The following table sets forth our ownership interests in our equity investments in real estate and their respective carrying values. The carrying values of these ventures are affected by the timing and nature of distributions (dollars in thousands):

Unconsolidated Hotels	State	Number of Rooms	% Owned	Hotel Type	Carrying Value at	
					September 30, 2019	December 31, 2018
Ritz-Carlton Bacara, Santa Barbara Venture <sup>(a) (b)</sup>	CA	358	40%	Resort	\$ 53,371	\$ 56,814
Ritz-Carlton Philadelphia Venture <sup>(c)</sup>	PA	301	60%	Full-service	27,239	29,951
Marriott Sawgrass Golf Resort & Spa Venture <sup>(d) (e)</sup>	FL	514	50%	Resort	25,826	25,439
Hyatt Centric French Quarter Venture <sup>(f)</sup>	LA	254	80%	Full-service	454	511
		<u>1,427</u>			<u>\$ 106,890</u>	<u>\$ 112,715</u>

(a) This investment represents a tenancy-in-common interest; the remaining 60.0% interest is owned by CWI 2.

(b) We received net cash distributions of \$4.7 million and \$1.3 million from this investment during the three and nine months ended September 30, 2019, respectively, which included our share of key money received from Marriott during the third quarter of 2019.

(c) We received cash distributions of \$0.8 million and \$1.7 million from this investment during the three and nine months ended September 30, 2019, respectively.

(d) We received cash distributions of \$1.8 million from this investment during the nine months ended September 30, 2019. No cash distributions were received during the three months ended September 30, 2019.

(e) This investment is considered a VIE (Note 2). We do not consolidate this entity because we are not the primary beneficiary and the nature of our involvement in the activities of the entity allows us to exercise significant influence, but does not give us power over decisions that significantly affect the economic performance of the entity.

(f) We received cash distributions of \$1.1 million from this investment during the nine months ended September 30, 2019. No cash distributions were received during the three months ended September 30, 2019.

Notes to Consolidated Financial Statements (Unaudited)

The following table sets forth our share of equity in (losses) earnings from our Unconsolidated Hotels, which is based on the HLBV model, as well as certain amortization adjustments related to basis differentials from acquisitions of investments (in thousands):

Venture	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Marriott Sawgrass Golf Resort & Spa Venture	\$ (955)	\$ (497)	\$ 2,185	\$ 1,614
Ritz-Carlton Bacara, Santa Barbara Venture	199	(196)	(2,124)	(3,034)
Hyatt Centric French Quarter Venture	(19)	387	1,085	1,443
Ritz-Carlton Philadelphia Venture	16	(283)	(1,045)	(1,066)
Westin Atlanta Venture <sup>(a)</sup>	—	—	—	505
Total equity in (losses) earnings of equity method investments in real estate, net	\$ (759)	\$ (589)	\$ 101	\$ (538)

(a) On October 19, 2017, the venture sold the Westin Atlanta Perimeter North to an unaffiliated third party. Our share of equity in earnings during the nine months ended September 30, 2018 was the result of additional cash distributions received in that period in connection with the disposition.

No other-than-temporary impairment charges related to our investments in these ventures were recognized during the three or nine months ended September 30, 2019 or 2018.

At September 30, 2019 and December 31, 2018, the unamortized basis differences on our equity investments were \$6.3 million and \$7.3 million, respectively. Net amortization of the basis differences reduced the carrying values of our equity investments by \$0.1 million for both the three months ended September 30, 2019 and 2018 and by \$0.3 million for both the nine months ended September 30, 2019 and 2018.

*Hurricane-Related Disruption*

The Marriott Sawgrass Golf Resort & Spa was impacted by Hurricane Irma when it made landfall in September 2017. The hotel sustained damage and was forced to close for a short period of time. Below is a summary of the items that comprised the loss (gain) recognized by the venture related to Hurricane Irma (in thousands):

	Three Months Ended September 30,	
	2019	2018
Net write-off of fixed assets	\$ —	\$ 147
Remediation work performed	—	6
Decrease in property damage insurance receivables	—	5
Loss on hurricane-related property damage	\$ —	\$ 158
	Nine Months Ended September 30,	
	2019	2018
Net write-off (write-up) of fixed assets	\$ 3,586	\$ (279)
Remediation work performed	—	118
(Increase) decrease in property damage insurance receivables	(3,596)	909
(Gain) loss on hurricane-related property damage <sup>(a)</sup>	\$ (10)	\$ 748

(a) Includes losses totaling \$1.3 million during the nine months ended September 30, 2018 resulting from pre-existing damage (which was discovered as a result of the hurricane and is not covered by insurance).

As the restoration work continues to be performed, the estimated total costs will change. Any changes to property damage estimates will be recorded in the periods in which they are determined and any additional remediation work will be recorded in the periods in which it is performed.

**Note 6. Intangible Assets and Liabilities**

Intangible assets and liabilities are summarized as follows (dollars in thousands):

	Amortization Period (Years)	September 30, 2019			December 31, 2018		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
<b>Finite-Lived Intangible Assets</b>							
Villa/condo rental programs	45 - 55	\$ 72,400	\$ (7,648)	\$ 64,752	\$ 72,400	\$ (6,520)	\$ 65,880
Below-market hotel ground leases and parking garage lease <sup>(a)</sup>	10 - 93	—	—	—	10,935	(645)	10,290
Other intangible assets	8 - 15	855	(423)	432	855	(354)	501
Total intangible assets, net		\$ 73,255	\$ (8,071)	\$ 65,184	\$ 84,190	\$ (7,519)	\$ 76,671
<b>Finite-Lived Intangible Liability</b>							
Above-market hotel ground lease <sup>(a)</sup>	85	\$ —	\$ —	\$ —	\$ (2,100)	\$ 114	\$ (1,986)

- (a) On January 1, 2019, we adopted ASU 2016-02, Leases (Topic 842) ([Note 2](#)). As a result of adopting this guidance, on January 1, 2019, we reclassified our below-market ground lease and parking garage lease intangible assets (previously included in Intangible assets, net) and above-market ground lease intangible liabilities (previously included in Accounts payable, accrued expenses and other liabilities) to Operating lease ROU assets on the consolidated balance sheet.

Net amortization of intangibles was \$0.4 million for both the three months ended September 30, 2019 and 2018, and \$1.1 million and \$1.3 million for the nine months ended September 30, 2019 and 2018, respectively. Amortization of the villa/condo rental programs and in-place lease intangibles are included in Depreciation and amortization in the consolidated financial statements.

**Note 7. Fair Value Measurements**

The fair value of an asset is defined as the exit price, which is the amount that would either be received when an asset is sold or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance establishes a three-tier fair value hierarchy based on the inputs used in measuring fair value. These tiers are: Level 1, for which quoted market prices for identical instruments are available in active markets, such as money market funds, equity securities and U.S. Treasury securities; Level 2, for which there are inputs other than quoted prices included within Level 1 that are observable for the instrument, such as certain derivative instruments, including interest rate caps and swaps; and Level 3, for securities that do not fall into Level 1 or Level 2 and for which little or no market data exists, therefore requiring us to develop our own assumptions.

**Items Measured at Fair Value on a Recurring Basis**

*Derivative Assets* — Our derivative assets, which are included in Other assets in the consolidated financial statements, are comprised of interest rate caps ([Note 8](#)).

The valuation of our derivative instruments is determined using a discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, as well as observable market-based inputs, including interest rate curves and implied volatilities. We incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of our derivative instruments for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as collateral postings and thresholds. These derivative instruments were classified as Level 2 as these instruments are custom, over-the-counter contracts with various bank counterparties that are not traded in an active market.

We did not have any transfers into or out of Level 1, Level 2 and Level 3 category of measurements during the nine months ended September 30, 2019 or 2018. Gains and losses (realized and unrealized) recognized on items measured at fair value on a recurring basis included in earnings are reported in Other income in the consolidated financial statements.

Our non-recourse debt, net, which we have classified as Level 3, had a carrying value of \$1.3 billion at both September 30, 2019 and December 31, 2018 and an estimated fair value of \$1.3 billion at both September 30, 2019 and December 31, 2018. We determined the estimated fair value using a discounted cash flow model with rates that take into account the interest rate risk. We also considered the value of the underlying collateral, taking into account the quality of the collateral and the then-current interest rate.

We estimated that our other financial assets and liabilities had fair values that approximated their carrying values at both September 30, 2019 and December 31, 2018.

#### *Items Measured at Fair Value on a Non-Recurring Basis (Including Impairment Charges)*

We periodically assess whether there are any indicators that the value of our real estate investments may be impaired or that their carrying value may not be recoverable. Where the undiscounted cash flows for an asset are less than the asset's carrying value when considering and evaluating the various alternative courses of action that may occur, we recognize an impairment charge to reduce the carrying value of the asset to its estimated fair value. Further, when we classify an asset as held for sale, we carry the asset at the lower of its current carrying value or its fair value, less estimated cost to sell. We did not recognize any impairment charges during the three or nine months ended September 30, 2019 or 2018.

### **Note 8. Risk Management and Use of Derivative Financial Instruments**

#### *Risk Management*

In the normal course of our ongoing business operations, we encounter economic risk. There are two main components of economic risk that impact us: interest rate risk and market risk. We are primarily subject to interest rate risk on our interest-bearing assets and liabilities. Market risk includes changes in the value of our properties and related loans.

#### *Derivative Financial Instruments*

When we use derivative instruments, it is generally to reduce our exposure to fluctuations in interest rates. We have not entered into, and do not plan to enter into, financial instruments for trading or speculative purposes. In addition to entering into derivative instruments on our own behalf, we may also be a party to derivative instruments that are embedded in other contracts, which are considered to be derivative instruments. The primary risks related to our use of derivative instruments include: (i) a counterparty to a hedging arrangement defaulting on its obligation and (ii) a downgrade in the credit quality of a counterparty to such an extent that our ability to sell or assign our side of the hedging transaction is impaired. While we seek to mitigate these risks by entering into hedging arrangements with large financial institutions that we deem to be creditworthy, it is possible that our hedging transactions, which are intended to limit losses, could adversely affect our earnings. Furthermore, if we terminate a hedging arrangement, we may be obligated to pay certain costs, such as transaction or breakage fees. We have established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities.

We measure derivative instruments at fair value and record them as assets or liabilities, depending on our rights or obligations under the applicable derivative contract. Derivatives that are not designated as hedges must be adjusted to fair value through earnings. For a derivative designated, and that qualified, as a cash flow hedge, the effective portion of the change in fair value of the derivative is recognized in Other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of the change in fair value of any derivative is immediately recognized in earnings.

The following table sets forth certain information regarding our derivative instruments on our Consolidated Hotels (in thousands):

Derivatives Designated as Hedging Instruments	Balance Sheet Location	Asset Derivatives Fair Value at	
		September 30, 2019	December 31, 2018
Interest rate caps	Other assets	\$ 4	\$ 84

All derivative transactions with an individual counterparty are governed by a master International Swap and Derivatives Association agreement, which can be considered as a master netting arrangement; however, we report all our derivative instruments on a gross basis in our consolidated financial statements. At both September 30, 2019 and December 31, 2018, no cash collateral had been posted nor received for any of our derivative positions.

We recognized unrealized losses of less than \$0.1 million and unrealized income of less than \$0.1 million in Other comprehensive income on derivatives in connection with our interest rate swaps and caps during the three months ended September 30, 2019 and 2018, respectively, and unrealized losses of \$0.2 million and unrealized income of \$0.1 million during the nine months ended September 30, 2019 and 2018, respectively.

We reclassified \$0.2 million and less than \$0.1 million from Other comprehensive income on derivatives into Interest expense during the three months ended September 30, 2019 and 2018, respectively, and \$0.2 million and \$0.4 million during the nine months ended September 30, 2019 and 2018, respectively.

Amounts reported in Other comprehensive income related to interest rate caps will be reclassified to Interest expense as interest expense is incurred on our variable-rate debt. At September 30, 2019, we estimated that an additional \$0.2 million will be reclassified as Interest expense during the next 12 months related to our interest rate caps.

#### *Interest Rate Swaps and Caps*

We are exposed to the impact of interest rate changes primarily through our borrowing activities. To limit this exposure, we attempt to obtain mortgage financing on a long-term, fixed-rate basis. However, from time to time, we or our investment partners may obtain variable-rate non-recourse mortgage loans and, as a result, may enter into interest rate swap or cap agreements with counterparties. Interest rate swaps, which effectively convert the variable-rate debt service obligations of a loan to a fixed rate, are agreements in which one party exchanges a stream of interest payments for a counterparty's stream of cash flow over a specific period. The notional, or face, amount on which the swaps are based is not exchanged. An interest rate cap limits the effective borrowing rate of variable-rate debt obligations while allowing participants to share in downward shifts in interest rates. Our objective in using these derivatives is to limit our exposure to interest rate movements.

The interest rate caps that we had outstanding on our Consolidated Hotels at September 30, 2019 were designated as cash flow hedges and are summarized as follows (dollars in thousands):

<b>Interest Rate Derivatives</b>	<b>Number of Instruments</b>	<b>Notional Amount</b>	<b>Fair Value at September 30, 2019</b>
Interest rate caps	8	\$ 356,070	\$ 4

#### *Credit Risk-Related Contingent Features*

We measure our credit exposure on a counterparty basis as the net positive aggregate estimated fair value of our derivatives, net of any collateral received. No collateral was received as of September 30, 2019. At September 30, 2019, both our total credit exposure and the maximum exposure to any single counterparty were less than \$0.1 million.

Some of the agreements we have with our derivative counterparties contain cross-default provisions that could trigger a declaration of default on our derivative obligations if we default, or are capable of being declared in default, on certain of our indebtedness. At September 30, 2019, we had not been declared in default on any of our derivative obligations. At both September 30, 2019 and December 31, 2018, we had no derivatives that were in a net liability position.

**Note 9. Debt*****Non-Recourse Debt***

Our non-recourse debt consists of mortgage notes payable, which are collateralized by the assignment of hotel properties. The following table presents the non-recourse debt, net on our Consolidated Hotel investments (dollars in thousands):

	Interest Rate Range	Current Maturity Date Range <sup>(a)</sup>	Carrying Amount at	
			September 30, 2019	December 31, 2018
Fixed rate	3.6% – 5.9%	7/2020 – 4/2024	\$ 939,233	\$ 1,026,451
Variable rate <sup>(b)</sup>	4.4% – 7.9%	3/2020 – 7/2022	335,614	299,563
			<u>\$ 1,274,847</u>	<u>\$ 1,326,014</u>

- (a) Many of our mortgage loans have extension options, which are subject to certain conditions. The maturity dates in the table do not reflect the extension options.
- (b) The interest rate range presented for these mortgage loans reflect the rates in effect at September 30, 2019 through the use of an interest rate cap, when applicable.

***Financing Activity During 2019******Hilton Garden Inn New Orleans French Quarter/CBD***

During the third quarter of 2019, we refinanced the \$10.0 million Hilton Garden Inn New Orleans French Quarter/CBD mortgage loan with a new mortgage loan of up to \$18.0 million, of which \$15.0 million was funded at closing. The loan has a floating annual interest rate of LIBOR plus 2.8% (subject to an interest rate cap) and a maturity date of July 1, 2022, with two one-year extension options. No gain or loss was recognized on the extinguishment of debt. This hotel was subsequently sold on October 9, 2019 ([Note 13](#)).

***Sheraton Austin Hotel at the Capitol***

During the second quarter of 2019, we refinanced the \$67.0 million Sheraton Austin Hotel at the Capitol mortgage loan with a new mortgage loan that has a maximum principal amount of \$92.4 million, of which we drew \$68.4 million at closing, with the remaining balance available to fund planned renovations at the hotel. The loan has a floating annual interest rate of LIBOR plus 3.5% (subject to an interest rate cap) and a maturity date of July 9, 2022 with two one-year extension options. We recognized a loss on extinguishment of debt of \$0.1 million on this refinancing during the second quarter of 2019.

*Lake Arrowhead Resort and Spa*

The \$14.5 million outstanding mortgage loan on Lake Arrowhead Resort and Spa that matured on May 29, 2019 was modified during the second quarter of 2019 to extend the maturity date to April 30, 2020. As part of this modification, we began making monthly amortization payments of \$40,000 that will continue through the maturity date.

***Financing Activity During 2018***

On June 15, 2018, we refinanced the Ritz-Carlton Fort Lauderdale senior mortgage and mezzanine loans totaling \$49.0 million and \$21.0 million, respectively, with new senior mortgage and mezzanine loans totaling \$47.0 million and \$28.3 million, respectively, which have floating annual interest rates of LIBOR plus 2.3% and LIBOR plus 5.8%, respectively, although we have entered into interest rate cap agreements with respect to each of these loans. Both loans have terms of three years. We recognized a net loss on extinguishment of debt of \$0.2 million on these refinancings during the nine months ended September 30, 2018.

On September 27, 2018, in connection with the sale of the Staybridge Suites Savannah Historic District (Note 4), we defeased the outstanding \$14.4 million mortgage loan on the hotel and recognized a \$0.3 million loss on extinguishment of debt during both the three and nine months ended September 30, 2018.

***Covenants***

Pursuant to our mortgage loan agreements, our consolidated subsidiaries are subject to various operational and financial covenants, including minimum debt service coverage and debt yield ratios. Most of our mortgage loan agreements contain “lock-box” provisions, which permit the lender to access or sweep a hotel’s excess cash flow and could be triggered by the lender under limited circumstances, including the failure to maintain minimum debt service coverage ratios. If a lender requires that we enter into a cash management agreement, we would generally be permitted to spend an amount equal to our budgeted hotel operating expenses, taxes, insurance and capital expenditure reserves for the relevant hotel. The lender would then hold all excess cash flow after the payment of debt service in an escrow account until certain performance hurdles are met. Except as discussed below, at September 30, 2019, we were in compliance with the applicable covenants for each of our mortgage loans.

At March 31, 2018, the minimum debt service coverage ratio for the Courtyard Pittsburgh Shadyside was not met; this ratio was still not met as of September 30, 2019 and we have entered into a cash management agreement with the lender.

At September 30, 2018, the minimum debt service coverage ratio for the Westin Minneapolis was not met and we entered into a cash management agreement that permits the lender to sweep the excess cash flow from the hotel. As of September 30, 2019, this ratio was still not met and the cash management agreement remained in effect.

At September 30, 2018, the minimum debt service coverage ratio for the Equinox, a Luxury Collection Golf Resort & Spa was not met; this ratio was still not met as of September 30, 2019 and we have entered into a cash management agreement with the lender.

At December 31, 2018, the minimum debt yield ratio for the Sanderling Resort was not met; therefore, in May 2019, the loan began to amortize in an amount equal to the original loan amount over a 25-year period and will continue to amortize until such time as the minimum debt yield ratio is met. As of September 30, 2019, this ratio was still not met.

At September 30, 2019, the minimum debt service coverage ratio for the Holiday Inn Manhattan 6th Avenue Chelsea was not met and we entered into a cash management agreement that permits the lender to sweep the excess cash flow from the hotel.

**WPC Credit Facility**

At September 30, 2019, we had an outstanding balance under the Bridge Loan of \$35.0 million. At September 30, 2019, no amount was outstanding under the Working Capital Facility; therefore \$25.0 million was available to be drawn. These loans are described in [Note 3](#).

**Scheduled Debt Principal Payments**

Scheduled debt principal payments during the remainder of 2019 and each of the next five calendar years following December 31, 2019 are as follows (in thousands):

Years Ending December 31,	Total
2019 (remainder) <sup>(a)</sup>	\$ 40,033
2020	238,389
2021	533,523
2022	327,435
2023	126,618
2024	50,252
Total principal payments	1,316,250
Unamortized deferred financing costs	(6,403)
Total	\$ 1,309,847

(a) Includes \$35.0 million of scheduled payments on the Bridge Loan to WPC ([Note 3](#)).

**Note 10. Commitments and Contingencies**

At September 30, 2019, we were not involved in any material litigation. Various claims and lawsuits arising in the normal course of business are pending against us, including liens for which we may obtain a bond, provide collateral or provide an indemnity, but we do not expect the results of such proceedings to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

**Hotel Management Agreements**

As of September 30, 2019, our Consolidated Hotel properties were operated pursuant to long-term management agreements with 12 different management companies, with initial terms ranging from five to 30 years. For hotels operated with separate franchise agreements, each management company receives a base management fee, generally ranging from 1.5% to 3.5% of hotel revenues. Four of our management agreements contain the right and license to operate the hotels under specified brands; no separate franchise agreements exist and no separate franchise fee is required for these hotels. The management agreements that include the benefit of a franchise agreement incur a base management fee ranging from 3.0% to 3.5% of hotel revenues. The management companies are generally also eligible to receive an incentive management fee, which is typically calculated as a percentage of operating profit, either (i) in excess of projections with a cap or (ii) after the owner has received a priority return on its investment in the hotel. We incurred management fee expense, including amortization of deferred management fees, of \$3.5 million and \$4.5 million for the three months ended September 30, 2019 and 2018, respectively, and \$13.0 million and \$14.0 million for the nine months ended September 30, 2019 and 2018, respectively.

**Franchise Agreements**

Fifteen of our Consolidated Hotels operate under franchise or license agreements with national brands that are separate from our management agreements. As of September 30, 2019, we had 10 franchise agreements with Marriott-owned brands, three with Hilton-owned brands, one with an InterContinental Hotels-owned brand and one with a Hyatt-owned brand related to our Consolidated Hotels. Our typical franchise agreements have initial terms ranging from 15 to 25 years. Three of our hotels are not operated with a hotel brand so the hotels do not have franchise agreements. Generally, our franchise agreements provide for a license fee, or royalty, of 3.0% to 6.0% of room revenues and, if applicable, 2.0% to 3.0% of food and beverage revenue. In addition, we generally pay 1.0% to 4.5% of room revenues as marketing and reservation system contributions for the system-wide benefit of brand hotels. Franchise fees are included in sales and marketing expense in our consolidated financial

statements. We incurred franchise fee expense, including amortization of deferred franchise fees, of \$4.4 million and \$3.9 million for the three months ended September 30, 2019 and 2018, respectively, and \$12.7 million and \$12.3 million for the nine months ended September 30, 2019 and 2018, respectively.

### *Capital Expenditures and Reserve Funds*

With respect to our hotels that are operated under management or franchise agreements with major international hotel brands and for most of our hotels subject to mortgage loans, we are obligated to maintain furniture, fixtures and equipment reserve accounts for future capital expenditures sufficient to cover the cost of routine improvements and alterations at these hotels. The amount funded into each of these reserve accounts is generally determined pursuant to the management agreements, franchise agreements and/or mortgage loan documents for each of the respective hotels and typically ranges between 3.0% and 5.0% of the respective hotel's total gross revenue. At both September 30, 2019 and December 31, 2018, \$37.9 million was held in furniture, fixtures and equipment reserve accounts for future capital expenditures, and is included in Restricted cash in the consolidated financial statements.

### *Renovation Commitments*

Certain of our hotel franchise and loan agreements require us to make planned renovations to our hotels. Additionally, from time to time, certain of our hotels may undergo renovations as a result of our decision to upgrade portions of the hotels, such as guestrooms, public space, meeting space, and/or restaurants, in order to better compete with other hotels and alternative lodging options in our markets. At September 30, 2019, we had various contracts outstanding with third parties in connection with the renovation of certain of our hotels. The remaining commitments under these contracts at September 30, 2019 totaled \$22.1 million. Funding for a renovation will first come from our furniture, fixtures and equipment reserve accounts, to the extent permitted by the terms of the management agreement. Should these reserves be unavailable or insufficient to cover the cost of the renovation, we will fund all or the remaining portion of the renovation with existing cash resources, proceeds available under our Working Capital Facility and/or other sources of available capital, including cash flow from operations.

### *Leases*

#### *Lease Obligations*

We recognize an operating ROU asset and a corresponding lease liability for ground lease arrangements, hotel parking leases and various hotel equipment leases for which we are the lessee. Our leases have remaining lease terms ranging from less than one year to 88 years (excluding extension options not reasonably certain of being exercised).

#### *Lease Cost*

Certain information related to the total lease cost for operating leases for the three and nine months ended September 30, 2019 is as follows (in thousands):

	<b>Three Months Ended September 30, 2019</b>	<b>Nine Months Ended September 30, 2019</b>
Fixed lease cost	\$ 3,317	\$ 10,281
Variable lease cost <sup>(a)</sup>	239	614
<b>Total lease cost</b>	<b>\$ 3,556</b>	<b>\$ 10,895</b>

(a) Our variable lease payments consist of payments based on a percentage of revenue.

*Other Information*

Supplemental balance sheet information related to ROU assets and lease liabilities is as follows (dollars in thousands):

	<b>September 30, 2019</b>
Operating lease ROU assets	\$ 47,461
Operating lease liabilities	71,540
Weighted-average remaining lease term	69.2 years
Weighted-average discount rate	9.1%

Cash paid for operating lease liabilities included in Net cash provided by operating activities totaled \$4.1 million for the nine months ended September 30, 2019.

*Undiscounted Cash Flows*

A reconciliation of the undiscounted cash flows for operating leases recorded on the consolidated balance sheet as of September 30, 2019 is as follows (in thousands):

<b>Years Ending December 31,</b>	<b>Total</b>
2019 (remainder)	\$ 1,384
2020	5,517
2021	5,425
2022	5,428
2023	5,326
Thereafter through 2107	903,189
<b>Total lease payments</b>	<b>926,269</b>
Less: amount of lease payments representing interest	(854,729)
<b>Present value of future lease payments/lease obligations</b>	<b>\$ 71,540</b>

Scheduled future minimum ground lease payments for the years subsequent to the year ended December 31, 2018 were: \$4.1 million for 2019, \$4.2 million for 2020, \$4.3 million for 2021, \$4.4 million for 2022, \$4.5 million for 2023 and \$811.3 million for the years thereafter.

**Note 11. Equity***Reclassifications Out of Accumulated Other Comprehensive Loss*

The following table presents a reconciliation of changes in Accumulated other comprehensive loss by component for the periods presented (in thousands):

<b>Gains and Losses on Derivative Instruments</b>	<b>Three Months Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
Beginning balance	\$ (420)	\$ (26)
Other comprehensive (loss) income before reclassifications	(22)	40
Amounts reclassified from accumulated other comprehensive loss to:		
Interest expense	176	46
Equity in (losses) earnings of equity method investments in real estate, net	6	—
Total	182	46
Net current period other comprehensive income	160	86
Net current period other comprehensive income attributable to noncontrolling interests	(6)	(1)
Ending balance	\$ (266)	\$ 59

<b>Gains and Losses on Derivative Instruments</b>	<b>Nine Months Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
Beginning balance	\$ (286)	\$ (455)
Other comprehensive (loss) income before reclassifications	(199)	85
Amounts reclassified from accumulated other comprehensive loss to:		
Interest expense	217	426
Equity in (losses) earnings of equity method investments in real estate, net	10	—
Total	227	426
Net current period other comprehensive income	28	511
Net current period other comprehensive (income) loss attributable to noncontrolling interests	(8)	3
Ending balance	\$ (266)	\$ 59

*Distributions Declared*

During the third quarter of 2019, our board of directors declared a quarterly distribution of \$0.1425 per share, which was paid on October 15, 2019 to stockholders of record on September 30, 2019, in the aggregate amount of \$20.2 million.

**Note 12. Income Taxes**

We elected to be treated as a REIT and believe that we have been organized and have operated in such a manner to maintain our qualification as a REIT for federal and state income tax purposes. As a REIT, we are generally not subject to corporate level federal income taxes on earnings distributed to our stockholders. Since inception, we have distributed at least 100.0% of our taxable income annually and intend to do so for the tax year ending December 31, 2019. Accordingly, we have not included any provisions for federal income taxes related to the REIT in the accompanying consolidated financial statements for the three and nine months ended September 30, 2019 and 2018. We conduct business in various states and municipalities within the United States, and, as a result, we or one or more of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. As a result, we are subject to certain state and local taxes and a provision for such taxes is included in the consolidated financial statements.

Certain of our subsidiaries have elected taxable REIT subsidiary (“TRS”) status. A TRS may provide certain services considered impermissible for REITs and may hold assets that REITs may not hold directly. The accompanying consolidated financial statements include an interim tax provision for our TRSs for the three and nine months ended September 30, 2019 and 2018. Current income tax expense was \$1.0 million and current income tax benefit was \$0.4 million for the three months ended September 30, 2019 and 2018, respectively, and current income tax expense was \$1.9 million and \$1.8 million for the nine months ended September 30, 2019 and 2018, respectively.

Our TRSs are subject to U.S. federal and state income taxes. As such, deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of assets and liabilities at the enacted tax rates expected to be in effect when the temporary differences reverse. A valuation allowance for deferred tax assets is provided if we believe that it is more likely than not that we will not realize the tax benefit of deferred tax assets based on available evidence at the time the determination is made. A change in circumstances may cause us to change our judgment about whether a deferred tax asset will more likely than not be realized. We generally report any change in the valuation allowance through our income statement in the period in which such changes in circumstances occur. The majority of our deferred tax assets relate to net operating losses, interest expense limitation and accrued expenses. The majority of our deferred tax liabilities relate to differences between the tax basis and financial reporting basis of our villa/condo rental management agreements. Provision for income taxes included deferred income tax expense of \$0.1 million and \$1.4 million for the three months ended September 30, 2019 and 2018, respectively, and deferred income tax expense of \$0.3 million and \$1.7 million for the nine months ended September 30, 2019 and 2018, respectively.

### Note 13. Subsequent Events

#### *Proposed Merger*

On October 22, 2019, we entered into a merger agreement with CWI 2, along with one of its wholly-owned subsidiaries (the “Merger Agreement”), pursuant to which we will merge with one of CWI 2’s subsidiaries and will survive as a wholly-owned subsidiary of CWI 2. In accordance with the Merger Agreement, we and CWI 2 also entered into agreements to internalize the management of the combined company following the merger. If the proposed merger is consummated, each share of our issued and outstanding common stock will be exchanged for 0.9106 shares of CWI 2’s Class A common stock, \$0.001 par value per share. It is expected that our stockholders will own approximately 58% of the outstanding common stock of the combined company, and CWI 2’s stockholders will own approximately 42%, immediately after the closing of the merger. Further details concerning the proposed merger are described in a Form 8-K that we filed with the SEC on October 22, 2019.

#### *Disposition*

On October 9, 2019, the Hilton Garden Inn New Orleans French Quarter/CBD venture sold the hotel to an unaffiliated third party for a contractual sales price of \$26.0 million, resulting in a gain on sale of real estate. We owned an 88% controlling ownership interest in the venture ([Note 4](#)).

#### *WPC Credit Facility*

On October 28, 2019, we repaid \$5.0 million towards the Bridge Loan ([Note 3](#)).

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

Management’s Discussion and Analysis of Financial Condition and Results of Operations is intended to provide the reader with information that will assist in understanding our financial statements and the reasons for changes in certain key components of our financial statements from period to period. Management’s Discussion and Analysis of Financial Condition and Results of Operations also provides the reader with our perspective on our financial position and liquidity, as well as certain other factors that may affect our future results. Our Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the 2018 Annual Report and subsequent reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

### **Business Overview**

As described in more detail in Item 1 of the 2018 Annual Report, we are a publicly-owned, non-traded REIT that invests in, and through our Advisor, manages and seeks to enhance the value of, interests in lodging and lodging-related properties. We have invested the proceeds from our initial public offering and follow-on offering in a diversified lodging portfolio, including full-service, select-service and resort hotels. Our results of operations are significantly impacted by seasonality and by hotel renovations. We have invested in hotels and then initiated significant renovations at certain hotels. Generally, during the renovation period, a portion of total rooms are unavailable and hotel operations are often disrupted, negatively impacting our results of operations. At September 30, 2019, we held ownership interests in 26 hotels, with a total of 7,396 rooms.

### **Significant Developments**

#### *Proposed Merger*

On October 22, 2019, we entered into a merger agreement with CWI 2, along with one of its wholly-owned subsidiaries, pursuant to which we will merge with and into one of CWI 2’s subsidiaries and will survive as a wholly-owned subsidiary of CWI 2. In accordance with the Merger Agreement, we and CWI 2 also entered into agreements to internalize the management of the combined companies following the merger. If the proposed merger is consummated, each share of our issued and outstanding common stock will be canceled and, in exchange for cancellation of such share, the rights attaching to such share will be converted automatically into the right to receive 0.9106 shares of validly issued, fully paid and nonassessable shares of CWI 2’s Class A common stock, \$0.001 par value per share. Further details concerning the proposed merger are described in a Form 8-K that we filed with the SEC on October 22, 2019.

#### *Disposition Activity*

On October 9, 2019, the Hilton Garden Inn New Orleans French Quarter/CBD venture sold the hotel to an unaffiliated third party for a contractual sales price of \$26.0 million. We owned an 88% controlling ownership interest in the venture.

On September 17, 2019, we sold our 100% ownership interest in the Courtyard San Diego Mission Valley to an unaffiliated third party for a contractual sales price of \$79.0 million, with net proceeds after the repayment of the related mortgage loan of approximately \$33.6 million, including the release of \$1.4 million of restricted cash. We recognized a gain on sale of \$5.9 million during the third quarter of 2019 in connection with this transaction.

#### *WPC Credit Facility*

We entered into an agreement effective September 26, 2019 that extended the maturity date of our Bridge Loan, on its existing terms, to December 31, 2019, with the option to extend the maturity to March 31, 2020, at our election. As part of this agreement, the Working Capital Facility, which is currently scheduled to mature on December 31, 2019, now has an option to extend the maturity date to March 31, 2020 at our election. Upon exercise of the three-month extension, the interest rate for both loans would increase to LIBOR plus 3.0% from the current interest rate of LIBOR plus 1.0%. At September 30, 2019, the outstanding balance under the Bridge Loan was \$35.0 million. No balance was outstanding under the Working Capital Facility at September 30, 2019. On October 28, 2019, we repaid \$5.0 million towards the Bridge Loan.

## Financial and Operating Highlights

(Dollars in thousands, except average daily rate (“ADR”) and revenue per available room (“RevPAR”))

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Hotel revenues <sup>(a)</sup>	\$ 151,118	\$ 148,235	\$ 469,362	\$ 457,925
Net (loss) income attributable to CWI stockholders	(2,454)	(7,210)	(16,519)	14,697
Cash distributions paid	20,099	19,742	60,089	59,219
Net cash provided by operating activities			76,040	58,556
Net cash provided by investing activities			62,276	123,223
Net cash used in financing activities			(119,172)	(180,701)
<b>Supplemental Financial Measures: <sup>(b)</sup></b>				
FFO attributable to CWI stockholders	17,322	16,733	43,026	46,381
MFFO attributable to CWI stockholders	20,183	18,915	50,827	50,818
<b>Consolidated Hotel Operating Statistics</b>				
Occupancy	75.9%	76.8%	75.3%	77.4%
ADR	\$ 220.48	\$ 219.84	\$ 232.12	\$ 224.52
RevPAR	167.26	168.78	174.89	173.88

(a) Hotel revenues include business interruption income of \$2.8 million and \$6.1 million recognized during the three months ended September 30, 2019 and 2018, respectively, and \$3.6 million and \$18.3 million recognized during the nine months ended September 30, 2019 and 2018, respectively, with amounts recognized during the periods relating primarily to Hurricane Irma.

(b) We consider funds from operations (“FFO”) and modified funds from operations (“MFFO”), which are supplemental measures that are not defined by GAAP (“non-GAAP measures”), to be important measures in the evaluation of our results of operations and capital resources. We evaluate our results of operations with a primary focus on the ability to generate cash flow necessary to meet our objective of funding distributions to stockholders. See [Supplemental Financial Measures](#) below for our definitions of these non-GAAP measures and reconciliations to their most directly comparable GAAP measures.

The comparison of our results period over period is influenced by both the number and size of the hotels consolidated in each of the respective periods. At September 30, 2019, we owned 22 Consolidated Hotels, compared to 24 Consolidated Hotels at September 30, 2018. At December 31, 2018, we owned 23 Consolidated Hotels, compared to 27 Consolidated Hotels at December 31, 2017.

## Portfolio Overview

The following table sets forth certain information for each of our Consolidated Hotels and our Unconsolidated Hotels at September 30, 2019:

Hotels	State	Number of Rooms	% Owned	Acquisition Date	Hotel Type
<b>Consolidated Hotels</b>					
<b><u>2012 Acquisitions</u></b>					
Hilton Garden Inn New Orleans French Quarter/CBD <sup>(a)</sup>	LA	155	88%	6/8/2012	Select-service
Lake Arrowhead Resort and Spa	CA	173	97%	7/9/2012	Resort
<b><u>2013 Acquisitions</u></b>					
Courtyard Pittsburgh Shadyside	PA	132	100%	3/12/2013	Select-service
Hutton Hotel Nashville	TN	250	100%	5/29/2013	Full-service
Holiday Inn Manhattan 6th Avenue Chelsea	NY	226	100%	6/6/2013	Full-service
Fairmont Sonoma Mission Inn & Spa	CA	226	100%	7/10/2013	Resort
Marriott Raleigh City Center	NC	401	100%	8/13/2013	Full-service
Hawks Cay Resort <sup>(b)</sup>	FL	425	100%	10/23/2013	Resort
Renaissance Chicago Downtown	IL	560	100%	12/20/2013	Full-service
<b><u>2014 Acquisitions</u></b>					
Hyatt Place Austin Downtown	TX	296	100%	4/1/2014	Select-service
Courtyard Times Square West	NY	224	100%	5/27/2014	Select-service
Sheraton Austin Hotel at the Capitol	TX	367	80%	5/28/2014	Full-service
Hampton Inn & Suites/Homewood Suites Denver Downtown Convention Center	CO	302	100%	6/25/2014	Select-service
Sanderling Resort	NC	128	100%	10/28/2014	Resort
Marriott Kansas City Country Club Plaza	MO	295	100%	11/18/2014	Full-service
<b><u>2015 Acquisitions</u></b>					
Westin Minneapolis	MN	214	100%	2/12/2015	Full-service
Westin Pasadena	CA	350	100%	3/19/2015	Full-service
Hilton Garden Inn/Homewood Suites Atlanta Midtown	GA	228	100%	4/29/2015	Select-service
Ritz-Carlton Key Biscayne <sup>(c)</sup>	FL	444	47%	5/29/2015	Resort
Ritz-Carlton Fort Lauderdale <sup>(d)</sup>	FL	198	70%	6/30/2015	Resort
Le Méridien Dallas, The Stoneleigh	TX	176	100%	11/20/2015	Full-service
<b><u>2016 Acquisition</u></b>					
Equinox, a Luxury Collection Golf Resort & Spa	VT	199	100%	2/17/2016	Resort
		5,969			
<b>Unconsolidated Hotels</b>					
Hyatt Centric New Orleans French Quarter	LA	254	80%	9/6/2011	Full-service
Marriott Sawgrass Golf Resort & Spa <sup>(e)</sup>	FL	514	50%	4/1/2015	Resort
Ritz-Carlton Philadelphia	PA	301	60%	5/15/2015	Full-service
Ritz-Carlton Bacara, Santa Barbara <sup>(f)</sup>	CA	358	40%	9/28/2017	Resort
		1,427			

(a) On October 9, 2019, the venture, in which we had an 88% controlling ownership interest, sold the hotel ([Note 13](#)).

(b) Includes 248 privately owned villas that participate in the villa/condo rental program at September 30, 2019, of which only 240 were available for rent as a result of damage caused by Hurricane Irma.

(c) CWI 2 owns an interest of approximately 19.3% in this venture. Also, the number of rooms presented includes 142 condo-hotel units that participate in the villa/condo rental program at September 30, 2019.

(d) Includes 32 condo-hotel units that participate in the villa/condo rental program at September 30, 2019.

(e) The remaining 50.0% interest in this venture is owned by CWI 2.

(f) This investment represents a tenancy-in-common interest; the remaining 60.0% interest is owned by CWI 2.

## **Results of Operations**

We evaluate our results of operations with a primary focus on our ability to generate cash flow necessary to meet our objectives of funding distributions to stockholders and increasing the value of our real estate investments. As a result, our assessment of operating results gives less emphasis to the effect of unrealized gains and losses, which may cause fluctuations in net income or loss for comparable periods but have no impact on cash flows, and to other non-cash charges, such as depreciation and impairment charges.

In addition, we use other information that may not be financial in nature, including statistical information, to evaluate the operating performance of our business, including occupancy rate, ADR and RevPAR. Occupancy rate, ADR and RevPAR are commonly used measures within the hotel industry to evaluate operating performance. RevPAR, which is calculated as the product of ADR and occupancy rate, is an important statistic for monitoring operating performance at our hotels. Our occupancy rate, ADR and RevPAR performance may be impacted by macroeconomic factors such as U.S. economic conditions, regional and local employment growth, personal income and corporate earnings, business relocation decisions, business and leisure travel, new hotel construction and the pricing strategies of competitors.

The comparability of our results year over year are impacted by, among other factors, the timing of any acquisitions, dispositions and/or any renovation-related activities.

The following table presents our comparative results of operations (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2019	2018	Change	2019	2018	Change
<b>Hotel Revenues</b>	\$ 151,118	\$ 148,235	\$ 2,883	\$ 469,362	\$ 457,925	\$ 11,437
<b>Hotel Operating Expenses</b>	133,558	130,217	3,341	412,633	396,452	16,181
Asset management fees to affiliate and other expenses	3,464	3,770	(306)	11,073	11,524	(451)
Corporate general and administrative expenses	3,052	2,839	213	9,211	8,555	656
Gain on hurricane-related property damage	(880)	(41)	(839)	(880)	(1,106)	226
Transaction costs	728	—	728	1,483	—	1,483
<b>Total Expenses</b>	139,922	136,785	3,137	433,520	415,425	18,095
<b>Operating income before net gain (loss) on sale of real estate</b>	11,196	11,450	(254)	35,842	42,500	(6,658)
Net gain (loss) on sale of real estate	5,881	(669)	6,550	5,881	31,260	(25,379)
<b>Operating Income</b>	17,077	10,781	6,296	41,723	73,760	(32,037)
Interest expense	(17,219)	(16,557)	(662)	(50,205)	(49,826)	(379)
Equity in (losses) earnings of equity method investments in real estate, net	(759)	(589)	(170)	101	(538)	639
Net loss on extinguishment of debt	—	(322)	322	(136)	(511)	375
Other income	355	140	215	605	508	97
<b>(Loss) Income Before Income Taxes</b>	(546)	(6,547)	6,001	(7,912)	23,393	(31,305)
Provision for income taxes	(1,030)	(986)	(44)	(2,133)	(3,516)	1,383
<b>Net (Loss) Income</b>	(1,576)	(7,533)	5,957	(10,045)	19,877	(29,922)
(Income) loss attributable to noncontrolling interests	(878)	323	(1,201)	(6,474)	(5,180)	(1,294)
<b>Net (Loss) Income Attributable to CWI Stockholders</b>	\$ (2,454)	\$ (7,210)	\$ 4,756	\$ (16,519)	\$ 14,697	\$ (31,216)
<b>Supplemental Financial Measure:<sup>(a)</sup></b>						
<b>MFFO Attributable to CWI Stockholders</b>	\$ 20,183	\$ 18,915	\$ 1,268	\$ 50,827	\$ 50,818	\$ 9

(a) We consider MFFO, a non-GAAP measure, to be an important metric in the evaluation of our results of operations and capital resources. We evaluate our results of operations with a primary focus on the ability to generate cash flow necessary to meet our objective of funding distributions to stockholders. See [Supplemental Financial Measures](#) below for our definition of non-GAAP measures and reconciliations to their most directly comparable GAAP measures.

Our Same Store Hotels are comprised of our 2012 Acquisitions, 2013 Acquisitions, 2014 Acquisitions, 2015 Acquisitions and 2016 Acquisition, excluding the results of any of those hotels sold or classified as held for sale at or prior to September 30, 2019, as well as the results for the Hawks Cay Resort, which was closed due to damage from Hurricane Irma from mid-September 2017 through August 2018 ([Note 4](#)).

The following table sets forth the average occupancy rate, ADR and RevPAR of our Consolidated Hotels for the three and nine months ended September 30, 2019 and 2018 for our Same Store Hotels.

Same Store Hotels	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Occupancy Rate	77.2%	77.3%	76.0%	76.9%
ADR	\$ 221.45	\$ 227.10	\$ 231.45	\$ 233.32
RevPAR	170.99	175.63	175.93	179.45

#### *Hotel Revenues*

For the three months ended September 30, 2019 as compared to the same period in 2018, hotel revenues increased by \$2.9 million, comprised of: an increase in revenue from the Hawks Cay Resort of \$5.0 million (representing the net impact to revenue after the recognition of business interruption income), partially offset by a decrease in revenue as a result of properties sold subsequent to the second quarter of 2018 or currently classified as held for sale of \$1.6 million and a decrease in revenue from our Same Store Hotels totaling \$0.5 million. The net decrease in revenue from our Same Store Hotels is primarily due to the impact of renovation-related disruption at certain of our hotels as well as the impact of Hurricane Dorian on our hotels in southern Florida.

For the nine months ended September 30, 2019 as compared to the same period in 2018, hotel revenues increased by \$11.4 million, comprised of: an increase in revenue from the Hawks Cay Resort of \$23.7 million (representing the net impact to revenue after the recognition of business interruption income), partially offset by a decrease in revenue as a result of properties sold subsequent to December 31, 2017 or currently classified as held for sale of \$7.1 million and a decrease in revenue from our Same Store Hotels of \$5.1 million. The net decrease in revenue from our Same Store Hotels is primarily due to the impact of renovation-related disruption at certain of our hotels as well as the impact Hurricane Dorian had on our hotels in southern Florida.

#### *Hotel Operating Expenses*

Room expense, food and beverage expense and other operating department costs fluctuate based on various factors, including occupancy, labor costs, utilities and insurance costs.

For the three months ended September 30, 2019 as compared to the same period in 2018, aggregate hotel operating expenses increased by \$3.3 million, comprised of: an increase in expenses from the Hawks Cay Resort of \$5.2 million, partially offset by a decrease in expenses as a result of properties sold subsequent to the second quarter of 2018 or currently classified as held for sale of \$1.2 million and a net decrease in expenses from our Same Store Hotels totaling \$0.6 million. The net decrease in expenses from our Same Store Hotels is in line with the changes in revenue discussed above.

For the nine months ended September 30, 2019 as compared to the same period in 2018, aggregate hotel operating expenses increased by \$16.2 million, comprised of: an increase in expenses from the Hawks Cay Resort of \$22.9 million, partially offset by a decrease in expenses as a result of properties sold subsequent to December 31, 2017 or currently classified as held for sale totaling \$5.4 million and a net decrease in expenses from our Same Store Hotels totaling \$1.3 million. The net decrease in expenses from our Same Store Hotels is in line with the changes in revenue discussed above.

#### *Gain on Hurricane-Related Property Damage*

During the three months ended September 30, 2019 and 2018, we recognized a gain on hurricane-related property damage of \$0.9 million and less than \$0.1 million, respectively, resulting from changes in our estimates of the total aggregate damage incurred.

During the nine months ended September 30, 2019 and 2018, we recognized a gain on hurricane-related property damage of \$0.9 million and \$1.1 million, respectively, resulting from changes in our estimates of the total aggregate damage incurred.

We and CWI 2 maintain insurance on all of our hotels, with an aggregate policy limit of \$500.0 million for both property damage and business interruption. Our insurance policies are subject to various terms and conditions, including property damage and business interruption deductibles on each hotel, which range from 2.0% to 5.0% of the insured value. We currently estimate our aggregate casualty insurance claim for our Consolidated Hotels related to Hurricane Irma to be in the range of \$60.0 million to \$70.0 million (which includes estimated clean up, repair and rebuilding costs) and our aggregate business interruption insurance claim to be in the range of \$25.0 million to \$35.0 million. We currently estimate the collective casualty insurance claim for us and CWI 2 combined to be in the range of \$65.0 million to \$80.0 million and the collective business interruption insurance claim to be in the range of \$25.0 million to \$35.0 million. As the restoration work continues to be performed, the estimated total costs will change. We believe that we maintain adequate insurance coverage on our hotels and are working closely with the insurance carriers and claims adjuster to obtain the maximum amount of insurance recovery provided under the policies. However, we can give no assurances as to the amounts of such claims, the timing of payments or the ultimate resolution of the claims.

We experienced a reduction in revenues as a result of Hurricane Irma. Our business interruption insurance covers lost revenue through the period of property restoration and for up to 12 months after the hotels are back to full operations. We have retained consultants to assess our business interruption claims and are currently reviewing our losses with our insurance carriers. We recorded \$2.8 million and \$5.8 million of revenue for covered business interruption related to Hurricane Irma during the three months ended September 30, 2019 and 2018, respectively, and \$3.6 million and \$16.3 million during the nine months ended September 30, 2019 and 2018, respectively. We record revenue for covered business interruption when both the recovery is probable and contingencies have been resolved with the insurance carriers.

#### *Transaction Costs*

During the three and nine months ended September 30, 2019, transactions costs were \$0.7 million and \$1.5 million, respectively, and represented legal, accounting, financial advisory and other transaction costs related to the proposed merger with CWI 2 and related transactions.

#### *Net Gain (Loss) on Sale of Real Estate*

During the three and nine months ended September 30, 2019, we recognized a gain on sale of real estate of \$5.9 million, related to our 100% ownership interest in the Courtyard San Diego Mission Valley to an unaffiliated third party for a contractual sales price of \$79.0 million in September 2019 ([Note 4](#)).

During the three months ended September 30, 2018, we recognized a loss of \$0.7 million related to the sale of our 100% ownership in the Staybridge Savannah Historic District to an unaffiliated third party for a contractual sales price of \$22.0 million in September 2018. During the nine months ended September 30, 2018, we also recognized (i) a gain of \$12.3 million related to the sale of our 100.0% ownership interest in the Marriott Boca Raton at Boca Center to an unaffiliated third-party for a contractual sales price of \$76.0 million in January 2018 and (ii) an aggregate gain of \$19.6 million, related to the sale of our 100.0% ownership interests in the Hampton Inn Memphis Beale Street and Hampton Inn Atlanta Downtown to an unaffiliated third-party for a contractual sales price of \$63.0 million in February 2018 ([Note 4](#)).

#### *Equity in (Losses) Earnings of Equity Method Investments in Real Estate, Net*

Equity in (losses) earnings of equity method investments in real estate, net represents earnings from our equity investments in Unconsolidated Hotels recognized in accordance with each investment agreement and based upon the allocation of the investment's net assets at book value as if the investment were hypothetically liquidated at the end of each reporting period ([Note 5](#)). We are required to periodically compare an investment's carrying value to its estimated fair value and recognize an impairment charge to the extent that the carrying value exceeds the estimated fair value and is determined to be other than temporary. No other-than-temporary impairment charges were recognized on our equity method investments in real estate during the nine months ended September 30, 2019 or 2018.

The following table sets forth our share of equity in (losses) earnings from our Unconsolidated Hotels, which are based on the HLBV model, as well as certain amortization adjustments related to basis differentials from acquisitions of investments (in thousands):

Venture	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Marriott Sawgrass Golf Resort & Spa Venture <sup>(a)</sup>	\$ (955)	\$ (497)	\$ 2,185	\$ 1,614
Ritz-Carlton Bacara, Santa Barbara Venture <sup>(b)</sup>	199	(196)	(2,124)	(3,034)
Hyatt Centric French Quarter Venture <sup>(c)</sup>	(19)	387	1,085	1,443
Ritz-Carlton Philadelphia Venture	16	(283)	(1,045)	(1,066)
Westin Atlanta Venture <sup>(d)</sup>	—	—	—	505
Total equity in (losses) earnings of equity method investments in real estate, net	\$ (759)	\$ (589)	\$ 101	\$ (538)

- (a) The increase in our share of equity in losses for the three months ended September 30, 2019 as compared to 2018 is primarily the result of a decline in the performance of the hotel, in part due to the impact of Hurricane Dorian. For the nine months ended September 30, 2019 as compared to 2018, the impact from the decline in the performance of the hotel during the third quarter of 2019 was more than offset by our share of the release of the joint venture's \$2.3 million valuation allowance for deferred tax assets.
- (b) The change in our share of equity in (losses) earnings from the venture for both the three and nine months ended September 30, 2019 as compared to the same periods in 2018 reflect an improvement in the operating results of the venture.
- (c) The change in our share of equity in earnings for both the three and nine months ended September 30, 2019 as compared to the same periods in 2018 was primarily a result of a decrease in distributions to us by the venture, largely as a result of a decline in the performance of the hotel.
- (d) On October 19, 2017, the venture sold the Westin Atlanta Perimeter North to an unaffiliated third party. Our share of equity in earnings during the nine months ended September 30, 2018 is the result of additional cash distributions received in that period in connection with the disposition.

#### Net Loss on Extinguishment of Debt

During the nine months ended September 30, 2019, we recognized a loss on extinguishment of debt of \$0.1 million related to the refinancing of the Sheraton Austin Hotel at the Capitol mortgage loan (Note 9).

During the three and nine months ended September 30, 2018, we recognized a net loss on extinguishment of debt of \$0.3 million and \$0.5 million, respectively. During the third quarter of 2018, we defeased the Staybridge Suites Savannah Historic District mortgage loan in connection with the disposition of the hotel (Note 4), and during the second quarter of 2018, we refinanced the Ritz-Carlton Fort Lauderdale senior mortgage and mezzanine loans.

#### (Income) Loss Attributable to Noncontrolling Interests

The following table sets forth our (income) loss attributable to noncontrolling interests (in thousands):

Venture	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Ritz-Carlton Key Biscayne Venture <sup>(a)</sup>	\$ 1,269	\$ 2,474	\$ (1,038)	\$ (1,161)
Ritz-Carlton Fort Lauderdale Venture <sup>(b)</sup>	924	420	552	37
Hilton Garden Inn New Orleans French Quarter/CBD Venture <sup>(c)</sup>	(620)	(30)	(710)	(90)
Sheraton Austin Hotel at the Capitol Venture	85	(63)	(373)	(516)
Operating Partnership — Available Cash Distribution (Note 3)	(2,536)	(2,478)	(4,905)	(3,450)
	\$ (878)	\$ 323	\$ (6,474)	\$ (5,180)

- (a) The decrease in loss attributable to noncontrolling interests for the three months ended September 30, 2019 as compared to the same period in 2018 is primarily the result of a decline in our external joint venture partner's capital under the HLBV method of accounting during the three months ended September 30, 2018, which as of September 30, 2018, was zero.
- (b) The increase in loss attributable to noncontrolling interests for both the three and nine months ended September 30, 2019 as compared to the same periods in 2018 is primarily the result of renovation-related disruption experienced at the hotel during the current year periods, as well as the impact of Hurricane Dorian.
- (c) The increase in income attributable to noncontrolling interests for both the three and nine months ended September 30, 2019 as compared to the same periods in 2018 is primarily the result of the distribution of \$0.6 million of refinancing proceeds to our joint venture partner during the three months ended September 30, 2019.

#### *Modified Funds from Operations*

MFFO is a non-GAAP measure that we use to evaluate our business. For a definition of MFFO and a reconciliation to net income or loss attributable to CWI stockholders, see [Supplemental Financial Measures](#) below.

For the three months ended September 30, 2019 as compared to the same period in 2018, MFFO increased by \$1.3 million. MFFO for the three months ended September 30, 2019 included an adjustment of \$0.8 million for costs incurred during the six months ended June 30, 2019 that related to the proposed merger that were not previously presented as an adjustment to MFFO during that period.

#### **Liquidity and Capital Resources**

Our principal demands for funds will be for the payment of operating expenses, interest and principal on current and future indebtedness, including the WPC Credit Facility, and distributions to stockholders. Liquidity is affected adversely by unanticipated costs and greater-than-anticipated operating expenses. We expect to meet our long-term liquidity requirements from cash generated from operations. To the extent that these funds are insufficient to satisfy our cash flow requirements, additional funds may be provided from asset sales, long- and/or short-term borrowings, and proceeds from mortgage financings or refinancings.

#### *Sources and Uses of Cash During the Period*

We have fully invested the proceeds from both our initial public offering and follow-on offering. We use the cash flow generated from hotel operations to meet our normal recurring operating expenses, service debt and fund distributions to our shareholders. Our cash flows fluctuate from period to period due to a number of factors, including the financial and operating performance of our hotels, the timing of purchases or dispositions of hotels, the timing and characterization of distributions from equity method investments in hotels and the seasonality in the demand for our hotels. Also, hotels we invest in may undergo renovations, during which they may experience disruptions, possibly resulting in reduced revenue and operating income. Despite these fluctuations, we believe that we will continue to generate sufficient cash from operations and from our equity method investments to meet our normal recurring short-term and long-term liquidity needs. We may also use existing cash resources, proceeds available under our Working Capital Facility, through its expiration, which, as amended, is currently expected to occur on December 31, 2019 ([Note 3](#)), the proceeds of mortgage loans, sales of assets or distributions reinvested in our common stock through our DRIP. We assess our ability to access capital on an ongoing basis. Our sources and uses of cash during the period are described below.

*Operating Activities* — For the nine months ended September 30, 2019 as compared to the same period in 2018, net cash provided by operating activities increased by \$17.5 million, reflecting the funding of remediation work to repair properties damaged by the hurricane totaling \$10.7 million during the nine months ended September 30, 2018, as well as net changes in other operating assets and liabilities. Additionally, a significant amount of the proceeds related to business interruption income recognized during the nine months ended September 30, 2018 were advanced to us during 2017.

*Investing Activities* — Net cash provided by investing activities for the nine months ended September 30, 2019 was \$62.3 million, primarily as a result of proceeds of \$77.4 million received from the sale of the Courtyard San Diego Mission Valley ([Note 4](#)) and \$11.7 million of insurance proceeds received related to Hurricane Irma, partially offset by funding \$30.0 million of capital expenditures for our Consolidated Hotels.

*Financing Activities* — Net cash used in financing activities for the nine months ended September 30, 2019 was \$119.2 million, primarily as a result of payments of mortgage financing totaling \$136.6 million (primarily from the refinancing of the Sheraton Austin at the Capitol loan totaling \$67.0 million ([Note 9](#)) and the paydown of the \$45.3 million Courtyard San Diego Mission

Valley mortgage loan in connection with the sale), cash distributions paid to stockholders aggregating \$60.1 million, redemptions of our common stock pursuant to our redemption plan totaling \$22.3 million and distributions to noncontrolling interests totaling \$8.6 million, partially offset by proceeds from mortgage financing totaling \$85.4 million (primarily from the refinancing of the Sheraton Austin at the Capitol loan ([Note 9](#))), as well as the reinvestment of distributions in shares of our common stock through our DRIP totaling \$32.3 million.

### *Distributions*

Our current objectives are to generate sufficient cash flow over time to provide stockholders with distributions and to manage a portfolio of investments with potential for capital appreciation throughout varying economic cycles. For the nine months ended September 30, 2019, we paid distributions to stockholders totaling \$60.1 million, which were comprised of cash distributions of \$27.8 million and distributions that were reinvested in shares of our common stock by stockholders through our DRIP of \$32.3 million. From inception through September 30, 2019, we declared distributions, excluding distributions paid in shares of our common stock, to stockholders totaling \$441.6 million, which were comprised of cash distributions of \$185.0 million and \$256.6 million of distributions that were reinvested by stockholders in shares of our common stock pursuant to our DRIP.

We believe that FFO, a non-GAAP measure, is an appropriate metric to evaluate our ability to fund distributions to stockholders. For a discussion of FFO, see [Supplemental Financial Measures](#) below. Over the life of our company, the regular quarterly cash distributions we pay are expected to be principally sourced from our FFO or our Cash flow from operations. However, we have funded a portion of our cash distributions to date using net proceeds from our public offerings and there can be no assurance that our FFO or our Cash flow from operations will be sufficient to cover our future distributions. Our distribution coverage using FFO was approximately 71% of total distributions declared for the nine months ended September 30, 2019, with the balance funded with proceeds from other sources of cash, such as financings, borrowings or the sales of assets. We fully covered total distributions declared for the nine months ended September 30, 2019 using Net cash provided by operating activities.

### *Redemptions*

We maintain a quarterly redemption program pursuant to which we may, at the discretion of our board of directors, redeem shares of our common stock from stockholders seeking liquidity. During the nine months ended September 30, 2019, we redeemed 2,259,533 shares of our common stock pursuant to our redemption plan, comprised of 487 redemption requests at an average share price of \$9.89. As of the date of this Report, we have fulfilled all of the valid redemption requests that we received during the nine months ended September 30, 2019. We funded all share redemptions during the nine months ended September 30, 2019 from distributions that were reinvested by stockholders in shares of our common stock pursuant to our DRIP.

## Summary of Financing

The table below summarizes our non-recourse debt, net and WPC Credit Facility (dollars in thousands):

	September 30, 2019	December 31, 2018
<b>Carrying Value</b>		
Fixed rate <sup>(a)</sup>	\$ 939,233	\$ 1,026,451
Variable rate:		
WPC Credit Facility — Bridge Loan (Note 3)	35,000	40,802
WPC Credit Facility — Working Capital Facility (Note 3)	—	835
Non-recourse debt <sup>(a)</sup> :		
Amount subject to interest rate caps	321,194	285,067
Amount subject to floating interest rate	14,420	14,496
	<u>370,614</u>	<u>341,200</u>
	<u>\$ 1,309,847</u>	<u>\$ 1,367,651</u>
<b>Percent of Total Debt</b>		
Fixed rate	72%	75%
Variable rate	28%	25%
	<u>100%</u>	<u>100%</u>
<b>Weighted-Average Interest Rate at End of Period</b>		
Fixed rate	4.4%	4.3%
Variable rate <sup>(b)</sup>	5.1%	5.3%

(a) Aggregate debt balance includes deferred financing costs totaling \$6.4 million and \$6.6 million at September 30, 2019 and December 31, 2018, respectively.

(b) The impact of our derivative instruments is reflected in the weighted-average interest rates.

### *Hilton Garden Inn New Orleans French Quarter/CBD*

During the third quarter of 2019, we refinanced the \$10.0 million Hilton Garden Inn New Orleans French Quarter/CBD mortgage loan with a new mortgage loan of up to \$18.0 million, of which \$15.0 million was funded at closing. The loan has a floating annual interest rate of LIBOR plus 2.8% (subject to an interest rate cap) and a maturity date of July 1, 2022, with two one-year extension options. No gain or loss was recognized on the extinguishment of debt. This hotel was subsequently sold on October 9, 2019.

### *Sheraton Austin Hotel at the Capitol*

During the second quarter of 2019, we refinanced the \$67.0 million Sheraton Austin Hotel at the Capitol mortgage loan with a new mortgage loan that has a maximum principal amount of \$92.4 million, of which we drew \$68.4 million at closing, with the remaining balance available to fund planned renovations at the hotel. The loan has a floating annual interest rate of LIBOR plus 3.5% (which is subject to an interest rate cap) and a maturity date of July 9, 2022 with two one-year extension options. We recognized a loss on extinguishment of debt of \$0.1 million on this refinancing.

### *Lake Arrowhead Resort and Spa*

The \$14.5 million outstanding mortgage loan on Lake Arrowhead Resort and Spa that matured on May 29, 2019 was modified during the second quarter of 2019 to extend the maturity date to April 30, 2020. As part of this modification, we began making monthly amortization payments of \$40,000 that will continue through the maturity date.

## *Covenants*

Pursuant to our mortgage loan agreements, our consolidated subsidiaries are subject to various operational and financial covenants, including minimum debt service coverage and debt yield ratios. Most of our mortgage loan agreements contain “lock-box” provisions, which permit the lender to access or sweep a hotel’s excess cash flow and could be triggered by the lender under limited circumstances, including the failure to maintain minimum debt service coverage ratios. If a lender requires that we enter into a cash management agreement, we would generally be permitted to spend an amount equal to our budgeted hotel operating expenses, taxes, insurance and capital expenditure reserves for the relevant hotel. The lender would then hold all excess cash flow after the payment of debt service in an escrow account until certain performance hurdles are met. Except as discussed below, at September 30, 2019, we were in compliance with the applicable covenants for each of our mortgage loans.

At March 31, 2018, the minimum debt service coverage ratio for the Courtyard Pittsburgh Shadyside was not met; this ratio was still not met as of September 30, 2019 and we have entered into a cash management agreement with the lender.

At September 30, 2018, the minimum debt service coverage ratio for the Westin Minneapolis was not met and we entered into a cash management agreement that permits the lender to sweep the excess cash flow from the hotel. As of September 30, 2019, this ratio was still not met and the cash management agreement remained in effect.

At September 30, 2018, the minimum debt service coverage ratio for the Equinox, a Luxury Collection Golf Resort & Spa was not met; this ratio was still not met as of September 30, 2019 and we have entered into a cash management agreement with the lender.

At December 31, 2018, the minimum debt yield ratio for the Sanderling Resort was not met; therefore, in May 2019, the loan began to amortize in an amount equal to the original loan amount over a 25-year period and will continue to amortize until such time as the minimum debt yield ratio is met. As of September 30, 2019, this ratio was still not met.

At September 30, 2019, the minimum debt service coverage ratio for the Holiday Inn Manhattan 6th Avenue Chelsea was not met and we entered into a cash management agreement that permits the lender to sweep the excess cash flow from the hotel.

## *Cash Resources*

At September 30, 2019, our cash resources consisted of cash and cash equivalents totaling \$78.8 million, of which \$30.1 million was designated as hotel operating cash. We also had the \$25.0 million Working Capital Facility, all of which remained available to be drawn at both September 30, 2019 and as of the date of this Report. Our cash resources can be used for working capital needs, debt service and other commitments, such as the renovation commitments noted below.

## *Cash Requirements*

During the next 12 months, we expect that our cash requirements will include (i) paying distributions to our stockholders, (ii) fulfilling our renovation commitments ([Note 10](#)), (iii) funding hurricane-related repair and remediation costs in excess of insurance proceeds received, (iv) funding lease commitments, (v) making scheduled mortgage loan principal payments, including (a) scheduled balloon payments totaling \$149.0 million on three mortgage loans on our Consolidated Hotels and (b) our share of balloon payments scheduled for two Unconsolidated Hotels totaling \$62.6 million, and (vi) paydown of the WPC Credit Facility, as well as other normal recurring operating expenses. We currently intend to refinance the mortgage loans, although there can be no assurance that we will be able to do so on favorable terms, if at all.

We expect to use cash generated from operations, the Working Capital Facility, mortgage financing and cash received from dispositions of properties to fund these cash requirements in addition to amounts held in escrow to fund our renovation commitments.

## *Capital Expenditures and Reserve Funds*

With respect to our hotels that are operated under management or franchise agreements with major international hotel brands and for most of our hotels subject to mortgage loans, we are obligated to maintain furniture, fixtures and equipment reserve accounts for future capital expenditures sufficient to cover the cost of routine improvements and alterations at these hotels. The amount funded into each of these reserve accounts is generally determined pursuant to the management agreements, franchise agreements and/or mortgage loan documents for each of the respective hotels and typically ranges between 3% and 5% of the

respective hotel's total gross revenue. At both September 30, 2019 and December 31, 2018, \$37.9 million was held in furniture, fixtures and equipment reserve accounts for future capital expenditures.

### **Off-Balance Sheet Arrangements and Contractual Obligations**

The table below summarizes our debt, off-balance sheet arrangements and other contractual obligations (primarily our capital commitments and lease obligations) at September 30, 2019 and the effect that these arrangements and obligations are expected to have on our liquidity and cash flow in the specified future periods (in thousands):

	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Non-recourse debt — Principal <sup>(a) (b)</sup>	\$ 1,281,250	\$ 168,069	\$ 935,249	\$ 177,932	\$ —
Interest on borrowings <sup>(c)</sup>	124,800	56,686	60,555	7,559	—
WPC Credit Facility (Bridge Loan) — Principal	35,000	35,000	—	—	—
Operating lease commitments <sup>(d)</sup>	926,269	5,530	10,879	10,680	899,180
Contractual capital commitments <sup>(e)</sup>	22,146	10,181	11,965	—	—
	<u>\$ 2,389,465</u>	<u>\$ 275,466</u>	<u>\$ 1,018,648</u>	<u>\$ 196,171</u>	<u>\$ 899,180</u>

(a) Excludes deferred financing costs totaling \$6.4 million.

(b) Total Non-recourse debt — Principal due in less than one year includes \$149.0 million of scheduled balloon payments on three consolidated mortgage loans. We currently intend to refinance these mortgage loans, although there can be no assurance that we will be able to do so on favorable terms, if at all.

(c) For variable-rate debt, interest on borrowings is calculated using the capped interest rate, when in effect.

(d) At September 30, 2019, this balance primarily related to our commitments on ground leases for two hotels, which expire in 2087 and 2099 and have contractual rent increases throughout their respective terms; therefore, the most significant commitments occur near the conclusion of the leases.

(e) Capital commitments represent our remaining contractual renovation commitments at our Consolidated Hotels, which does not reflect any renovation work to be undertaken as a result of Hurricane Irma ([Note 10](#)).

### **Supplemental Financial Measures**

In the real estate industry, analysts and investors employ certain non-GAAP supplemental financial measures in order to facilitate meaningful comparisons between periods and among peer companies. Additionally, in the formulation of our goals and in the evaluation of the effectiveness of our strategies, we use FFO and MFFO, which are non-GAAP measures defined by our management. We believe that these measures are useful to investors to consider because they may assist them to better understand and measure the performance of our business over time and against similar companies. A description of FFO and MFFO, and reconciliations of these non-GAAP measures to the most directly comparable GAAP measures, are provided below.

#### *FFO and MFFO*

Due to certain unique operating characteristics of real estate companies, as discussed below, the National Association of Real Estate Investment Trusts ("NAREIT"), an industry trade group, has promulgated a non-GAAP measure known as FFO, which we believe to be an appropriate supplemental measure, when used in addition to and in conjunction with results presented in accordance with GAAP, to reflect the operating performance of a REIT. The use of FFO is recommended by the REIT industry as a supplemental non-GAAP measure. FFO is not equivalent to, nor a substitute for, net income or loss as determined under GAAP.

We define FFO, a non-GAAP measure, consistent with the standards established by the White Paper on FFO approved by the Board of Governors of NAREIT, as restated in December 2018. The White Paper defines FFO as net income or loss computed in accordance with GAAP, excluding gains or losses from sales of property, impairment charges on real estate, and depreciation and amortization from real estate assets; and after adjustments for unconsolidated partnerships and jointly owned investments. Adjustments for unconsolidated partnerships and jointly owned investments are calculated to reflect FFO. Our FFO calculation complies with NAREIT's policy described above. However, NAREIT's definition of FFO does not distinguish between the conventional method of equity accounting and the HL BV method of accounting for unconsolidated partnerships and jointly owned investments.

The historical accounting convention used for real estate assets requires straight-line depreciation of buildings and improvements, which implies that the value of real estate assets diminishes predictably over time, especially if such assets are not adequately maintained or repaired and renovated as required by relevant circumstances in order to maintain the value disclosed. We believe that, since real estate values historically rise and fall with market conditions, including inflation, interest rates, the business cycle, unemployment and consumer spending, presentations of operating results for a REIT using historical accounting for depreciation may be less informative. Historical accounting for real estate involves the use of GAAP. Any other method of accounting for real estate such as the fair value method cannot be construed to be any more accurate or relevant than the comparable methodologies of real estate valuation found in GAAP. Nevertheless, we believe that the use of FFO, which excludes the impact of real estate-related depreciation and amortization, as well as impairment charges of real estate-related assets, provides a more complete understanding of our performance to investors and to management; and when compared year over year, reflects the impact on our operations from trends in occupancy rates, operating costs, general and administrative expenses, and interest costs, which may not be immediately apparent from net income or loss. In particular, we believe it is appropriate to disregard impairment charges, as this is a fair value adjustment that is largely based on market fluctuations and assessments regarding general market conditions, which can change over time. An asset will only be evaluated for impairment if certain impairment indicators exist. For real estate assets held for investment and related intangible assets in which an impairment indicator is identified, we follow a two-step process to determine whether an asset is impaired and to determine the amount of the charge. First, we compare the carrying value of the property's asset group to the estimated future net undiscounted cash flow that we expect the property's asset group will generate, including any estimated proceeds from the eventual sale of the property's asset group. It should be noted, however, that the property's asset group's estimated fair value is primarily determined using market information from outside sources such as broker quotes or recent comparable sales. In cases where the available market information is not deemed appropriate, we perform a future net cash flow analysis discounted for inherent risk associated with each asset to determine an estimated fair value. While impairment charges are excluded from the calculation of FFO described above due to the fact that impairments are based on estimated future undiscounted cash flows, it could be difficult to recover any impairment charges. However, FFO and MFFO, as described below, should not be construed to be more relevant or accurate than the current GAAP methodology in calculating net income or loss or in its applicability in evaluating the operating performance of the company. The method utilized to evaluate the value and performance of real estate under GAAP should be construed as a more relevant measure of operational performance and considered more prominently than the non-GAAP measures FFO and MFFO and the adjustments to GAAP in calculating FFO and MFFO.

Changes in the accounting and reporting promulgations under GAAP (for acquisition fees and expenses from a capitalization/depreciation model to an expensed-as-incurred model) were put into effect subsequent to the establishment of NAREIT's definition of FFO. Management believes these cash-settled expenses, such as acquisition fees that are typically accounted for as operating expenses, do not affect our overall long-term operating performance. Publicly registered, non-traded REITs typically have a significant amount of acquisition activity and are substantially more dynamic during their initial years of investment and operation. While other start-up entities may also experience significant acquisition activity during their initial years, we believe that non-traded REITs are unique in that they have a limited life with targeted exit strategies within a relatively limited time frame after acquisition activity ceases. Due to the above factors and other unique features of publicly registered, non-traded REITs, the Institute for Portfolio Alternatives (formerly known as the Investment Program Association) ("IPA"), an industry trade group, has standardized a measure known as MFFO, which the IPA has recommended as a supplemental measure for publicly registered non-traded REITs and which we believe to be another appropriate non-GAAP measure to reflect the operating performance of a non-traded REIT having the characteristics described above. MFFO is not equivalent to our net income or loss as determined under GAAP, and MFFO may not be a useful measure of the impact of long-term operating performance on value if we do not continue to operate with a limited life and targeted exit strategy, as currently intended. We believe that, because MFFO excludes costs that we consider more reflective of investing activities and other non-operating items included in FFO and also excludes acquisition fees and expenses that affect our operations only in periods in which properties are acquired, MFFO can provide, on a going forward basis, an indication of the sustainability (that is, the capacity to continue to be maintained) of our operating performance after the period in which we are acquiring properties and once our portfolio is in place. By providing MFFO, we believe we are presenting useful information that assists investors and analysts to better assess the sustainability of our operating performance now that our offering has been completed and once essentially all of our properties have been acquired. We also believe that MFFO is a recognized measure of sustainable operating performance by the non-traded REIT industry. Further, we believe MFFO is useful in comparing the sustainability of our operating performance, with the sustainability of the operating performance of other real estate companies that are not as involved in acquisition activities. MFFO should only be used to assess the sustainability of a company's operating performance after a company's offering has been completed and properties have been acquired, as it excludes acquisition costs that have a negative effect on a company's operating performance during the periods in which properties are acquired.

We define MFFO consistent with the IPA's *Practice Guideline 2010-01, Supplemental Performance Measure for Publicly Registered, Non-Listed REITs: Modified Funds from Operations* (the "Practice Guideline"), issued by the IPA in November

2010. This Practice Guideline defines MFFO as FFO further adjusted for the following items included in the determination of GAAP net income or loss, as applicable: acquisition fees and expenses; accretion of discounts and amortization of premiums on debt investments; where applicable, payments of loan principal made by our equity investees accounted for under the HLBV model where such payments reduce our equity in earnings of equity method investments in real estate, nonrecurring impairments of real estate-related investments (i.e., infrequent or unusual, not reasonably likely to recur in the ordinary course of business); mark-to-market adjustments included in net income or loss; nonrecurring gains or losses included in net income or loss from the extinguishment or sale of debt, hedges, derivatives or securities holdings, where trading of such holdings is not a fundamental attribute of the business plan, unrealized gains or losses resulting from consolidation from, or deconsolidation to, equity accounting, and after adjustments for Consolidated and Unconsolidated Hotels, with such adjustments calculated to reflect MFFO on the same basis. The accretion of discounts and amortization of premiums on debt investments, unrealized gains and losses on hedges, derivatives or securities holdings, unrealized gains and losses resulting from consolidations, as well as other listed cash flow adjustments are adjustments made to net income or loss in calculating the cash flows provided by operating activities and, in some cases, reflect gains or losses that are unrealized and may not ultimately be realized.

Our MFFO calculation complies with the IPA's Practice Guideline described above. In calculating MFFO, we exclude acquisition-related expenses, fair value adjustments of derivative financial instruments and the adjustments of such items related to noncontrolling interests. Under GAAP, acquisition fees and expenses are characterized as operating expenses in determining operating net income or loss. These expenses are paid in cash by a company. All paid and accrued acquisition fees and expenses will have negative effects on returns to investors, the potential for future distributions, and cash flows generated by the company, unless earnings from operations or net sales proceeds from the disposition of other properties are generated to cover the purchase price of the property, these fees and expenses and other costs related to such property. Further, under GAAP, certain contemplated non-cash fair value and other non-cash adjustments are considered operating non-cash adjustments to net income or loss in determining cash flow from operating activities. We account for certain of our equity investments using the HLBV model which is based on distributable cash as defined in the operating agreement.

Our management uses MFFO and the adjustments used to calculate it in order to evaluate our performance against other non-traded REITs, which have limited lives with short and defined acquisition periods and targeted exit strategies shortly thereafter. As noted above, MFFO may not be a useful measure of the impact of long-term operating performance on value if we do not continue to operate in this manner. We believe that MFFO and the adjustments used to calculate it allow us to present our performance in a manner that takes into account certain characteristics unique to non-traded REITs, such as their limited life, defined acquisition period and targeted exit strategy, and is therefore a useful measure for investors. For example, acquisition costs are generally funded from the proceeds of our offering and other financing sources and not from operations. By excluding expensed acquisition costs, the use of MFFO provides information consistent with management's analysis of the operating performance of the properties. Additionally, fair value adjustments, which are based on the impact of current market fluctuations and underlying assessments of general market conditions, but can also result from operational factors such as occupancy rates, may not be directly related or attributable to our current operating performance. By excluding such changes that may reflect anticipated and unrealized gains or losses, we believe MFFO provides useful supplemental information.

Presentation of this information is intended to provide useful information to investors as they compare the operating performance of different REITs, although it should be noted that not all REITs calculate FFO and MFFO the same way, so comparisons with other REITs may not be meaningful. Furthermore, FFO and MFFO are not necessarily indicative of cash flow available to fund cash needs and should not be considered as an alternative to net income or loss as an indication of our performance, as an alternative to cash flows from operations as an indication of our liquidity, or indicative of funds available to fund our cash needs including our ability to make distributions to our stockholders. FFO and MFFO should be reviewed in conjunction with other GAAP measurements as an indication of our performance.

Neither the SEC, NAREIT nor any other regulatory body has passed judgment on the acceptability of the adjustments that we use to calculate FFO or MFFO. In the future, the SEC, NAREIT or another regulatory body may decide to standardize the allowable adjustments across the non-traded REIT industry and we would have to adjust our calculation and characterization of FFO and MFFO accordingly.

FFO and MFFO were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net (loss) income attributable to CWI stockholders	\$ (2,454)	\$ (7,210)	\$ (16,519)	\$ 14,697
Adjustments:				
Depreciation and amortization of real property	19,186	18,708	58,175	57,838
Net (gain) loss on sale of real estate	(5,881)	669	(5,881)	(31,260)
Proportionate share of adjustments for partially-owned entities — FFO adjustments	6,471	4,566	7,251	5,106
Total adjustments	19,776	23,943	59,545	31,684
FFO attributable to CWI stockholders (as defined by NAREIT)	17,322	16,733	43,026	46,381
Adjustments:				
Straight-line and other rent adjustments	1,946	1,761	6,246	4,443
Transaction costs <sup>(a)</sup>	1,483	—	1,483	—
Gain on hurricane-related property damage <sup>(b)</sup>	(880)	(41)	(880)	(1,106)
Net loss on extinguishment of debt	—	322	136	511
Proportionate share of adjustments for partially-owned entities — MFFO adjustments	312	140	816	589
Total adjustments	2,861	2,182	7,801	4,437
MFFO attributable to CWI stockholders	\$ 20,183	\$ 18,915	\$ 50,827	\$ 50,818

(a) The adjustment for the three months ended September 30, 2019 includes costs related to the proposed merger of \$0.8 million that were included in Corporate general and administrative expenses in the consolidated financial statements during the six months ended June 30, 2019 and not presented as an adjustment to MFFO in that period. Upon announcement of the proposed merger, these costs were reclassified in the consolidated statement of operations to Transaction costs and presented as an adjustment to MFFO in the current quarter.

(b) We excluded the gain on hurricane-related property damage (which does not include business interruption income) because of its non-recurring nature.

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

#### Market Risk

We currently have limited exposure to financial market risks, including changes in interest rates. We currently have no foreign operations and are not exposed to foreign currency fluctuations.

#### Interest Rate Risk

The values of our real estate and related fixed-rate debt obligations are subject to fluctuations based on changes in interest rates. The value of our real estate is also subject to fluctuations based on local and regional economic conditions, which may affect our ability to refinance property-level mortgage debt when balloon payments are scheduled, if we do not choose to repay the debt when due. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political conditions, and other factors beyond our control. An increase in interest rates would likely cause the fair value of our assets to decrease.

We are exposed to the impact of interest rate changes primarily through our borrowing activities. To limit this exposure, we generally seek non-recourse mortgage financing on a long-term, fixed-rate basis. However, from time to time, we or our joint investment partners have obtained, and may in the future obtain, variable-rate non-recourse mortgage loans, and, as a result, we have entered into, and may continue to enter into, interest rate swap agreements or interest rate cap agreements with counterparties. See [Note 8](#) for additional information on our interest rate swaps and caps.

At September 30, 2019, all of our debt bore interest at fixed rates or was subject to an interest rate cap, with the exception of the Bridge Loan, which had an outstanding balance of \$35.0 million, as well as one mortgage loan with an outstanding balance of \$14.4 million. Our debt obligations are more fully described in [Note 9](#) and [Summary of Financing](#) in Item 2 above. The following table presents principal cash outflows for our Consolidated Hotels based upon expected maturity dates of our long-term debt obligations outstanding at September 30, 2019 and excludes deferred financing costs (in thousands):

	2019 (Remainder)	2020	2021	2022	2023	2024	Total	Fair Value
Fixed-rate debt	\$ 4,124	\$ 58,627	\$ 458,173	\$ 244,105	\$ 126,618	\$ 50,252	\$ 941,899	\$ 940,998
Variable-rate debt <sup>(a)</sup>	\$ 909	\$ 179,762	\$ 75,350	\$ 83,330	\$ —	\$ —	\$ 339,351	\$ 340,322

(a) Excludes \$35.0 million outstanding under the Bridge Loan from WPC ([Note 3](#)). Unless the Advisory Agreement expires or is terminated, the Bridge Loan, as amended, is currently scheduled to mature on December 31, 2019.

The estimated fair value of our fixed-rate debt and our variable-rate debt that currently bears interest at fixed rates or has effectively been converted to a fixed rate through the use of interest rate swaps, or that has been subject to an interest rate cap, is affected by changes in interest rates. A decrease or increase in interest rates of 1.0% would change the estimated fair value of this debt at September 30, 2019 by an aggregate increase of \$24.6 million or an aggregate decrease of \$25.2 million, respectively. Annual interest expense on our variable-rate debt that is subject to an interest rate cap at September 30, 2019 would increase or decrease by \$3.1 million for each respective 1.0% change in annual interest rates.

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

##### *Disclosure Controls and Procedures*

Our disclosure controls and procedures include internal controls and other procedures designed to provide reasonable assurance that information required to be disclosed in this and other reports filed under the Exchange Act is recorded, processed, summarized and reported within the required time periods specified in the SEC's rules and forms; and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures. It should be noted that no system of controls can provide complete assurance of achieving a company's objectives and that future events may impact the effectiveness of a system of controls.

Our Chief Executive Officer and Chief Financial Officer, after conducting an evaluation, together with members of our management, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2019, have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective as of September 30, 2019 at a reasonable level of assurance.

##### *Changes in Internal Control Over Financial Reporting*

There have been no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## PART II — OTHER INFORMATION

### Item 2. Unregistered Sales of Equity Securities.

#### *Unregistered Sales of Equity Securities*

During the three months ended September 30, 2019, we issued 342,920 shares of common stock to our Advisor as consideration for asset management fees. These shares were issued at our most recently published NAV of \$10.39 per share. In acquiring our shares, our Advisor represented that such interests were being acquired by it for investment purposes and not with a view to the distribution thereof. Since none of these transactions were considered to have involved a “public offering” within the meaning of Section 4(a)(2) of the Securities Act of 1933, the shares issued were deemed to be exempt from registration.

All prior sales of unregistered securities have been reported in our previously filed quarterly reports on Form 10-Q and annual reports on Form 10-K.

#### *Issuer Purchases of Equity Securities*

The following table provides information with respect to repurchases of our common stock during the three months ended September 30, 2019:

2019 Period	Total number of shares purchased <sup>(a)</sup>	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
July 1 – 31	1,617	\$ 10.00	N/A	N/A
August 1 – 31	—	—	N/A	N/A
September 1 – 30	861,190	9.90	N/A	N/A
Total	<u>862,807</u>			

- (a) Represents shares of our common stock repurchased under our redemption plan, pursuant to which we may elect to redeem shares at the request of our stockholders, subject to certain exceptions, conditions and limitations. The maximum number of shares purchasable by us in any period depends on a number of factors and is at the discretion of our board of directors. We generally receive fees in connection with share redemptions. The average price paid per share will vary depending on the number of redemption requests that were made during the period, the number of redemption requests that qualify for treatment as special circumstances under the terms of the plan, and the most recently published NAV.

**Item 6. Exhibits.**

The following exhibits are filed with this Report. Documents other than those designated as being filed herewith are incorporated herein by reference.

<b>Exhibit No.</b>	<b>Description</b>	<b>Method of Filing</b>
2.1	Agreement and Plan of Merger, dated as of October 22, 2019, among Carey Watermark Investors Incorporated, Carey Watermark Investors 2 Incorporated and Apex Merger Sub LLC.	Incorporated by reference to Exhibit 2.1 to Current Report on Form 8-K, filed on October 22, 2019
2.2	Internalization Agreement, dated as of October 22, 2019, among Carey Watermark Investors Incorporated, CWI OP, LP, Carey Watermark Investors 2 Incorporated, CWI 2 OP, LP, W. P. Carey Inc., Carey Watermark Holdings, LLC, CLA Holdings, LLC, Carey REIT II, Inc., WPC Holdco LLC, Carey Watermark Holdings 2, LLC, Carey Lodging Advisors, LLC, Watermark Capital Partners, LLC, CWA, LLC, and CWA 2, LLC.	Incorporated by reference to Exhibit 2.2 to Current Report on Form 8-K, filed on October 22, 2019
10.1	Commitment Agreement, dated as of October 1, 2019, among Watermark Capital Partners, LLC, Carey Watermark Investors Incorporated, Carey Watermark Investors 2 Incorporated, and Michael Medzigian.	Incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K, filed on October 22, 2019
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

**SIGNATURES**

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

Carey Watermark Investors Incorporated

Date: November 8, 2019

By: /s/ Mallika Sinha

Mallika Sinha

Chief Financial Officer

(Principal Financial Officer)

Date: November 8, 2019

By: /s/ Noah K. Carter

Noah K. Carter

Chief Accounting Officer

(Principal Accounting Officer)

## EXHIBIT INDEX

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101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

[\(Back To Top\)](#)

## Section 2: EX-31.1 (EXHIBIT 31.1)

**Exhibit 31.1**

### **Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Michael G. Medzigian, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Carey Watermark Investors Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Michael G. Medzigian

Michael G. Medzigian  
Chief Executive Officer

[\(Back To Top\)](#)

## Section 3: EX-31.2 (EXHIBIT 31.2)

**Exhibit 31.2**

### **Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Mallika Sinha, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Carey Watermark Investors Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

- (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2019

/s/ Mallika Sinha  
Mallika Sinha  
Chief Financial Officer

[\(Back To Top\)](#)

## Section 4: EX-32 (EXHIBIT 32)

**Exhibit 32**

### **Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Carey Watermark Investors Incorporated on Form 10-Q for the period ended September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of Carey Watermark Investors Incorporated, does hereby certify, to the best of such officer's knowledge and belief, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Carey Watermark Investors Incorporated.

Date: November 8, 2019

/s/ Michael G. Medzigian  
Michael G. Medzigian  
Chief Executive Officer

Date: November 8, 2019

/s/ Mallika Sinha  
Mallika Sinha  
Chief Financial Officer

The certification set forth above is being furnished as an exhibit solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not being filed as part of the Report as a separate disclosure document of Carey Watermark Investors Incorporated or the certifying officers.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Carey Watermark Investors Incorporated and will be retained by Carey Watermark Investors Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)