# SUPERTEL HOSPITALITY INC.

2005 ANNUAL REPORT

SUPERTEL IS A SELF-ADVISED REAL ESTATE INVESTMENT TRUST SPECIALIZING IN LIMITED-SERVICE LODGING.

April 15, 2006

**Fellow Shareholders:**

In 2005, Supertel Hospitality has continued its philosophy of controlled growth to expand its hotel portfolio, increase occupancy rates and reduce overall costs. These fundamentals, coupled with a positive economic environment led to strong results in 2005 with a 5 percent increase in revenues and 20 percent increase in dividend payments from the previous year.

There were many highlights in 2005. Supertel acquired one hotel in Nebraska, five hotels in Indiana and one in North Carolina which added 668 rooms to our portfolio. Supertel's properties now consist of franchise agreements for Super 8, Comfort Inn, Comfort Suites, Hampton Inn, Holiday Inn Express, Days Inn, Ramada Limited, Guest House Inn, Sleep Inn and a Supertel boutique suites property in Key Largo, Florida. This diversity enables Supertel to participate in the best practices of each of these respected hospitality partners.

Supertel has been able to reduce costs and leverage efficiencies while providing clean, friendly and affordable accommodations to business and leisure travelers. Royal Host has done a great job managing the cost structure of our hotels during 2005 and they are continuing to expand sales and marketing initiatives that will assist the property managers in their efforts to maximize occupancy and the Average Daily Rate (ADR).

Supertel reported revenues of $60.7 million and a net earnings of $2.8 million or 23 cents per diluted share, for the year ended December 31, 2005, compared to $2.0 million, or 16 cents per diluted share, for the same period ended December 31, 2004. Dividend payments were increased to a total of 24 cents a share in 2005, up from 20 cents a share in 2004.

Revenues for 2005 compared to 2004, increased $2.9 million or 5 percent. The additional revenues generated by the seven hotels acquired in 2005 totaled $1.6 million. The increase in revenues was also due, in part, to an increase in ADR of $1.41 or 2.7 percent and a 0.5 percent increase in occupancy, which resulted in a $1.04 or 3.2 percent increase of Revenue Per Available Room (RevPAR) for the year ended December 31, 2005, compared to the same 2004 period.

Supertel believes that Funds From Operations (FFO[1]) as that term is defined by the National Association of Real Estate Investment Trusts is also a good measure of the operating efficiency of its hotel properties. FFO, which is net earnings plus depreciation plus or minus losses or gains from the sale of properties, was increased to 80 cents per share for the year ended December 31, 2005 compared to 64 cents per share for the year ago period.

In 2005, the shareholders approved the name change to Supertel Hospitality, Inc. and the NASDAQ symbol was changed to "SPPR." Besides our seven new acquisitions, Supertel also began construction on a 41-room Supertel Inn and Conference Center in Creston, Iowa. The Conference Center, expected to be completed in June 2006, can host events up to 200 people.

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[1]FFO per share is a non-GAAP financial measure within the meaning of the rules of the Securities & Exchange Commission and accordingly has been reconciled to the comparable GAAP measure. For further discussion of FFO, see Item 6, Selected Financial Data, in the accompanying Form 10-K.

We believe Supertel is well positioned for 2006. A public offering and sale of 1,521,258 shares of Series A Convertible Preferred Stock (Nasdaq: SPPRP) at $10 per share took place in December 2005. The proceeds of the offering were applied to our $22 million revolving credit facility which will be available to provide funds for acquisitions and general corporate purposes.

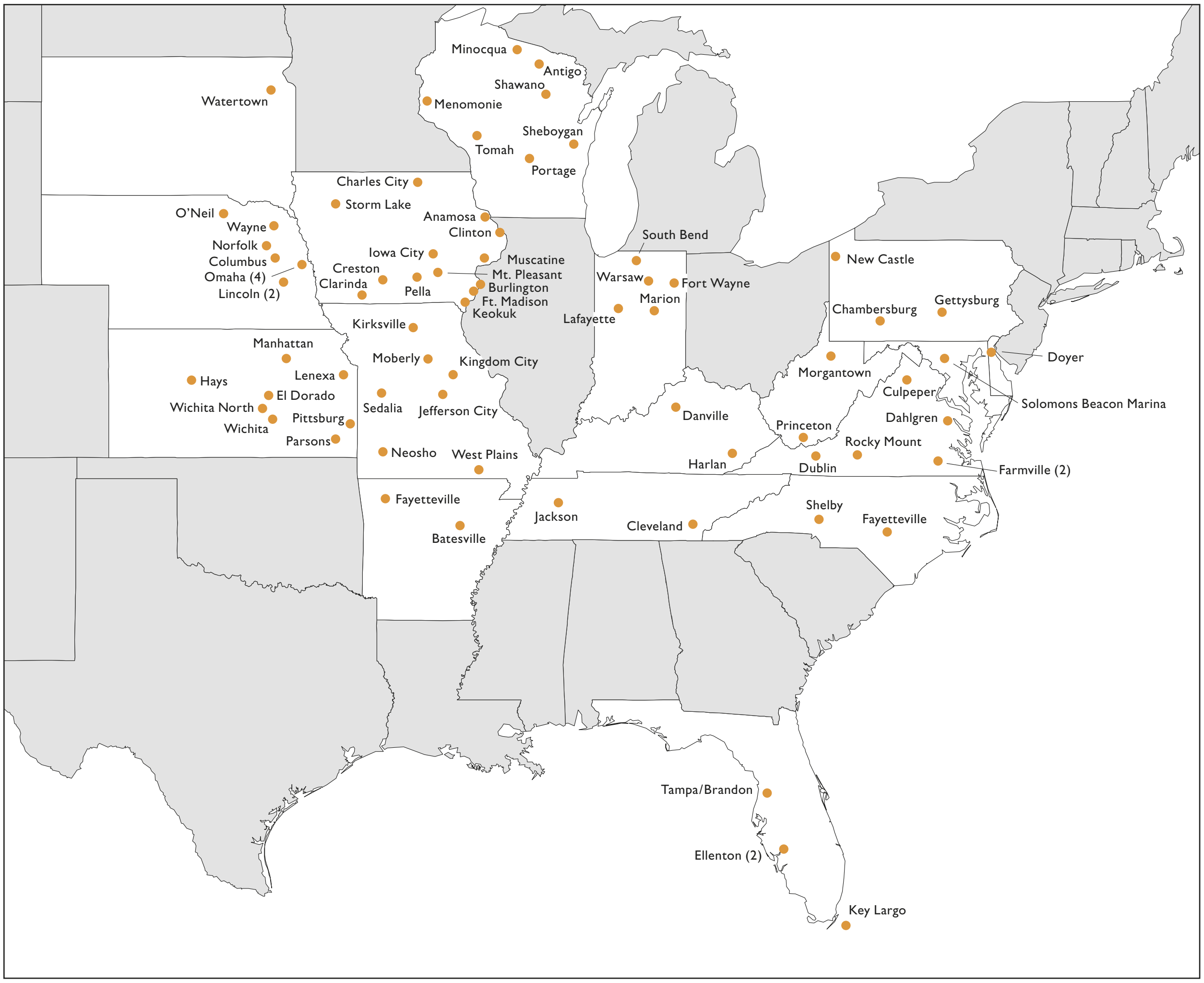
Looking ahead, Supertel feels that it is uniquely positioned to pursue a controlled acquisition strategy. The overall hospitality industry is experiencing a period of growth, especially in the limited service sector. We will continue to leverage efficiencies for cost control, while striving to increase occupancy rates and ADR. Most importantly Supertel will not waver from its commitment of providing clean, friendly and affordable accommodations, which is what ultimately brings guests back to our properties.

Our acquisition strategy and criteria for acquisition remains the same. We are acquiring hotels within existing geographic clusters to achieve operating and marketing efficiencies. Market attractiveness is based on high room demand or low supply and the opportunity to improve post acquisition operating results.

We remain committed to carefully managing your investment in Supertel Hospitality. Thank you for your continued support.

Paul J. Schulte
Chairman, President and Chief Executive Officer

SUPERTEL OWNS 76 PROPERTIES WITH APPROXIMATELY 5,400 ROOMS IN 17 STATES IN THE MIDWESTERN AND EASTERN U.S.



SUPERTEL HOSPITALITY FRANCHISE PARTNERS

This diversity enables Supertel to participate in the best practices of each of these respected brands.

## 2005 HIGHLIGHTS

- Acquisition of seven hotels
- New $22 million revolving credit facility, effective on January 13, 2005
- Payment of dividends during each quarter for a total of 24 cents per share in 2005, up from 20 cents per share in 2004
- Name change to Supertel Hospitality, Inc. and trading symbol change of our common stock on the Nasdaq National Market to “SPPR”
- Series A Convertible Preferred Stock (Nasdaq: SPPRP) public offering and sale of 1,521,258 shares at $10 per share on December 30, 2005
- Earnings of 23 cents per diluted share for 2005, compared to earnings of 16 cents and 8 cents per diluted share for 2004 and 2003

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2005**

**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: 0-25060**

# Supertel Hospitality, Inc.
**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Virginia** | **52-1889548** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **309 N. 5th St., Norfolk, NE** | **68701** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**(402) 371-2520**
**(Registrant's telephone number, including area code)**

**None**
**(Former name, former address and former fiscal year, if changed since last report)**

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class | Name of each exchange on which registered |
|---|---|
| **None** | **None** |

**Securities registered pursuant to Section 12(g) of the Act:**
**Common Stock, $.01 par value per share**
**Series A Convertible Preferred Stock, $.01 par value per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

As of June 30, 2005 the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $38,045,000 based on the $4.15 closing price as reported on the Nasdaq National Market.

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

| Class | Outstanding at March 17, 2006 |
|---|---|
| Common Stock, $.01 par value per share | 12,064,283 shares |

**DOCUMENTS INCORPORATED BY REFERENCE**

| Document | Parts Into Which Incorporated |
|---|---|
| Proxy Statement for the Annual Meeting of Shareholders to be held on May 25, 2006 (Proxy Statement) | Part III |

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# PART I

## Item 1. Business

### Overview

We are a self-administered real estate investment trust ("REIT"), and through our subsidiaries, we own 76 limited service hotels in 17 states. Our hotels operate under several national franchise brands.

Our significant events for 2005 include:

- the payment of dividends during each quarter, for a total of $.24 per share in 2005, up from $.20 per share in 2004;
- our name change from Humphrey Hospitality Trust, Inc. to Supertel Hospitality, Inc.; and trading symbol change of our common stock on the Nasdaq National Market from "HUMP" to "SPPR".
- the acquisition of seven hotels;
- a new $22 million revolving credit facility, effective on January 13, 2005;
- Series A Convertible Preferred Stock (Nasdaq: SPPRP) public offering and sale of 1,521,258 shares at $10 per share on December 30, 2005;
- earnings of $.23 per diluted share for 2005, compared to earnings of $.16 and $.08 per diluted share for 2004 and 2003.

### Available Information

Our executive offices are located at 309 N. 5th St, Norfolk, Nebraska 68701, our telephone number is (402) 371-2520, and we maintain an Internet website located at www.supertelinc.com. Our annual reports on Form 10-K and quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports are available free of charge on our website as soon as reasonably practicable after they are filed with the SEC. We also make available the charters of our board committees and our Code of Business Conduct and Ethics on our website. Copies of these documents are available in print to any shareholder who requests them. Requests should be sent to Supertel Hospitality, Inc., 309 N. 5th St, P.O. Box 1448, Norfolk, Nebraska 68701, Attn: Corporate Secretary.

### (a) General Development of Business

We are a real estate investment trust for federal income tax purposes and we were incorporated in Virginia on August 23, 1994. Our common stock began to trade on The Nasdaq National Market on October 30, 1996. Our preferred stock began to trade on The Nasdaq National Market on December 30, 2005.

Through our wholly owned subsidiaries, Supertel Hospitality REIT Trust and E&P REIT Trust, we own a controlling interest in Supertel Limited Partnership and E&P Financing Limited Partnership. As of December 31, 2005, we owned an approximately 96% general partnership interest in Supertel Limited Partnership and a 100% interest in E&P Financing Limited Partnership. Supertel Limited Partnership owns a 100% interest in Solomons GP, LLC which owns a 99% general partnership interest in Solomons Beacon Inn Limited Partnership. We own the remaining 1% limited partnership interest in Solomons Beacon Inn Limited Partnership and we own a 100% interest in Supertel Hospitality Management, Inc. Supertel Limited Partnership also owns a 100% interest in SPPR-South Bend, LLC and 99% interest in SPPR-Hotels, LLC. The remaining 1% interest in SPPR-Hotels, LLC is owned by SPPR Holdings, Inc, our wholly owned subsidiary.

Under the REIT Modernization Act ("RMA"), which became effective January 1, 2000, REITs are permitted to lease their hotels to wholly owned taxable REIT subsidiaries. We formed TRS Leasing, Inc. and its wholly owned subsidiaries TRS Subsidiary LLC and SPPR TRS Subsidiary, LLC (collectively the "TRS Lessee") in accordance with the RMA. Pursuant to the RMA, the TRS Lessee is required to enter into management agreements with an "eligible independent contractor" who will manage the hotels leased by the TRS Lessee. Accordingly the hotels are leased to our taxable TRS Lessee and are managed by Royal Host Management, Inc. Royal Host Management is a subsidiary of Royal Host Inc., a Canada based publicly owned real estate investment trust.

### (b) Financial Information About Industry Segments

We are engaged primarily in the business of owning equity interests in hotel properties. Therefore, presentation of information about industry segments is not applicable. See the Consolidated Financial Statements and notes thereto included in Item 8 of this Annual Report on Form 10-K for certain financial information required in this Item 1.

**(c) Narrative Description of Business**

General At December 31, 2005, we owned, through our subsidiaries, 76 hotels in 17 states. The hotels are operated by Royal Host Management. Our primary objective is to increase shareholder value through increasing the operating returns of the hotels, and by acquiring equity interests in hotels that meet our investment criteria.

Internal Growth Strategy We anticipate using our net earnings and available cash flow to pay dividends to our stockholders and make ongoing capital improvements, including furniture, fixtures and equipment, to our hotels. Excess funds after those uses, if any, will be used for internal growth or reduction of debt.

Acquisition Strategy Any acquisition, investment or purchase of property requires approval of the Investment Committee of our board of directors. Our general investment criteria are described below:

- nationally franchised hotels in locations with relatively high demand for rooms, relatively low supply of competing hotels and significant barriers to entry into the hotel business, such as a scarcity of suitable hotel sites or zoning restrictions;
- hotels which could benefit from new management, a new marketing strategy and association with a national franchisor;
- hotels which could benefit significantly from renovations; and
- hotels in attractive locations that could benefit by changing franchises to a grade that is more appropriate for the location and clientele.

We acquired seven hotels in 2005 through our subsidiaries. The following table reflects additional information regarding each of these hotels:

| Hotel | Location | Date Acquired | Rooms |
|---|---|---|---|
| Sleep Inn | Omaha, NE | Sep – 05 | 90 |
| Comfort Inn | Fayetteville, NC | Nov – 05 | 120 |
| Comfort Suites | Fort Wayne, IN | Nov – 05 | 128 |
| Comfort Suites | Marion, IN | Nov – 05 | 62 |
| Comfort Suites | Lafayette, IN | Nov – 05 | 62 |
| Comfort Inn & Suites | Warsaw, IN | Nov – 05 | 71 |
| Comfort Suites | South Bend, IN | Nov – 05 | 135 |
| | | | 668 |

Development Strategy Subject to market conditions and the availability of financing, we may selectively grow through the development of new limited-service hotel properties. We are interested in sites that offer the potential to attract a diverse mix of market segments.

Our site selection criteria include some or all of the following characteristics:

- urban or resort locations with relatively high demand for rooms, a relatively low supply of competing hotels and significant barriers to entry in the hotel business;
- areas that have strong industrial bases with the potential for future growth;
- communities with state or federal installations, colleges or universities; and
- sites that currently have an aging hotel presence.

These criteria describe the basic characteristics that we look for prior to committing to the development of a new hotel. Sites that are selected may have some or all of the market characteristics described above, as well as characteristics that are not specifically described herein. Sites selected by us will not necessarily possess all of these characteristics.

Sale of Hotels We may undertake the sale of one or more of the hotels from time to time in response to changes in market conditions, our current or projected return on our investment in the hotels or other factors which the board of directors deems relevant. We undertook a specific disposition program beginning in 2001 that included the sale of 23 hotels through December 31, 2004. The proceeds from the sale of these hotels were used primarily to repay existing debt. We did not sell any hotels in 2005 and none of our hotels were classified as being held for sale as of December 31, 2005; however, we may sell additional hotels in the future as market conditions and other factors so warrant.

Operating Practices We are advised by Royal Host Management that it utilizes a centralized accounting and data processing system, which facilitates financial statement and budget preparation, payroll management, internal auditing and other support functions for the on-site hotel management team.

Royal Host Management advises us that each hotel it manages employs a general manager who is responsible for the overall operations of the hotel. The general managers report to regional directors. Royal Host Management also utilizes senior managers who assist the regional directors in the mentoring of newer managers and/or assisting properties needing additional resources. As a management company, we are advised by Royal Host Management that it actively seeks feedback from the general managers through a manager advisory board comprised

of managers nominated by the regional directors from each territory. Daily operations are managed using a centralized approach led by regional directors. Royal Host Management advises us that its strategy is to encourage decision-making by those people closest to the hotel operation level at the lowest administrative cost.

The principal provisions of our management agreement with Royal Host Management are as follows:

- Royal Host Management is paid a base fee equal to 4.75% of gross hotel income with respect to 70 of our hotels and 4% of gross hotel income with respect to 6 of our hotels;
- if annual net operating income exceeds 10% of our total investment in the hotels, then Royal Host receives an incentive fee of 10% of the excess of operating income up to the first $1 million, and 20% of excess net operating income above $1 million;
- the agreement runs through December 31, 2009 and is automatically extended for five years thereafter if specific net operating income levels are achieved, subject to Royal Host Management's option not to extend the agreement;
- either of us may terminate the agreement if net operating income is not at least 8.5% of our total investment in the hotels or if we undergo a change in control (if we terminate the agreement for the change in control, then we pay Royal Host Management a termination fee equal to 50% of its basic management fee for the prior 12 months);
- we may terminate the agreement if any of the hotels fails three successive franchisor inspections if the deficiencies are within the reasonable control of Royal Host Management; and
- we may also terminate the agreement if tax laws change to allow a hotel REIT to self manage its properties (in which event we would pay Royal Host Management a termination fee equal to 50% of its basic management fee for the prior 12 months.

The hotels currently operate under the following franchise brands:

| Franchise Brand | Number of Hotels |
|---|---|
| (a) Super 8 | 44 |
| (b) Comfort Inn/Comfort Suites | 20 |
| (c) Hampton Inn | 4 |
| (d) Holiday Inn Express | 3 |
| (b) Sleep Inn | 1 |
| (a) Days Inn | 1 |
| (a) Ramada Limited | 1 |
| (e) Guest House Inn | 1 |
| (f) Suites at Key Largo | 1 |

**Franchise Information**

(a) Super 8®, Ramada Limited®, and Days Inn® are registered trademarks of Cendant, Inc.

(b) Comfort Inn®, Comfort Suites® and Sleep Inn® are registered trademarks of Choice Hotels International, Inc.

(c) Hampton Inn® is a registered trademark of Hilton Hotels Corporation.

(d) Holiday Inn Express® is a registered trademark of Six Continents Hotels, Inc.

(e) Guesthouse® is a registered trademark of Guesthouse International Franchise Systems, Inc.

(f) Suites at Key Largo is an independent boutique suites property with a 30 bay marina.

Seasonality of Hotel Business The hotel industry is seasonal in nature. Generally, revenues for hotels operating in the geographic areas in which we operate are greater in the second and third quarters of the calendar year than in the first and fourth quarters, with the exception of our hotels located in Florida, which experience peak demand in the first and fourth quarters of the year. Historically, overall hotel operations reflect this seasonal pattern.

Competition The hotel industry is highly competitive. Each of our hotels is located in a developed area that includes other hotel properties. The number of competitive hotel properties in a particular area could have a material adverse effect on revenues, occupancy and the average daily room rate of the hotels or at hotel properties acquired or developed in the future. A number of our hotels have experienced increased competition in the form of newly constructed competing hotels in the local markets, and we expect the entry of new competition to continue in several additional markets over the next several years.

We may compete for investment opportunities with entities that have substantially greater financial resources than us. These entities generally may be able to accept more risk than we can prudently manage. Competition in general may reduce the number of suitable investment opportunities for us and increase the bargaining power of property owners seeking to sell. Further, we believe that competition from entities organized for purposes substantially similar to our objectives could increase significantly.

Employees At December 31, 2005, we had 13 employees. Royal Host Management, the manager of our hotels, has a workforce of approximately 1,245 employees dedicated to the operation of the hotels.

## Item 1A. RISK FACTORS

The following risk factors describe various risks that may affect our business, financial condition and operations.

*Our failure to qualify as a REIT under the federal tax laws would result in adverse tax consequences.*

We have operated and intend to continue to operate in a manner so as to qualify as a REIT for federal income tax purposes. However, the REIT qualification requirements are extremely complicated and interpretations of the federal income tax laws governing qualification as a REIT are limited. Accordingly, we cannot be certain that we have been or will continue to be successful in operating as a REIT. At any time, new laws, interpretations or court decisions may change the federal tax laws or the federal income tax consequences of qualification as a REIT.

If we fail to qualify as a REIT in any taxable year, we would be required to pay federal income tax on our taxable income and our taxable income would be computed without a dividends paid deduction. We might need to borrow money or sell assets in order to pay the tax. Our payment of income tax likely would substantially decrease the amounts available to be paid out to our shareholders. In addition, we no longer would be required to distribute substantially all of our taxable income to our shareholders. Unless our failure to qualify as a REIT is excused under the federal income tax laws, we could not re-elect REIT status until the fifth calendar year following the year in which we fail to qualify.

*An economic recession and industry downturn could adversely affect our results of operations.*

If room supply outpaces demand, our operating margins may deteriorate and we may be unable to execute our business plan. In addition, if this trend continues, we may be unable to continue to meet our debt service obligations or to obtain necessary additional financing.

*We have restrictive debt covenants that could adversely affect our ability to run our business.*

We file quarterly loan compliance certificates with certain of our lenders. As of September 30, 2004, we requested and received a loan-to-value and a debt service ratio waiver with respect to a term loan with First National Bank of Omaha N.A. On February 17, 2005, the bank agreed to a covenant modification effective through June 30, 2006, providing for a lower loan-to-value ratio and debt service coverage ratio. We were in compliance with all other loan covenants during 2005.

Weakness in the economy, and the lodging industry at large, may result in our non-compliance with our loan covenants. Such non-compliance with our covenants may result in our lenders restricting the use of our operating funds for capital improvements to our existing hotels, including improvements required by our franchise agreements. We cannot assure you that our loan covenants will permit us to maintain our historic business strategy.

*Our restrictive debt covenants may jeopardize our tax status as a REIT.*

To maintain our REIT tax status, we generally must distribute at least 90% of our taxable income annually. In addition, we are subject to a 4% non-deductible excise tax if the actual amount distributed to shareholders in a calendar year is less than a minimum amount specified under the federal income tax laws. We have previously announced a general dividend policy of paying out approximately 100% of annual REIT taxable income. In the event we do not comply with our debt service obligations, our lenders may limit our ability to make distributions to our shareholders, which could adversely affect our REIT tax status.

*Our failure to have distributed old Supertel Hospitality, Inc.'s earnings and profits may compromise our tax status.*

At the end of any taxable year, a REIT may not have any accumulated earnings and profits (described generally for federal income tax purposes as cumulative undistributed net income) from a non-REIT corporation. In October 1999, our company and the old Supertel Hospitality, Inc. merged. We were the surviving entity in the merger and in May 2005 we changed our name to Supertel Hospitality, Inc. Prior to the effective time of the merger between our company and old Supertel Hospitality, Inc., old Supertel paid a dividend to its stockholders of record in the amount of its accumulated earnings and profits for federal income tax purposes. Accordingly, we should not have succeeded to any of the then current and accumulated earnings and profits of Supertel. However, the determination of accumulated earnings and profits for federal income tax purposes is extremely complex and Supertel's computations of its accumulated earnings and profits are not binding upon the Internal Revenue Service. Should the IRS successfully assert that the old Supertel's accumulated earnings and profits were greater than the amount distributed by Supertel, we may fail to qualify as a REIT.

*Our sale of assets acquired in a 1999 merger within ten years of the merger will result in tax.*

In connection with our election to be taxed as a REIT, we have elected to be subject to the "built-in gain" rules. Under these rules, taxes may be payable at the time and to the extent that the net unrealized gains on assets acquired, which included hotels, in the 1999 merger with the old Supertel Hospitality, Inc. are recognized in taxable dispositions of such assets in the subsequent ten-year period. This ten-year period expires October 2009. We recognized built-in gains taxes of $286,000 due to dispositions of five of those hotels in 2004.

*Our debt service obligations could require us to liquidate our properties and may reduce cash available for distribution to our shareholders.*

As of December 31, 2005, we had approximately $92.0 million of existing indebtedness with maturity dates ranging from November 2006 to 2024. Approximately $5.4 million of principal is due in 2006 and $12.4 million is due in 2007. We cannot assure you that we will be able to re-finance or repay such debt when due or that the terms of any new debt financings will be as favorable to us as the terms of our existing debt financing.

Adverse economic conditions could result in higher interest rates and other unfavorable terms on our current and future borrowings. Higher interest rates could increase debt service requirements on floating rate debt and could reduce the amounts available for distribution to our shareholders. In the past, we have obtained, and may obtain in the future, one or more forms of interest rate protection in the form of swap agreements, interest rate cap contracts or similar agreements to "hedge" against the possible negative effects of interest rate fluctuations. However, we cannot assure you that any hedging will relieve the adverse effects of interest rate fluctuations.

In order to meet our debt service obligations, we may have to sell additional hotel investments, potentially at a loss or at times that prohibit us from achieving attractive returns. Failure to pay our indebtedness when due or failure to cure covenant defaults could result in higher interest rates during the period of such loan defaults, and could ultimately result in the loss of our hotels through lender foreclosure.

*Our ability to make distributions to our shareholders is subject to fluctuations in our financial performance and operating results as well as capital improvement requirements.*

In the event of downturns in our operating results and financial performance, or unanticipated capital improvements to our hotels, including capital improvements that may be required by our franchisors, we may need to reduce the amount of distributions to our shareholders. The amount and timing of distributions are in the sole discretion of our board of directors. We cannot assure you that we will be able to generate sufficient cash in order to fund future distributions or that any future distributions are likely to be at the same rate as our historical distributions.

Among the factors that could adversely affect our results of operations and our distributions to shareholders are: decreased revenue per available room and reduced net operating profits or operating losses; increased debt service requirements, including those resulting from higher interest rates on our variable rate indebtedness; and capital expenditures at our hotels, including capital expenditures required by the franchisors of our hotels. Hotel revenue can decrease for a number of reasons, including increased competition from new hotel rooms and decreased demand for hotel rooms. These factors can reduce both occupancy and room rates at our hotels.

*Our returns depend on management of our hotels by third parties.*

In order to qualify as a REIT, we cannot operate any hotel or participate in the decisions affecting the daily operations of any hotel. Under the REIT Modernization Act of 1999, REITs are permitted to lease their hotels to wholly-owned lessees such as TRS Lessee. However, TRS Lessee may not operate the leased hotels and, therefore, must enter into management agreements with third-party eligible independent contractors to manage the hotels. Thus, an independent operator under a management agreement with TRS Lessee controls the daily operations of each of our hotels.

Under the terms of such management agreement, our ability to participate in operating decisions regarding the hotels is limited. We depend on Royal Host Management to adequately operate our hotels as provided in the management agreement. We do not have the authority to require any hotel to be operated in a particular manner or to govern any particular aspect of the daily operations of any hotel (for instance, setting room rates). Thus, even if we believe our hotels are being operated inefficiently or in a manner that does not result in satisfactory occupancy rates, revenue per available room and average daily rates, we may not be able to force Royal Host Management to change its method of operation of our hotels. We can only seek redress if a management company violates the terms of the applicable management agreement with TRS lessee, and then only to the extent of the remedies provided for under the terms of the management agreement. Additionally, in the event that we need to replace our management company, we may experience decreased occupancy and other significant disruptions at our hotels and in our operations generally.

*Our ability to make distributions to our shareholders may be affected by factors in the hotel industry that are beyond our control.*

*Operating Risks*

Our hotels are subject to various operating risks found throughout the hotel industry. Many of these risks are beyond our control. These include, among other things, the following:

- our hotels compete with other hotel properties in their respective geographic markets, and many of our competitors have substantially greater marketing and financial resources than we do;
- over-building in our markets, which adversely affects occupancy and revenues at our hotels;
- dependence on business and commercial travelers and tourism;
- terrorist incidents which may deter travel;
- increases in energy costs, airline fares and other expenses, which may affect travel patterns and reduce the number of business and commercial travelers and tourists; and
- adverse effects of general, regional and local economic conditions.

These factors could adversely affect the amount of rent we receive from leasing our hotels and reduce the net operating profits of TRS Lessee, which in turn could adversely affect our ability to make distributions to our shareholders. Decreases in room revenues of our hotels will result in reduced operating profits for TRS Lessee and decreased lease revenues to our company under our current percentage leases with TRS Lessee.

*Competition for Acquisitions*

We compete for investment opportunities with entities that have substantially greater financial resources than we do. These entities generally may be able to accept more risk than we can manage wisely. This competition may generally limit the number of suitable investment opportunities offered to us. This competition may also increase the bargaining power of property owners seeking to sell to us, making it more difficult for us to acquire new properties on attractive terms.

*Seasonality of Hotel Business*

The hotel industry is seasonal in nature. Generally, occupancy rates and hotel revenues are greater in the second and third quarters than in the first and fourth quarters, with the exception of our hotels located in Florida. This seasonality can be expected to cause quarterly fluctuations in our lease revenues. Our quarterly earnings may be adversely affected by factors outside our control, including bad weather conditions and poor economic factors. As a result, we may have to enter into short-term borrowings in our first and fourth quarters in order to offset these fluctuations in revenues.

*Investment Concentration in Particular Segments of Single Industry*

Our entire business is hotel-related. Our investment strategy is to acquire interests in limited service hotel properties. Therefore, a downturn in the hotel industry in general and the limited service segment in which we operate in particular will have a material adverse effect on our lease revenues and amounts available for distribution to our shareholders.

*Capital Expenditures*

Our hotels have an ongoing need for renovations and other capital improvements, including replacements, from time to time, of furniture, fixtures and equipment. The franchisors of our hotels also require periodic capital improvements as a condition of keeping the franchise licenses. The costs of all of these capital improvements could adversely affect our financial condition and reduce the amounts available for distribution to our shareholders. These renovations may give rise to the following risks:

- possible environmental problems;
- construction cost overruns and delays;
- a possible shortage of available cash to fund renovations and the related possibility that financing for these renovations may not be available to us on affordable terms; and
- uncertainties as to market demand or a loss of market demand after renovations have begun.

For the twelve months ended December 31, 2005, we spent approximately $4.9 million for capital improvements to our hotels.

*Investment risks in the real estate industry generally may adversely affect our ability to make distributions to our shareholders.*

*General Risks of Investing in Real Estate*

Our investments in hotels are subject to varying degrees of risk that generally arise from the ownership of real property. The underlying value of our real estate investments, and our income and ability to make distributions to our shareholders depends on maintaining or increasing room revenues and operating income of our hotels. Both income from our hotels and our ability to make distributions to our shareholders may be adversely affected by changes beyond our control, TRS Lessee's control and the hotels' managers' control, including the following:

- adverse changes in national and local economic and market conditions;
- changes in interest rates and in the availability, cost and terms of debt financing;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the ongoing need for capital improvements, particularly in older structures;
- changes in operating expenses;
- civil unrest, acts of war and acts of God, including earthquakes, floods and other natural disasters, which may result in uninsured and underinsured losses; and
- the relative illiquidity of real estate investments.

*Uninsured and Underinsured Losses*

We maintain comprehensive insurance on each of our hotels, including liability, fire and extended coverage of the type and amount we believe are customarily obtained for or by hotel owners. However, various types of catastrophic losses, like earthquakes, floods and wars, may not be insurable or may not be economically insurable. In the event of a substantial loss, our insurance coverage may not be able to cover the full current market value or replacement cost of our lost investment. Inflation, changes in building codes and ordinances, environmental considerations and other factors might also keep us from using insurance proceeds to replace or renovate a hotel after it has been damaged or destroyed. Under those circumstances, the insurance proceeds we receive might be inadequate to restore our economic position on the damaged or destroyed property. If an uninsured loss occurs, we may lose both our invested capital and anticipated profits from the property. Our insurance premiums may increase significantly in the future, which may have a materially adverse impact on our cash flow. Furthermore, we may not be able to purchase policies in the future with coverage limits and deductibles similar to those purchased for the year 2006. Because it is impossible to determine what kind of policies will be available in the future and at what prices, we are unable to determine whether we will be able to maintain insurance coverage levels similar to those secured for 2006. Our real property insurance policies put into effect on December 31, 2004 include limited terrorism coverage, except for acts of war.

*Increases in property taxes could adversely affect our cash flow.*

Real and personal property taxes on our current and future hotel properties may increase as property tax rates change and as the properties are assessed or reassessed by taxing authorities. An increase in property taxes could have an adverse effect on our ability to make distributions to shareholders.

*Increases in occupancy taxes and other local taxes could adversely affect our cash flow.*

The cities and counties in which our hotels operate periodically attempt to increase their revenue by imposing additional local taxes, which may be assessed both on the room charges to our customers and on a per diem basis. Because of our negotiated room rates for some customers and market circumstances generally, we may not be able to fully pass on these charges to our customers, and so an increase in these taxes could have an adverse effect on our cash flow and our ability to make distributions to shareholders.

*Operating our hotels under franchise agreements could adversely affect distributions to our shareholders.*

Seventy Five of our hotels operate under franchise agreements and we are subject to the risks of concentrating our hotel investments in several franchise brands. These risks include reductions in business following negative publicity related to one of our particular brands. Risks associated with our brands could adversely affect our lease revenues and the amounts available for distribution to our shareholders.

The maintenance of the franchise licenses for our hotels is subject to our franchisors' operating standards and other terms and conditions. Our franchisors periodically inspect our hotels to ensure that we and TRS Lessee follow their standards. Failure to maintain these standards or other terms and conditions could result in a franchise license being canceled. As a condition of our continued holding of a franchise license, a franchisor could also possibly require us to make capital expenditures, even if we do not believe the capital improvements are necessary or desirable or will result in an acceptable return on our investment. Nonetheless, we may risk losing a franchise license if we do not make franchisor-required capital expenditures.

If a franchisor terminates the franchise license, we may try either to obtain a suitable replacement franchise or to operate the hotel without a franchise license. The loss of a franchise license could materially and adversely affect the operations or the underlying value of the hotel because of the loss of associated name recognition, marketing support and centralized reservation systems provided by the franchisor. As of December 31, 2005, TRS Lessee holds all of the franchise licenses for our hotels. Loss of a franchise license for one or more hotels could materially and adversely affect our revenues. This loss of revenues could, therefore, also adversely affect our cash available for distribution to shareholders.

*Our inability to obtain financing could limit our growth.*

We are required to distribute at least 90% of our REIT taxable income to our shareholders each year in order to continue to qualify as a REIT. Our debt service obligations and distribution requirements limit our ability to fund capital expenditures, acquisitions and hotel development through retained earnings. Our ability to grow through acquisitions or development of hotels will be limited if we cannot obtain debt or equity financing.

Neither our articles of incorporation nor our bylaws limit the amount of debt we can incur. Our board can implement and modify a debt limitation policy without shareholder approval. We cannot assure you that we will be able to obtain additional equity financing or debt financing or that we will be able to obtain any financing on favorable terms.

*Noncompliance with governmental regulations could adversely affect our operating results.*

*Environmental Matters*

Our hotel properties are subject to various federal, state and local environmental laws. Under these laws, courts and government agencies have the authority to require the owner of a contaminated property to clean up the property, even if the owner did not know of or was not responsible for the contamination. These laws also apply to persons who owned a property at the time it became contaminated. In addition to the costs of cleanup, contamination can affect the value of a property and, therefore, an owner's ability to borrow funds using the property as collateral. Under these environmental laws, courts and government agencies also have the authority to require that a person who sent waste to a waste disposal facility, like a landfill or an incinerator, pay for the clean-up of that facility if it becomes contaminated and threatens human health or the environment. Furthermore, court decisions have established that third parties may recover damages for injury caused by property contamination. For instance, a person exposed to asbestos while staying in a hotel may seek to recover damages if he suffers injury from the asbestos. Lastly, some of these environmental laws restrict the use of a property or place conditions on various activities at a property. One example is laws that require a business using chemicals to manage them carefully and to notify local officials that the chemicals are being used.

Our company could be responsible for the costs discussed above if it found itself in one or more of these situations. The costs to clean up a contaminated property, to defend against a claim, or to comply with environmental laws could be material and could affect the funds available for distribution to our shareholders. To determine whether any costs of this nature might be required, we commissioned Phase I environmental site assessments, or "ESAs" before we acquired our hotels, and in 2002, commissioned new ESAs for 32 of our hotels in conjunction with a refinancing of the debt obligations of those hotels. These studies typically included a review of historical information and a site visit, but not soil or groundwater testing. We obtained the ESAs to help us identify whether we might be responsible for cleanup costs or other costs in connection with our hotels. The ESAs on our hotels did not reveal any environmental conditions that are likely to have a material adverse effect on our business, assets, results of operations or liquidity. However, ESAs do not always identify all potential problems or environmental liabilities. Consequently, we may have material environmental liabilities of which we are unaware.

*Americans with Disabilities Act and Other Changes in Governmental Rules and Regulations*

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

*Mold claims could adversely affect our financial condition.*

Public consciousness regarding mold has recently been elevated and if mold is detected in any of our hotels, we may be subject to adverse publicity, which could adversely affect our operations and financial results from that hotel. Such claims could require us to spend significant time and money in litigation or pay significant damages. In addition, we may be required to close all or portions of the affected hotel during mold remediation operations, which under certain conditions may be difficult to eradicate. We may be required to remove and replace moldy materials in the hotel, or perform extensive facility repairs, and the presence of mold in any hotel also could adversely impact the fair market value of that hotel.

*Provisions of our articles of incorporation and Virginia law may limit the ability of a third party to acquire control of our company.*

*Ownership Limitation*

Our articles of incorporation provide that no person may directly or indirectly own more than 9.9% of our common stock or 9.9% of any series of our preferred stock. This may prevent an acquisition of control of our company by a third party without our board's approval, even if our shareholders believe the change of control is in their interest.

*Authority to Issue Preferred Stock*

Our articles of incorporation authorize our board to issue up to 10,000,000 shares of preferred stock and to establish the preferences and rights of any shares issued. The issuance of shares of preferred stock may have the effect of delaying or preventing a change in control of our company, including transactions at a premium over the market price of our capital stock, even if shareholders believe that a change of control is in their interest.

*Virginia Anti-Takeover Statutes*

As a Virginia corporation, we are subject to various anti-takeover laws found in the Virginia Stock Corporation Act. These laws place restrictions and require compliance with various procedures designed to protect the shareholders of Virginia corporations against unfair or coercive mergers and acquisitions. These restrictions and procedural requirements may discourage takeover offers for, or changes in control of, our company, including transactions at a premium over the market price of our capital stock, even if shareholders believe that a change of control is in their interest.

*Our ownership limitation may prevent you from engaging in certain transfers of our capital stock.*

In order to maintain our REIT qualification, no more than 50% in value of our outstanding capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal income tax laws to include various kinds of entities) during the last half of any taxable year. In addition, if any shareholder or group of related or affiliated shareholders of our lessee owns, actually or constructively, 10% or more of our stock, we likely would lose our REIT status. Our articles of incorporation contain the ownership limitation, which prohibits both direct and indirect ownership of more than 9.9% of the outstanding shares of our common stock or 9.9% of any series of our preferred stock by any person, subject to several exceptions. Generally, any shares of our capital stock owned by affiliated owners will be added together for purposes of the ownership limitation.

If anyone transfers shares in a way that would violate the ownership limitation or prevent us from continuing to qualify as a REIT under the federal income tax laws, we will consider the transfer to be null and void from the outset, and the intended transferee of those shares will be deemed never to have owned the shares. Those shares instead will be transferred to a trust for the benefit of a charitable beneficiary and will be either redeemed by our company or sold to a person whose ownership of the shares will not violate the ownership limitation. Anyone who acquires shares in violation of the ownership limitation or the other restrictions on transfer in our articles of incorporation bears the risk that he will suffer a financial loss when the shares are redeemed or sold if the market price of our stock falls between the date of purchase and the date of redemption or sale.

*We may not be able to complete development of new hotels on time or within budget.*

We may develop hotel properties as suitable opportunities arise. New project development is subject to a number of risks that could cause increased costs or delays in our ability to generate revenue from any development hotel, reducing our cash available for distribution to shareholders. These risks include:

- construction delays or cost overruns that may increase project costs;
- competition for suitable development sites;

- receipt of zoning, land use, building, construction, occupancy and other required governmental permits and authorizations; and
- substantial development costs in connection with projects that are not completed.

We may not be able to complete the development of any projects we begin and, if completed, our development and construction activities may not be completed in a timely manner or within budget.

We may also rehabilitate hotels that we believe are underperforming. These rehabilitation projects will be subject to the same risks as development projects.

*Hotels that we develop have no operating history and may not achieve levels of occupancy that result in levels of operating income that provide us with an attractive return on our investment.*

The new hotels that we may develop have no operating history. These hotels, both during the start-up period and after they have stabilized, may not achieve anticipated levels of occupancy, average daily room rates, or gross operating margins, and could result in operating losses and reduce the amount of distributions to our shareholders.

*Property ownership through joint ventures and partnerships could limit our control of those investments.*

Joint ventures or partnerships involve risks not otherwise present for investments we make on our own. It is possible that our co-venturers or partners may have different interests or goals than we do at any time and that they may take actions contrary to our requests, policies or objectives, including our policy with respect to maintaining our qualification as a REIT. Other risks of joint venture investment include impasses on decisions, because no single co-venturer or partner has full control over the joint venture or partnership. Joint ventures may include other restrictions on us, including requirements that we provide the joint venture with the right of first offer or right of first refusal to acquire any new property we consider acquiring directly.

*Our business could be disrupted if we need to find a new manager upon termination of an existing management agreement.*

If Royal Host Management fails to materially comply with the terms of their management agreement, we have the right to terminate such management agreement. Upon termination, we would have to find another manager to manage the property. We cannot operate the hotels directly due to federal income tax restrictions. We cannot assure you that we would be able to find another manager or that, if another manager were found, we would be able to enter into a new management agreement favorable to us. Our franchisors may require us to make substantial capital improvements to the hotels prior to their approval, if required, of a new manager. There would be disruption during any change of hotel management that could adversely affect our operating results and reduce our distributions to our shareholders.

*If we decide to sell hotels, we may not be able to sell those hotels on favorable terms.*

We have sold twenty-two hotels since 2002, ten in 2002, seven in 2003 and five in 2004. We did not sell any hotels in 2005. We may decide to sell additional hotels in the future. We may not be able to sell such hotels on favorable terms, and such hotels may be sold at a loss. As with acquisitions, we face competition for buyers of our hotel properties. Other sellers of hotels may have the financial resources to dispose of their hotels on unfavorable terms that we would be unable to accept. If we cannot find buyers for any properties that are designated for sale, we will not be able to implement our divestiture strategy. In the event that we cannot fully execute our divestiture strategy or realize the benefits therefrom, we will not be able to fully execute our growth strategy.

*We depend on key personnel.*

We depend on the efforts and expertise of our Chief Executive Officer and Chief Financial Officer to drive our day-to-day operations and strategic business direction. The loss of any of their services could have an adverse effect on our operations. Our ability to replace key individuals may be difficult because of the limited number of individuals with the breadth of skills and experience needed to excel in the hotel industry. There can be no assurance that we would be able to hire, train, retain or motivate such individuals.

### Item 1B. Unresolved Staff Comments

None.

### Item 2. Properties

The following table sets forth certain information with respect to the Hotels as of December 31, 2005:

| Hotel Brand | Rooms |
|---|---|
| **Super 8** | |
| Aksarben-Omaha, NE | 73 |
| Anamosa, IA | 35 |
| Antigo, WI | 52 |
| Batesville, AR | 49 |
| Burlington, IA | 62 |
| Charles City, IA | 43 |
| Clinton, IA | 63 |
| Columbus, NE | 63 |
| Cornhusker–Lincoln, NE | 133 |
| Creston, IA | 123 |
| El Dorado, KS | 49 |
| Fayetteville, AR | 83 |
| Ft. Madison, IA | 41 |
| Hays, KS | 78 |
| Iowa City, IA | 86 |
| Jefferson City, MO | 77 |
| Keokuk, IA | 61 |
| Kingdom City, MO | 62 |
| Kirksville, MO | 61 |
| Lenexa, KS | 101 |
| Manhattan, KS | 87 |
| Menomonie, WI | 81 |
| Moberly, MO | 60 |
| Mt. Pleasant, IA | 55 |
| Muscatine, IA | 63 |
| Neosho, MO | 58 |
| Norfolk, NE | 66 |
| Omaha, NE | 116 |
| O’Neill, NE | 72 |
| Parsons, KS | 48 |
| Pella, IA | 40 |
| Pittsburg, KS | 64 |
| Portage, WI | 61 |
| Sedalia, MO | 87 |
| Shawano, WI | 55 |
| Storm Lake, IA | 59 |
| Tomah, WI | 65 |
| Watertown, SD | 57 |
| Wayne, NE | 40 |
| West Dodge– Omaha, NE | 101 |
| West “O” – Lincoln, NE | 82 |
| Wichita, KS | 119 |
| Wichita – (Park City), KS | 59 |
| West Plains, MO | 49 |
| **Comfort Inn /Comfort Suites** | |
| Culpeper, VA | 49 |
| Chambersburg, PA | 63 |
| Dahlgren, VA | 59 |
| Dublin, VA | 99 |
| Farmville, VA | 51 |

| | |
|---|---|
| Gettysburg, PA | 80 |
| Morgantown, WV | 80 |
| Minocqua, WI | 51 |
| New Castle, PA | 79 |
| Princeton, WV | 51 |
| Rocky Mount, VA | 61 |
| Sheboygan, WI | 59 |
| Beacon Marina-Solomons, MD | 60 |
| Dover, DE | 64 |
| Fayetteville, NC | 120 |
| Warsaw, IN | 71 |
| Lafayette, IN | 62 |
| Marion, IN | 62 |
| South Bend, IN | 135 |
| Fort Wayne, IN | 128 |
| **Sleep Inn** | |
| Omaha, NE | 90 |
| **Days Inn** | |
| Farmville, VA | 59 |
| **Hampton Inn** | |
| Brandon, FL | 80 |
| Cleveland, TN | 59 |
| Jackson, TN | 121 |
| Shelby, NC | 77 |
| **Guest House Inn** | |
| Ellenton, FL | 63 |
| **Holiday Inn Express** | |
| Danville, KY | 63 |
| Gettysburg, PA | 51 |
| Harlan, KY | 62 |
| **Ramada Limited** | |
| Ellenton, FL | 73 |
| **Suites at Key Largo** | |
| Key Largo, FL | 40 |
| Totals | 5,361 |

Additional property information is found in Item 8 Schedule III of this Annual Report on Form 10-K.

**Item 3. Legal Proceedings**

We are not a party to, nor are any of our properties subject to, any material legal proceedings. We are, from time to time, engaged in routine litigation incidental to the business.

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

None.

## PART II

### Item 5. Market for the Registrant's Common Equity / Related Shareholder Matters and Issuer Purchases of Equity Securities.

(a) Market Information

The common stock trades on the Nasdaq National Market under the symbol "SPPR." The closing sales price for the common stock on March 16, 2006 was $4.91 per share. The table below sets forth the dividends declared per share and high and low sales prices per share reported on the Nasdaq National Market for the periods indicated.

| | Common Stock | | |
|---|---|---|---|
| | High | Low | Dividend |
| **2004** | | | |
| **First Quarter** | $ 4.94 | 4.15 | 0.05 |
| **Second Quarter** | $ 4.60 | 3.55 | 0.05 |
| **Third Quarter** | $ 4.95 | 3.71 | 0.05 |
| **Fourth Quarter** | $ 4.18 | 3.60 | 0.05 |
| **2005** | | | |
| **First Quarter** | $ 3.99 | 3.66 | 0.06 |
| **Second Quarter** | $ 4.60 | 3.67 | 0.06 |
| **Third Quarter** | $ 5.12 | 4.12 | 0.07 |
| **Fourth Quarter** | $ 5.00 | 4.40 | 0.07 |

(b) Holders

As of March 16, 2006, the approximate number of holders of record of the common stock was 160 and the approximate number of beneficial owners was 2,350.

(c) Dividends

Dividends paid during the year ended December 31, 2005 ($.24) represented ordinary income ($.24) to shareholders. The 2004 fourth quarter dividend ($.05) was paid in January 2005, and will be reported as a component of 2005 dividend payments for income tax purposes. The 2005 fourth quarter dividend ($.07) was paid in

January 2006, and will be reported as a component of 2006 dividend payments for income tax purposes. We will continue to pay dividends to shareholders as business conditions allow, in accordance with our previously announced policy of distributing approximately 100% of our taxable net income. The actual amount of future dividends will be determined by the board of directors based on the actual results of operations, economic conditions, capital expenditure requirements and other factors that the board of directors deems relevant.

### Item 6. Selected Financial Data

Through December 31, 2001, operating revenues and expenses of the hotels (other than those of the eleven hotels classified for sale from June 1, 2001) were reflected in the financial statements of Humphrey Hospitality Management, Inc. (HHM). Pursuant to the master lease, with an effective date of January 1, 2002, the hotels previously leased to HHM were then leased to the TRS Lessee which, in turn, entered into the management agreement with HHM. Accordingly, our consolidated financial statements include all of the operating revenues and expenses of the hotels for 2005, 2004, 2003 and 2002.

Effective July 31, 2004, the TRS Lessee terminated its hotel management agreement with HHM and effective August 1, 2004, TRS Lessee entered into a new hotel management agreement with Royal Host Management.

The following table sets forth our selected financial information. The selected operating data and balance sheet data have been extracted from our consolidated financial statements for each of the periods presented and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K.

| (In thousands, except per share data) | As of or for the Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| Operating data (1): | | | | | |
| Room rentals and other hotel services (2) | $ 60,537 | $ 57,634 | $ 57,209 | $ 58,739 | $ 4,797 |
| Base and percentage rents (3) | — | — | — | — | 19,092 |
| Net earnings (loss) from continuing operations | 2,778 | 1,299 | 281 | (3,175) | (439) |
| Discontinued Operations | — | 678 | 728 | 178 | 1,148 |
| Net earnings (loss) | 2,778 | 1,977 | 1,009 | (2,997) | 709 |
| Preferred stock dividends | (6) | — | — | — | — |
| Net earnings (loss) available to Common Shareholders | 2,772 | 1,977 | 1,009 | (2,997) | 709 |
| FFO (4) | 9,637 | 7,732 | 5,418 | 3,361 | 8,874 |
| Net earnings (loss) per common share from continuing operations - basic and diluted | 0.23 | 0.11 | 0.02 | (0.28) | (0.04) |
| Net earnings (loss) per common share from discontinued operations - basic and diluted | — | 0.05 | 0.06 | 0.02 | 0.10 |
| Net earnings (loss) per common share | 0.23 | 0.16 | 0.08 | (0.26) | 0.06 |
| FFO per share - basic and diluted (4) | 0.80 | 0.64 | 0.45 | 0.30 | 0.79 |
| Total assets | 156,956 | 118,923 | 124,949 | 114,260 | 167,949 |
| Total long-term debt | 92,008 | 71,418 | 77,611 | 94,275 | 115,872 |
| Net cash flow: | | | | | |
| Provided by operating activities | 10,215 | 9,123 | 10,121 | 2,424 | 13,758 |
| Provided (used) by investing activities | (32,355) | (197) | 8,885 | 17,835 | (2,816) |
| Provided (used) by financing activities | 22,986 | (8,912) | (20,222) | (23,761) | (6,149) |
| Dividends per share (5) | 0.26 | 0.20 | 0.17 | — | 0.23 |
| Weighted average number of shares outstanding - basic and diluted | 12,062 | 12,054 | 12,045 | 11,318 | 11,226 |
| **RECONCILIATION OF NET EARNINGS TO FFO** | | | | | |
| Net earnings (loss) available to Common Shareholders | $ 2,772 | $ 1,977 | $ 1,009 | $ (2,997) | $ 709 |
| Depreciation and Amortization | 6,863 | 6,488 | 6,896 | 8,210 | 8,204 |
| (Gain) loss on disposition of assets | 2 | (733) | (2,487) | (1,852) | (39) |
| FFO (4) | $ 9,637 | $ 7,732 | $ 5,418 | $ 3,361 | $ 8,874 |

(1) Revenues for all periods exclude revenues from hotels sold or classified as held for sale after January 1, 2002, which are classified in discontinued operations in the statements of operations.

(2) Hotel revenues for 2001 include room and other revenues from operations of eleven hotels classified for sale for the period June 1, 2001 through December 31, 2001. Hotel revenues for 2005, 2004, 2003 and 2002 include room and other revenues from the operations of the hotels.

(3) Represents annual base rent plus aggregate percentage rent pursuant to the percentage leases with Humphrey Hospitality Management, Inc. (HHM), a former management company. On January 1, 2002, the hotels which had been leased to HHM were leased to TRS Lessee.

(4) FFO is a non-GAAP financial measure. We consider FFO to be a market accepted measure of an equity REIT's operating performance, which is necessary, along with net earnings (loss), for an understanding of our operating results. FFO, as defined under the National Association of Real Estate Investment Trusts (NAREIT) standards, consists of net income computed in accordance with accounting principles generally accepted in the United States of America ("GAAP"), excluding gains (or losses) from sales of real estate assets, plus depreciation and amortization of real estate assets. We believe our method of calculating FFO complies with the NAREIT definition. FFO does not represent amounts available for management's discretionary use because of needed capital replacement or expansion, debt service obligations, or other commitments and uncertainties. FFO should not be considered as an alternative to net

income (loss) (computed in accordance with GAAP) as an indicator of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to pay dividends or make distributions. All REITs do not calculate FFO in the same manner, therefore, our calculation may not be the same as the calculation of FFO for similar REITs. We use FFO as a performance measure to facilitate a periodic evaluation of our operating results relative to those of our peers, who like us, are typically members of NAREIT. We consider FFO a useful additional measure of performance for an equity REIT because it facilitates an understanding of the operating performance of its properties without giving effect to real estate depreciation and amortization, which assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, we believe that FFO provides a meaningful indication of our performance.

FFO for 2005, 2004, 2003, 2002 and 2001 includes impairment losses on real estate of $0, $0, $2,069,000, $2,246,000 and $1,192,000, respectively. Prior to the third quarter of 2003, we followed a practice of excluding such losses from FFO. However, we revised this practice based on clarification of the SEC staff's position on the FFO treatment of impairment losses and guidance from NAREIT issued during the third quarter of 2003.

(5) Represents dividends declared by the Company. Dividends paid during the year ended December 31, 2005 ($0.24) represented ordinary income to shareholders. The 2004 fourth quarter dividend ($0.05) was paid in January 2005, and will be reported as a component of 2005 dividend payments for income tax purposes. The 2005 fourth quarter dividend ($0.07) was paid in January 2006, and will be reported as a component of 2006 dividend payments for income tax purposes.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward-Looking Statements

Certain information both included and incorporated by reference in this management's discussion and analysis and other sections of this Form 10-K may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are based on assumptions that management has made in light of experience in the business in which we operate, as well as management's perceptions of historical trends, current conditions, expected future developments and other factors believed to be appropriate under the circumstances. These statements are not guarantees of performance or results. They involve risks, uncertainties (some of which are beyond our control) and assumptions. Management believes that these forward-looking statements are based on reasonable assumptions.

Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations are generally identifiable by use of the words "may," "will," "should," "expect," "anticipate," "estimate," "believe," "intend" or "project" or the negative thereof or other variations thereon or

comparable terminology. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to, changes in: economic conditions generally and the real estate market specifically, legislative/regulatory changes (including changes to laws governing the taxation of real estate investment trusts), availability of capital, risks associated with debt financing, interest rates, competition, supply and demand for hotel rooms in our current and proposed market areas, policies and guidelines applicable to real estate investment trusts and other risks and uncertainties described herein, and in our filings with the SEC from time to time. These risks and uncertainties should be considered in evaluating any forward-looking statements contained or incorporated by reference herein. We caution readers not to place undue reliance on any forward-looking statements included in this report which speak only as of the date of this report.

### Overview

We are a self-administered real estate investment trust, and through our subsidiaries, we own 76 limited service hotels in 17 states. Our hotels operate under several national franchise brands.

Our significant events for 2005 include:

- the payment of dividends during each quarter, for a total of $.24 per share in 2005, up from $.20 per share in 2004;
- our name change from Humphrey Hospitality Trust, Inc. to Supertel Hospitality, Inc.; and trading symbol change of our common stock on the Nasdaq National Market from "HUMP" to "SPPR";
- the acquisition of seven hotels;
- a new $22 million revolving credit facility, effective on January 13, 2005;

- Series A Convertible Preferred Stock (Nasdaq: SPPRP) public offering and sale of 1,521,258 shares at $10 per share on December 30, 2005;
- earnings of $.23 per diluted share for 2005, compared to earnings of $.16 and $.08 per diluted share for 2004 and 2003, respectively;
- the dividend declared for the first quarter of 2006 is $.09, payable April 28, 2006 for shareholders of record March 31, 2006, this represents a $.02 cents increase from the prior quarter.

Through our wholly owned subsidiaries, Supertel Hospitality REIT Trust and E&P REIT Trust, we own a controlling interest in Supertel Limited Partnership and E&P Financing Limited Partnership. As of December 31, 2005, we owned an approximately 96% general partnership interest in Supertel Limited Partnership and a 100% interest in E&P Financing Limited Partnership. Supertel Limited Partnership owns a 100% interest in Solomons GP, LLC which owns a 99% general partnership interest in Solomons Beacon Inn Limited Partnership. We own the remaining 1% limited partnership interest in Solomons Beacon Inn Limited Partnership. Supertel Limited Partnership also owns a 100% interest in SPPR-South Bend, LLC and 99% interest in SPPR-Hotels, LLC. The remaining 1% interest in SPPR – Hotels, LLC is owned by SPPR Holdings, Inc, our wholly-owned subsidiary.

The discussion that follows is based primarily on our consolidated financial statements as of December 31, 2005 and 2004, and for the years ended December 31, 2005, 2004 and 2003, and should be read along with the consolidated financial statements and related notes.

**RevPAR, ADR and Occupancy**

The following table presents our revenue per available room (“RevPAR”), average daily rate (“ADR”) and occupancy, by state, for 2005, 2004 and 2003, respectively. The comparisons from continuing operations include 76, 69 and 69 hotels for the respective years.

| | Year ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | | 2004 | | | 2003 | | |
| State | RevPAR | Occ. | ADR | RevPAR | Occ. | ADR | RevPAR | Occ. | ADR |
| Arkansas | $29.24 | 58.4% | $50.05 | $26.32 | 54.2% | $48.56 | $27.07 | 58.9% | $45.94 |
| Delaware | 61.44 | 73.5% | 83.58 | 60.50 | 79.0% | 76.56 | 61.55 | 80.7% | 76.26 |
| Florida | 51.96 | 68.8% | 75.53 | 51.65 | 68.2% | 75.68 | 46.14 | 62.6% | 73.66 |
| Indiana[1] | 37.04 | 52.7% | 70.25 | — | — | — | — | — | — |
| Iowa | 27.97 | 63.4% | 44.10 | 26.83 | 63.3% | 42.41 | 26.90 | 61.7% | 43.60 |
| Kansas | 29.06 | 61.0% | 47.66 | 27.86 | 59.1% | 47.13 | 29.31 | 62.5% | 46.89 |
| Kentucky | 39.60 | 64.3% | 61.56 | 34.54 | 57.2% | 60.36 | 34.35 | 59.1% | 58.07 |
| Maryland | 51.74 | 64.8% | 79.89 | 47.52 | 62.7% | 75.79 | 55.46 | 75.2% | 73.71 |
| Missouri | 24.95 | 55.4% | 45.07 | 25.00 | 55.0% | 45.49 | 25.39 | 53.8% | 47.20 |
| Nebraska | 23.78 | 54.5% | 43.63 | 24.20 | 57.2% | 42.31 | 24.67 | 58.5% | 42.20 |
| North Carolina | 35.41 | 58.6% | 60.41 | 31.50 | 55.2% | 57.09 | 30.79 | 54.4% | 56.61 |
| Pennsylvania | 46.62 | 65.3% | 71.42 | 45.59 | 66.1% | 69.01 | 45.56 | 67.9% | 67.09 |
| South Dakota | 28.00 | 61.6% | 45.45 | 27.83 | 63.4% | 43.88 | 30.18 | 70.3% | 42.95 |
| Tennessee | 45.64 | 73.7% | 61.90 | 44.41 | 75.5% | 58.85 | 42.23 | 72.6% | 58.17 |
| Virginia | 42.81 | 73.9% | 57.91 | 37.18 | 65.0% | 57.19 | 36.66 | 64.8% | 56.57 |
| West Virginia | 50.51 | 80.1% | 63.07 | 48.12 | 78.9% | 61.03 | 45.97 | 76.2% | 60.32 |
| Wisconsin | 32.54 | 59.0% | 55.14 | 34.64 | 62.4% | 55.52 | 32.85 | 61.0% | 53.86 |
| | $33.68 | 62.4% | $54.00 | $32.64 | 62.1% | $52.59 | $32.44 | 62.3% | $52.11 |

Our RevPAR, ADR and Occupancy, by franchise affiliation, from continuing operations, for 2005, 2004 and 2003, respectively, were as follows:

| | Year ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | | 2004 | | | 2003 | | |
| Flag | RevPAR | Occ. | ADR | RevPAR | Occ. | ADR | RevPAR | Occ. | ADR |
| Super 8 | $26.82 | 58.7% | $45.72 | $26.68 | 59.4% | $44.95 | $27.19 | 60.1% | $45.23 |
| Comfort Inn/Comfort Suites | 45.39 | 69.3% | 65.46 | 43.55 | 68.1% | 63.97 | 42.77 | 67.9% | 63.01 |
| Hampton Inn | 47.04 | 69.6% | 67.62 | 45.31 | 70.6% | 64.15 | 42.68 | 67.8% | 62.93 |
| Holiday Inn Express | 44.71 | 64.9% | 68.85 | 40.17 | 59.5% | 67.50 | 40.01 | 62.3% | 64.18 |
| Suites at Key Largo | 72.62 | 68.0% | 106.85 | 85.97 | 71.0% | 121.11 | 84.59 | 76.1% | 111.16 |
| Ramada Limited | 44.87 | 73.2% | 61.26 | 40.18 | 68.3% | 58.80 | 32.62 | 58.5% | 55.72 |
| Guest House Inn | 35.43 | 62.0% | 57.16 | 31.52 | 58.1% | 54.25 | 25.77 | 49.3% | 52.22 |
| Days Inn | 35.66 | 62.9% | 56.67 | 32.27 | 58.0% | 55.66 | 34.44 | 62.7% | 54.90 |
| Sleep Inn [1] | 41.71 | 77.6% | 53.73 | — | — | — | — | — | — |
| | $33.68 | 62.4% | $54.00 | $32.64 | 62.1% | $52.59 | $32.44 | 62.3% | $52.11 |

(1) Acquired in 2005.

## Results of Operations

*Comparison of the year ended December 31, 2005 to the year ended December 31, 2004*

Operating results are summarized as follows for the years ended December 31 (table in thousands):

| | 2005 | | | 2004 | | | |
|---|---|---|---|---|---|---|---|
| | Continuing Operations | Discontinued Operations | Total | Continuing Operations | Discontinued Operations | Total | Continuing Operations Variance |
| Revenues | $ 60,695 | $ — | $ 60,695 | $ 57,809 | $ 635 | $ 58,444 | $ 2,886 |
| Hotel and property operations expenses | 42,372 | — | 42,372 | 41,242 | 636 | 41,878 | (1,130) |
| Interest expense | 5,959 | — | 5,959 | 5,559 | 24 | 5,583 | (400) |
| Depreciation and Amortization expense | 6,863 | — | 6,863 | 6,418 | 75 | 6,493 | (445) |
| General and administrative expenses | 2,526 | — | 2,526 | 2,134 | — | 2,134 | (392) |
| Termination and Relocation Costs | — | — | — | 1,169 | — | 1,169 | 1,169 |
| Net gains (losses) on dispositions of assets and provision for impairment loss | (2) | — | (2) | (12) | 745 | 733 | 10 |
| Minority interest | 226 | — | 226 | 218 | — | 218 | (8) |
| Income tax expense (benefit) | (31) | — | (31) | (242) | (33) | (275) | (211) |
| | $ 2,778 | $ — | $ 2,778 | $ 1,299 | $ 678 | $ 1,977 | $ 1,479 |

*Revenues and Operating Expenses*

Revenues increased, from continuing operations, by approximately $2.9 million during 2005, of which $1.6 million was due to acquisition of hotel properties during 2005. The increase in revenue was also due, in part, to an increase in average daily rate (ADR) of $1.41 or 2.7% and a 0.3% increase in occupancy, which resulted in a $1.04 or 3.2% increase of revenue per available room (RevPAR) for the year ended December 31, 2005 compared to the year ago period.

Hotel and property operations expenses, from continuing operations increased by approximately $1.1 million during 2005, due to acquisition of hotel properties during 2005 with operations expense of $1.2 million.

*Interest Expense and Depreciation Expense*

Interest expense, from continuing operations increased by approximately $400,000, due partially to acquisitions and rising rates. Depreciation expense increased $445,000, primarily due to acquisitions and asset additions outpacing the amount of assets exceeding their useful life. General and administrative cost increased by approximately $392,000, due primarily to increases in payroll/taxes/benefits and consulting fees during 2005.

*Termination and Relocation Costs*

There were no Termination and Relocation Costs during 2005. The 2004 cost of $1.2 million was a result of termination fees directly related to TRS Lessee terminating its hotel management agreement with Humphrey Hospitality Management (HHM) for $500,000 and agreeing to reimburse HHM for certain employment-related severance costs of approximately $189,000. Additional one-time expenses associated with the termination of the hotel management agreement and a related decision to relocate the corporate offices from Columbia, MD to Norfolk, NE approximated $379,000, which is primarily represented by executive separation agreements, legal and consulting services. In addition, capitalized expenditures for replacement software and computer equipment totaled to approximately $225,000.

*Income Tax*

The Income tax expense (benefit) is related to the taxable earnings (loss) from the Company's taxable subsidiary, the TRS Lessee. Management believes the Federal income tax rate for the TRS Lessee will be approximately 40%. The tax benefit is a result of TRS Lessee's losses for the year ended December 31, 2005 and 2004. The income tax expense (benefit) will vary based on the taxable earnings of the TRS Lessee, a C corporation. The income tax benefit decreased by approximately $211,000 during 2005 compared to the year ago period, due to a reduced loss by the TRS Lessee in 2005 compared to the year ago period.

*Dispositions*

In 2005 no hotel sales were realized. In 2004, we recognized net gains on the disposition of assets of approximately $733,000, due primarily to net gains on the sale of five hotels ($745,000, net of built-in gain taxes of $286,000). No impairment charges were recorded for 2005 and 2004.

*Comparison of the year ended December 31, 2004 to the year ended December 31, 2003*

Operating results are summarized as follows for the years ended December 31 (table in thousands):

| | 2004 | | | 2003 | | | Continuing Operations Variance |
|---|---|---|---|---|---|---|---|
| | Continuing Operations | Discontinued Operations | Total | Continuing Operations | Discontinued Operations | Total | |
| Revenues | $ 57,809 | $ 635 | $ 58,444 | $ 57,404 | $ 4,499 | $ 61,903 | $ 405 |
| Hotel and property operations expenses | 41,242 | 636 | 41,878 | 41,640 | 3,788 | 45,428 | 398 |
| Interest expense | 5,559 | 24 | 5,583 | 6,244 | 542 | 6,786 | 685 |
| Depreciation and Amortization expense | 6,418 | 75 | 6,493 | 6,435 | 461 | 6,896 | 17 |
| General and administrative expenses | 2,134 | — | 2,134 | 2,052 | — | 2,052 | (82) |
| Termination and Relocation Costs | 1,169 | — | 1,169 | — | — | — | (1,169) |
| Net gains (losses) on dispositions of assets and provision for impairment loss | (12) | 745 | 733 | (543) | 961 | 418 | 531 |
| Minority interest | 218 | — | 218 | 270 | — | 270 | 52 |
| Income tax expense (benefit) | (242) | (33) | (275) | (61) | (59) | (120) | 181 |
| | $ 1,299 | $ 678 | $ 1,977 | $ 281 | $ 728 | $ 1,009 | $ 1,018 |

*Revenues and Operating Expenses*

Revenues declined by approximately $3.5 million during 2004, due primarily to the sale of 12 hotel properties during 2004 and 2003 ($3.8 million), five of which were sold in 2004, offset by a slight increase in comparable RevPAR ($.20 or $343,000).

Hotel and property operations expenses declined by approximately $3.6 million during 2004, due primarily to the sale of 12 hotel properties during 2004 and 2003 ($3.2 million) and lower costs of ancillary services ($67,000), lower labor cost ($94,000), lower fixed cost ($387,000) and increased benefit cost $296,000.

*Interest Expense and Depreciation Expense*

Interest expense declined by approximately $1.2 million during 2004, due primarily to the early extinguishment of long-term debt using the proceeds from the sale of 12 hotel properties since January 1, 2003. Depreciation expense has also declined ($403,000), primarily as a result of the sale of certain of our hotel properties. General and administrative costs increased by approximately $82,000 (payroll/taxes/benefits increased $79,000) during 2004.

*Termination and Relocation Costs*

Termination and Relocation Costs reflect termination fees directly related to TRS Lessee terminating its hotel management agreement with HHM ($500,000) and agreeing to reimburse HHM for certain employment-related severance costs of approximately $189,000. Additional one-time expenses associated with the termination of the hotel

management agreement and a related decision to relocate the corporate offices from Columbia, MD to Norfolk, NE approximated $379,000, which is primarily represented by executive separation agreements, legal and consulting services. In addition, capitalized expenditures for replacement software and computer equipment totaled to approximately $225,000.

*Income Tax*

The Income tax expense (benefit) is related to the taxable earnings (loss) from the Company's taxable subsidiary, the TRS Lessee. Management believes the Federal income tax rate for the TRS Lessee will be approximately 40%. The tax benefit is a result of TRS Lessee's losses for the year ended December 31, 2004 and 2003. The income tax expense (benefit) will vary based on the taxable earnings of the TRS Lessee, a C corporation. The income tax benefit increased by approximately $155,000 during 2004 compared to the year ago period, due to an increased loss by the TRS Lessee in 2004 compared to the year ago period.

*Dispositions*

In 2004, we recognized net gains on the disposition of assets of approximately $733,000, due primarily to net gains on the sale of five hotels ($745,000, net of built-in gain taxes of $286,000). In 2003, we recognized net gains on the disposition of assets of approximately $418,000, due primarily to net gains on the sale of seven hotels ($961,000, net of built-in gain taxes of $178,000 and a provision for built-in gain taxes which was reduced ($300,000) based on a change in the allocation of hotel sales proceeds from us to the TRS Lessee.

*Impairment Charges*

In 2004, no impairment charges were recorded. In 2003, we recorded impairment charges on three hotels ($1,152,000) and two additional hotels which did not meet our criteria for classification as held for sale at December 31, 2003 ($917,000), which were later sold during 2004.

**Liquidity and Capital Resources**

Our income and ability to meet our debt service obligations, and make distributions to our shareholders, depends upon the operations of the hotels being conducted in a manner that maintains or increases revenue, or reduces expenses, to generate sufficient hotel operating income for TRS Lessee to pay the hotels' operating expenses, including management fees and rents to us. We depend on rent payments from TRS Lessee to pay our operating expenses and debt service and to make distributions to shareholders.

We expect to meet our short-term liquidity requirements generally through borrowings on our revolving credit facility with Great Western Bank and net cash provided by operations. We believe that our available borrowing capacity and net cash provided by operations will be adequate to fund both operating requirements and the payment of dividends in accordance with REIT requirements.

We expect to meet our long-term liquidity requirements, such as scheduled debt maturities, through long-term secured and unsecured borrowings and the issuance of additional securities.

Financing

At December 31, 2005, we had long-term debt of $92.0 million consisting of notes and mortgages payable, with a weighted average term to maturity of 6.5 years and a weighted average interest rate of 7.22%. Aggregate annual principal payments for the next five years and thereafter are as follows (in thousands):

| | |
|---|---|
| 2006 | $ 5,373 |
| 2007 | 12,366 |
| 2008 | 2,923 |
| 2009 | 15,609 |
| 2010 | 2,387 |
| Thereafter | 53,350 |
| | $ 92,008 |

We have or currently intend to finance or refinance the debt payments coming due in 2006 in the amount of $2.8 million. The remainder of the maturities in 2006, approximately $2.6 million, consist of principal amortization on other mortgage loans which we expect to fund through cash flow from operations.

We file quarterly loan compliance certificates with certain of our lenders. As of December 31, 2005, we were in compliance with all loan covenants.

As of September 30, 2004 we requested and received a loan-to-value and a debt service ratio waiver with respect to a term loan with First National Bank of Omaha N.A. Ten of our hotels secure the $12 million term loan. We had a loan to value ratio of 63% and a debt service ratio of 1.46:1 as compared to the covenant requirements of the term loan of 60% and 1.5:1. The bank has agreed that through and including June 30, 2006, the loan-to-value ratio will be determined using a capitalization rate of 11% for valuing the hotels (versus an original rate of 12%) and the debt service coverage ratio will be 1.35:1. As of December 31, 2005, we were in compliance with the covenants under this term loan, as so modified.

If we fail to pay our indebtedness when due, or fail to comply with covenants, we could incur higher interest rates during the period of such loan defaults, and could ultimately lose the hotels through lender foreclosure.

Acquisition of Hotels

The Company acquired the 90-room Sleep Inn and Suites hotel located in Omaha, Nebraska in September 2005. The purchase price of $3.6 million was paid by approximately $800,000 with an assumed mortgage note payable and 633,047 of common operating units of Supertel Limited Partnership (a limited partnership 96% owned by the Company), of which 266,131 common operating units were immediately redeemed for $1.2 million in cash.

On November 7, 2005, SPPR-Hotels, LLC, a single-purpose bankruptcy remote entity 99% owned by Supertel Limited Partnership and 1% owned by SPPR Holdings, Inc., a wholly-owned subsidiary of the Company, acquired five hotels (four located in Indiana and one in North Carolina) in the amount of approximately $20.2 million, which was funded by approximately $5.4 million of borrowings from Supertel Hospitality's existing credit facilities with Great Western Bank and a $14.8 million loan from Citigroup Global Markets Realty Corp.

On November 30, 2005, SPPR-South Bend, LLC, a single-purpose bankruptcy remote entity 100% owned by Supertel Limited Partnership, acquired one hotel located in Indiana, in the amount of $12,080,000. The acquisition was funded thru the assumption of an approximate $6.1 million promissory note payable to GE Capital Franchise Finance Corporation, a $3.0 million promissory note payable to Independent Property Operators of America, LLC and approximately $3.0 million of borrowings from Supertel Hospitality's existing credit facilities with Great Western Bank.

Disposition of Hotels

During 2005 we did not sell any hotels. As of December 31, 2005, none of our hotels were classified as held for sale.

Redemption of Preferred Operating Partnership Units

We own, through our subsidiary, Supertel Hospitality REIT Trust, an approximate 96% general partnership interest in Supertel Limited Partnership, through which we own 20 of our hotels. We are the sole general partner of the limited partnership, and the remaining approximate 4% is held by limited partners who hold, as of December 31, 2005, 372,195 common operating partnership units and 195,610 preferred operating partnership units. Each limited partner of Supertel Limited Partnership may, subject to certain limitations, require that Supertel Limited Partnership redeem all or a portion of his or her common or preferred units, at any time after a specified period following the date he or she acquired the units, by delivering a redemption notice to Supertel Limited Partnership. When a limited partner tenders his or her common units to the partnership for redemption, we can, in our sole discretion, choose to purchase the units for either (1) a number of our shares of common stock equal to the number of units redeemed (subject to certain adjustments) or (2) cash in an amount equal to the market value of the number of our shares of common stock the limited partner would have received if we chose to purchase the units for common stock. We anticipate that we generally will elect to purchase the common units for common stock. The preferred units are convertible by the holders into common units on a one-for-one basis or may be redeemed for cash at $10 per unit until October 2009. The preferred units receive a preferred dividend distribution of $1.10 per preferred unit annually, payable on a monthly basis and do not participate in the allocations of profits and losses of Supertel Limited Partnership.

Capital Commitments

Below is a summary of certain obligations that will require capital:

| Contractual Obligations | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|---|---|---|---|---|---|
| Long-term debt | $ 128,559 | $ 11,966 | $ 26,334 | $ 26,653 | $ 63,606 |
| Land leases | 2,742 | 59 | 118 | 118 | 2,447 |
| Total contractual obligations | $ 131,301 | $ 12,025 | $ 26,452 | $ 26,771 | $ 66,053 |

We have various standing or renewable contracts with vendors. These contracts are all cancelable with immaterial or no cancellation penalties. Contract terms are generally one year or less.

Other

To maintain our REIT tax status, we generally must distribute at least 90% of our taxable income annually. In addition, we are subject to a 4% non-deductible excise tax if the actual amount distributed to shareholders in a calendar year is less than a minimum amount specified under the federal income tax laws. We have a general dividend policy of paying out approximately 100% of annual REIT taxable income. The actual amount of any future dividends will be determined by the board of directors based on our actual results of operations, economic conditions, capital expenditure requirements and other factors that the board of directors deems relevant.

**Off Balance Sheet Financing Transactions**

We have not entered into any off balance sheet financing transactions.

**Critical Accounting Policies**

Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management’s most difficult, complex or subjective judgments. We have identified the following principal accounting policy that has a material effect on our consolidated financial statements:

*Impairment of assets*

If events or changes in circumstances indicate that the carrying value of a hotel property to be held and used may be impaired, a recoverability analysis is performed based on estimated undiscounted cash flows to be generated from the property in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows, the property is written down to estimated fair value and an impairment loss is recognized. If a decision is made to sell a hotel property, we evaluate the recoverability of the carrying amount of the asset. If the evaluation indicates that the carrying value is not recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell and an impairment loss is recognized. Estimates of cash flows and fair values of the properties are based on current market conditions and consider matters such as revenues and occupancies for the properties, recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. The estimates are subject to revision as market conditions and management’s assessment of them change. If we misjudge or estimate incorrectly, we may record an impairment charge that is inappropriate or fail to record a charge when we should have done so, and the amount of these charges may be inaccurate.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

**Market Risk Information**

The market risk associated with financial instruments and derivative financial or commodity instruments is the risk of loss from adverse changes in market prices or rates. Our market risk arises primarily from interest rate risk relating to variable rate borrowings. Our interest rate risk management objective is to limit the impact of interest rate changes on earnings and cash flows. In order to achieve this objective, we rely primarily on long-term, fixed rate non-recourse loans from institutional lenders to finance our hotels. We are not currently using derivative financial or commodity instruments to manage interest rate risk.

Management monitors our interest rate risk closely. The table below presents the annual maturities, weighted average interest rates on outstanding debt at the end of each year and fair values required to evaluate the expected cash flows under debt and related agreements, and our sensitivity to interest rate changes at December 31, 2005. Information relating to debt maturities is based on expected maturity dates and is summarized as follows (in thousands):

| | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter | Total | Fair Value |
|---|---|---|---|---|---|---|---|---|
| Fixed Rate Debt | $ 5,180 | $ 2,515 | $ 2,698 | $ 15,367 | $ 2,125 | $ 48,366 | $ 76,251 | $ 80,746 |
| Average Interest Rate | 7.29% | 7.32% | 7.31% | 7.26% | 7.03% | 6.71% | 7.09% | — |
| Variable Rate Debt | $ 193 | $ 9,851 | $ 225 | $ 242 | $ 262 | $ 4,984 | $ 15,757 | $ 15,095 |
| Average Interest Rate | 7.38% | 7.49% | 7.61% | 7.61% | 7.61% | 7.61% | 7.52% | — |

As the table incorporates only those exposures that exist as of December 31, 2005, it does not consider exposures or positions that could arise after that date. As a result, our ultimate realized gain or loss with respect to interest rate fluctuations would depend on the exposures that arise after December 31, 2005.

**Item 8. Financial Statements and Supplementary Data**

## SUPERTEL HOSPITALITY, INC. AND SUBSIDIARIES
## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE



Supplementary information required by this Item is presented in Item 6.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders
Supertel Hospitality, Inc.:

We have audited the consolidated balance sheets of Supertel Hospitality, Inc. and subsidiaries (the Company) as of December 31, 2005 and 2004 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2005. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule III . These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Supertel Hospitality, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule III, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Omaha, Nebraska
March 30, 2006

**Supertel Hospitality, Inc. and Subsidiaries**
**CONSOLIDATED BALANCE SHEET**
**(In thousands, except per share data)**

| | As of | |
|---|---|---|
| | December 31, 2005 | December 31, 2004 |
| **ASSETS** | | |
| Investments in hotel properties | $ 205,169 | $ 163,891 |
| Less accumulated depreciation | 55,399 | 49,346 |
| | 149,770 | 114,545 |
| Cash and cash equivalents | 1,163 | 317 |
| Accounts receivable | 1,252 | 803 |
| Prepaid expenses and other assets | 2,999 | 1,699 |
| Deferred financing costs, net | 1,772 | 1,559 |
| | $ 156,956 | $ 118,923 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **LIABILITIES** | | |
| Accounts payable, accrued expenses and other liabilities | $ 7,937 | $ 5,769 |
| Long-term debt | 92,008 | 71,418 |
| | 99,945 | 77,187 |
| Minority interest in consolidated partnerships | 3,560 | 2,024 |
| **SHAREHOLDERS' EQUITY** | | |
| Preferred stock, $.01 par value, 10,000,000 shares authorized; 1,521,258 shares issued and outstanding, liquidation preference of $15,213 | 15 | — |
| Preferred Stock Warrants | 53 | — |
| Common stock, $.01 par value, 25,000,000 shares authorized; 12,064,283 and 12,059,849 outstanding | 121 | 121 |
| Additional paid-in capital | 65,621 | 51,585 |
| Distributions in excess of retained earnings | (12,359) | (11,994) |
| | 53,451 | 39,712 |
| **COMMITMENTS AND CONTINGENCIES** | | |
| | $ 156,956 | $ 118,923 |

See accompanying notes to consolidated financial statements.

**Supertel Hospitality, Inc. and Subsidiaries**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(In thousands, except per share data)**

| | Years ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| **REVENUES** | | | |
| Room rentals and other hotel services | $ 60,537 | $ 57,634 | $ 57,209 |
| Other | 158 | 175 | 195 |
| | 60,695 | 57,809 | 57,404 |
| **EXPENSES** | | | |
| Hotel and property operations | 42,372 | 41,242 | 41,640 |
| Depreciation and amortization | 6,863 | 6,418 | 6,435 |
| General and administrative | 2,526 | 2,134 | 2,052 |
| Termination and relocation costs | — | 1,169 | — |
| | 51,761 | 50,963 | 50,127 |
| **EARNINGS BEFORE NET LOSSES ON DISPOSITIONS OF ASSETS, INTEREST, MINORITY INTEREST, INCOME TAX BENEFIT AND DISCONTINUED OPERATIONS** | 8,934 | 6,846 | 7,277 |
| Net losses on dispositions of assets | (2) | (12) | (543) |
| Interest | (5,959) | (5,559) | (6,244) |
| Minority interest | (226) | (218) | (270) |
| **EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES** | 2,747 | 1,057 | 220 |
| Income tax benefit | (31) | (242) | (61) |
| **EARNINGS FROM CONTINUING OPERATIONS** | 2,778 | 1,299 | 281 |
| **DISCONTINUED OPERATIONS** | | | |
| Net income (loss) from discontinued operations net of income tax benefit | — | (67) | (233) |
| Gain on sale of discontinued operations, net of impairment provision and income taxes | — | 745 | 961 |
| Income from discontinued operations | — | 678 | 728 |
| **NET EARNINGS** | 2,778 | 1,977 | 1,009 |
| Preferred Stock Dividend | (6) | — | — |
| **NET EARNINGS AVAILABLE TO COMMON SHAREHOLDERS** | $ 2,772 | $ 1,977 | $ 1,009 |
| **NET EARNINGS PER COMMON SHARE - BASIC AND DILUTED:** | | | |
| Continuing operations | $ 0.23 | $ 0.11 | $ 0.02 |
| Discontinued operations | — | 0.05 | 0.06 |
| Net earnings | $ 0.23 | $ 0.16 | $ 0.08 |

See accompanying notes to consolidated financial statements.

## Supertel Hospitality, Inc. and Subsidiaries
## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
### (In thousands, except per share data)

| | Years ended December 31, 2005, 2004 and 2003 | | | | | |
|---|---|---|---|---|---|---|
| | Preferred Stock | Preferred Stk Warrants | Common Stock | Additional Paid-In Capital | Distributions in Excess of Retained Earnings | Total |
| **Balance at December 31, 2002** | $ — | $ — | $ 113 | $ 49,776 | $ (10,520) | $ 39,369 |
| Conversion of operating partnership units to common stock | — | — | 7 | 1,722 | — | 1,729 |
| Common Dividends - $.17 per share | — | — | — | — | (2,048) | (2,048) |
| Net earnings | — | — | — | — | 1,009 | 1,009 |
| **Balance at December 31, 2003** | $ — | $ — | $ 120 | $ 51,498 | $ (11,559) | $ 40,059 |
| Conversion of operating partnership units to common stock | — | — | 1 | 87 | — | 88 |
| Common Dividends - $.20 per share | — | — | — | — | (2,412) | (2,412) |
| Net earnings | — | — | — | — | 1,977 | 1,977 |
| **Balance at December 31, 2004** | $ — | $ — | $ 121 | $ 51,585 | $ (11,994) | $ 39,712 |
| Conversion of operating partnership units to common stock | — | — | — | 41 | — | 41 |
| Common Dividends - $.26 per share | — | — | — | — | (3,137) | (3,137) |
| Preferred Stock offering | 15 | 53 | — | 13,995 | — | 14,063 |
| Preferred Dividends | — | — | — | — | (6) | (6) |
| Net earnings | — | — | — | — | 2,778 | 2,778 |
| **Balance at December 31, 2005** | $ 15 | $ 53 | $ 121 | $ 65,621 | $ (12,359) | $ 53,451 |

See accompanying notes to consolidated financial statements.

**Supertel Hospitality, Inc. and Subsidiaries**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**

| | December 31, 2005 | December 31, 2004 | December 31, 2003 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net earnings | $ 2,778 | $ 1,977 | $ 1,009 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation | 6,851 | 6,488 | 6,896 |
| Amortization of intangible assets and deferred financing costs | 379 | 228 | 308 |
| Net (gains) losses on dispositions of assets | 2 | (733) | (2,487) |
| Provision for impairment loss | — | — | 2,069 |
| Write-off of assets related to relocation costs | — | 91 | — |
| Imputed interest on notes payable | (155) | — | — |
| Minority interest | 226 | 218 | 270 |
| Changes in operating assets and liabilities: | | | |
| (Increase) decrease in assets | (1,761) | 251 | 2,332 |
| Increase (decrease) in liabilities | 1,895 | 603 | (276) |
| Net cash provided by operating activities | 10,215 | 9,123 | 10,121 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Additions to hotel properties | (6,363) | (3,923) | (4,642) |
| Acquisition of hotel properties | (25,998) | — | — |
| Proceeds from sale of hotel assets | 6 | 3,726 | 13,527 |
| Net cash provided (used) by investing activities | (32,355) | (197) | 8,885 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Deferred financing costs | (580) | (88) | (30) |
| Principal payments on long-term debt | (9,137) | (17,233) | (17,444) |
| Proceeds from long-term debt | 22,952 | 11,040 | 780 |
| Redemption of operating partnership units | (1,174) | — | (1,808) |
| Distributions to minority partners | (215) | (219) | (274) |
| Preferred Stock offering | 14,063 | — | — |
| Dividends paid | (2,923) | (2,412) | (1,446) |
| Net cash provided (used) by financing activities | 22,986 | (8,912) | (20,222) |
| Increase (decrease) in cash and cash equivalents | 846 | 14 | (1,216) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | 317 | 303 | 1,519 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | $ 1,163 | $ 317 | $ 303 |
| **SUPPLEMENTAL CASH FLOW INFORMATION:** | | | |
| Interest paid, net of amounts capitalized | $ 5,203 | $ 5,906 | $ 6,074 |
| Income taxes paid | — | — | — |
| **SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES** | | | |
| Dividends declared | $ 3,143 | $ 2,412 | $ 2,048 |
| Conversion of operating partnership units | $ 41 | $ 88 | $ 1,729 |
| Issuance of operating partnership units | $ 2,793 | $ — | $ — |
| Assumed debt from Wells Fargo on Sleep Inn | $ 807 | $ — | $ — |
| Assumed debt from GE on South Bend | $ 6,123 | $ — | $ — |

See accompanying notes to consolidated financial statements.

**Supertel Hospitality, Inc. and Subsidiaries**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2005, 2004 and 2003**
**(Dollars in thousands, except per share data)**

## Note 1. Organization and Summary of Significant Accounting Policies

Description of Business

Supertel Hospitality, Inc. (SHI) was incorporated on August 23, 1994. SHI is a self-administered real estate investment trust (REIT) for Federal income tax purposes.

SHI, through its wholly owned subsidiaries, Supertel Hospitality REIT Trust and E&P REIT Trust (collectively, the "Company") owns a controlling interest in Supertel Limited Partnership ("SLP") and E&P Financing Limited Partnership ("E&P LP"). All of the Company's interests in 70 properties with the exception of furniture, fixtures and equipment held by TRS Leasing, Inc. are held directly or indirectly by E&P LP, SLP or Solomons Beacon Inn Limited Partnership (SBILP) (collectively, the "Partnerships"). The Company's interest in six properties are held directly by either SPPR-Hotels, LLC (SHLLC) or SPPR-South Bend, LLC (SSBLLC). SHI is the sole general partner in SLP and at December 31, 2005, owned approximately 96% of the Units in SLP. SLP is the general partner in SBILP. At December 31, 2005, SLP and SHI owned 99% and 1% interests in SBILP, respectively, and SHI owned 100% of Supertel Hospitality Management, Inc and SPPR Holdings, Inc. (SPPRHI), SLP and SPPRHI owned 99% and 1% of SHLLC, respectively, and SLP owned 100% of SSBLLC.

As of December 31, 2005, the Company, through the Partnerships, owned 76 limited service hotels (the "hotels") and one office building. The hotels are leased to the Company's wholly owned taxable REIT subsidiary, TRS Leasing, Inc, and its wholly owned subsidiaries TRS Subsidiary, LLC and SPPR TRS Subsidiary, LLC (collectively "TRS Lessee"), and were managed by Humphrey Hospitality Management, Inc. and its wholly owned subsidiary, Supertel Hospitality Management, Inc. ("SHMI") (collectively "HHM"), through July 31, 2004 at which time the contract with HHM was terminated. Effective August 1, 2004, the TRS Lessee entered into a new hotel management agreement with Royal Host Management, Inc., (RHM). RHM is a subsidiary of Royal Host, Inc. a Canada based publicly owned Real Estate Investment Trust which is an owner, franchisor and manager of limited and focused service hotel properties in the United States and Canada. The agreement with RHM provides for a base management fee representing 4.75% and 4.00% of hotel revenue, on 70 and 6 hotels, respectively.

For the year ended 2003 and through July 31, 2004, James I. Humphrey, Jr., the sole shareholder of HHM, was a director of the Company. Paul Schulte, the Company's Chairman of the Board, served as President of SHMI for an annual compensation package of one dollar ($1.00) through the year ended December 31, 2003 and for the period ended July 31, 2004. No other member of the Company's board had a financial interest in HHM.

Effective August 2004, SHMI was acquired by SHI.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Partnerships and the TRS Lessee. All significant intercompany balances and transactions have been eliminated in consolidation.

**Note 1. Organization and Summary of Significant Accounting Policies (continued)**

Basis of Presentation

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses recognized during the reporting period. The significant estimates pertain to impairment analysis and allocation of purchase price (SFAS No. 141). Actual results could differ from those estimates.

Capitalization Policy

Acquisition, development and construction costs of properties in development are capitalized including, where applicable, direct and indirect costs, including real estate taxes and interest costs. Development and construction costs and costs of significant improvements, replacements, renovations to furniture and equipment expenditures for hotel properties are capitalized while costs of maintenance and repairs are expensed as incurred.

Deferred Financing Cost

Direct costs incurred in financing transactions are capitalized as deferred costs and amortized to interest cost over the term of the related loan using the effective interest method.

Investment in Hotel Properties

Hotel properties to be held and used in operations are recorded at cost and reduced for impairment losses where appropriate. Hotel properties held for sale are carried at the lower of their carrying value (i.e., cost less accumulated depreciation and any impairment loss recognized, where applicable) or estimated fair value less costs to sell. The net carrying values of hotel properties are classified as held for sale when senior management authorizes their disposition, the Company begins marketing the properties for sale and various other criteria for a plan of sale are met. Depreciation of these properties is discontinued at that time, but operating revenues, other operating expenses and interest continue to be recognized until the date of sale. Revenues and expenses of properties that are classified as held for sale or sold are presented as discontinued operations for all periods presented in the statements of operations if the properties will be or have been sold on terms where the Company has limited or no continuing involvement with them after the sale. If active marketing ceases or the properties no longer meet the criteria to be classified as held for sale, the properties are reclassified as operating and measured at the lower of their (a) carrying amount before the properties were classified as held for sale, adjusted for any depreciation expense that would have been recognized had the properties been continuously classified as operating or (b) their fair value at the date of the subsequent decision not to sell.

If events or circumstances indicate that the carrying value of a hotel property to be held and used may be impaired, a recoverability analysis is performed based on estimated undiscounted future cash flows to be generated from the property. If the analysis indicates that the carrying value is not recoverable from future cash flows, the property is written down to estimated fair value and an impairment loss is recognized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 20 to 40 years for buildings and 5 to 12 years for furniture, fixtures and equipment.

**Note 1. Organization and Summary of Significant Accounting Policies (continued)**

Gains from sales of hotel properties are recognized using the full accrual method provided that various criteria relating to the terms of the transactions and any subsequent involvement by the Company with the properties sold are met. Gains relating to the transactions that do not meet the established criteria are deferred and recognized when the criteria are met or using the installment or cost recovery methods, as appropriate in the circumstances.

Cash and Cash Equivalents

Cash and cash equivalents include cash and various highly liquid investments with original maturities of three months or less when acquired, and are carried at cost which approximates fair value.

Revenue Recognition

Revenues from the operations of the hotel properties are recognized when earned.

Income Taxes

The Company qualifies and intends to continue to qualify as a REIT under applicable provisions of the Internal Revenue Code, as amended. In general, under such Code provisions, a trust which has made the required election and, in the taxable year, meets certain requirements and distributes to its shareholders at least 90% of its REIT taxable income will not be subject to Federal income tax to the extent of the income which it distributes. Earnings and profits, which determine the taxability of dividends to shareholders, differ from net income reported for financial reporting purposes due primarily to differences in depreciation of hotel properties for Federal tax purposes. Except with respect to the TRS Lessee, the Company does not believe that it will be liable for significant Federal or state income taxes in future years.

Deferred income taxes relate primarily to the TRS Lessee and are accounted for using the asset and liability method. Under this method, deferred income taxes are recognized for temporary differences between the financial reporting bases of assets and liabilities of the TRS Lessee and their respective tax bases and for operating loss and tax credit carryforwards based on enacted tax rates expected to be in effect when such amounts are realized or settled. However, deferred tax assets are recognized only to the extent that it is more likely than not that they will be realized based on consideration of available evidence, including tax planning strategies and other factors.

Under the REIT Modernization Act (“RMA”), which became effective January 1, 2001, the Company is permitted to lease its hotels to one or more wholly owned taxable REIT subsidiaries (“TRS”) and may continue to qualify as a REIT provided that the TRS enters into management agreements with an “eligible independent contractor” that will manage the hotels leased by the TRS. The Company formed the TRS Lessee and, effective January 1, 2002, the TRS Lessee leased all of the hotel properties. The TRS Lessee is subject to taxation as a C-Corporation. The TRS Lessee has incurred operating losses for financial reporting and Federal income tax purposes for 2005, 2004 and 2003.

In October 1999, the Company and the old Supertel Hospitality, Inc., merged and the Company was the surviving entity. In 2005, the Company changed its name to Supertel Hospitality, Inc. In connection with its election to be taxed as a REIT, the Company has elected to be subject to the “built-in gain” rules. Under these rules,

**Note 1. Organization and Summary of Significant Accounting Policies (continued)**

taxes may be payable at the time and to the extent that the net unrealized gains on assets acquired in a 1999 merger with the old Supertel are recognized in taxable dispositions of such assets in the subsequent ten-year period. This ten-year period expires October 2009. The Company had no built-in gains taxes in 2005. The Company recognized built-in gains taxes of $286 due to dispositions of properties in 2004 and $178 in 2003.

Financial Instruments

Fair values of financial instruments approximate their carrying values in the financial statements, except for long-term debt for which fair value information is presented in Note 5.

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding. Diluted EPS is computed after adjusting the numerator and denominator of the basic EPS computation for the effects of any dilutive potential common shares outstanding during the period, if any. The weighted average number of shares used in the basic EPS computation for 2005, 2004 and 2003 were 12,062,000, 12,054,000 and 12,045,000 respectively.

At December 31, 2005, 2004 and 2003 there were approximately 372,000, 10,000 and 20,000, respectively of SLP common operating units outstanding. These units have been excluded from the diluted earnings per share calculation as there would be no effect on the amounts allocated to the common unit holders (whose units are convertible on a one-to-one basis to common shares) since their share of income would be added back to income. In addition, the 195,610 shares of SLP preferred operating units are antidilutive.

At December 31, 2005, there were 1,521,258 shares of Series A Convertible Preferred Stock and 126,311 preferred stock warrants issued to Anderson & Strudwick. The effect of dilutive Series A convertible preferred stock and preferred stock warrants for the two days ending December 31, 2005 was the equivalent of approximately 15,979 shares of common stock outstanding. Because the preferred stock calculation was anti-dilutive and the exercise price of the warrants exceeded the market price of the common stock and convertible preferred stock, these incremental shares were excluded from the computation of diluted earnings per share. See additional information regarding preferred stock and warrants in Note 8.

Minority Interest

Minority interest in the operating partnership represents the limited partners' proportionate share of the equity in the operating partnership. During 2005, 2004 and 2003, respectively, 4,434, 10,479 and 731,234 units of limited partnership interest were redeemed by unit holders. At December 31, 2005, the aggregate partnership interest held by the limited partners in the operating partnership was approximately 4.00%. Income is allocated to minority interest based on the weighted average percentage ownership throughout the year. The limited partner's common operating units were increased by 366,916 in the 2005. See additional information regarding operating partnership units in Note 8.

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

**Note 1. Organization and Summary of Significant Accounting Policies (continued)**

Concentration of Credit Risk

The Company maintained a major portion of its deposits with Great Western Bank, a Nebraska Corporation at December 31, 2005 and US Bank National Association ("US Bank") at December 31, 2004. The balance on deposit at Great Western Bank and US Bank exceeded the federal deposit insurance limit; however, management believes that no significant credit risk exists with respect to the uninsured portion of this cash balance. A change of the primary depository for the Company was made in January 2005 from US Bank to Great Western Bank.

**Note 2. Acquisitions**

On November 7, 2005 the Company acquired five hotels from the Independent Property Operators of America, LLC (IPOA). Four of the hotels are located in Indiana and one in North Carolina. On November 30, 2005 the Company acquired a sixth hotel from IPOA located in Indiana. The aggregate purchase price of the six hotels was approximately $32.1 million, of which $6.1 million was assumed debt and $26 million was paid in cash.

All of the hotels acquired in 2005 were considered to be compatible with the Company's overall hotel business strategy.

The results of the acquired properties' operations have been included in the consolidated financial statements since their dates of acquisition.

The following table summarizes the estimated fair value of the assets acquired as well as the liabilities assumed for the IPOA properties as of the date of the acquisition.

| | |
|---|---|
| Investment in properties: | |
| Land | $ 4,355 |
| Building | 24,239 |
| Furniture, Fixtures & Equipment | 3,527 |
| Total assets acquired | $ 32,121 |
| Long-term debt | $ 6,123 |
| Total liabilities assumed | 6,123 |
| Net assets acquired | $ 25,998 |

The investment in properties represents the estimated fair value of the hotel properties based on the purchase price. The long-term debt reflects $6,123 of assumed mortgage note payable at 7.41% per annum.

In addition to the IPOA acquisition, on September 1, 2005 the Company acquired a Sleep-Inn hotel in Omaha, Nebraska for $3.6 million through the assumption of $807 of debt and the issuance of 633,047 common operating units in Supertel Limited Partnership valued at $2,793. As the common operating units are convertible to the Company's common shares on a one for one basis, their value was based on a five business day average ending August 31, 2005 of the Company's closing common share price which amounted to $4.412 per share. Immediately following the issuance of the 633,047 common operating units, holders of 266,131 units submitted the units for $1,174 in cash which resulted in 366,916 of the common operating units remaining after this transaction.

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

The following unaudited pro forma financial statements of operations for the years ended December 31, 2005 and December 31, 2004 give effect to the above transactions as if they had occurred at the beginning of their respective periods.

The unaudited pro forma financial data do not purport to represent what the Company's results of operations would actually have been if the transactions had in fact occurred on the dates discussed above. They also do not project or forecast the Company's results of operations for any future date or period.

| | 2005 Pro Forma Consolidated | 2004 Pro Forma Consolidated |
|---|---|---|
| Revenues | $ 71,274 | $ 69,822 |
| Earnings from Continuing Operations | $ 2,939 | $ 1,310 |
| Net earnings | $ 2,939 | $ 1,988 |
| Net earnings per share | $ 0.24 | $ 0.16 |

The pro forma statement of operations reflects the acquisition of seven hotels. The information presented represents the activity for these acquired properties from and including January 1, for the years presented to, but not including, the date of our acquisition. The pro forma statement reflects the following adjustments:

- Hotel operating expenses reflect the cost reductions resulting from reduced management fees, insurance expense and the elimination of an excess administrative position, offset by an increase in franchise fees.
- Depreciation expense is adjusted for acquired depreciable basis.
- Interest expense includes the additional interest and amortization of deferred financing costs related to the additional debt entered into and assumed on acquisition.

### Note 3. Investments in Hotel Properties

Investments in hotel properties consisted of the following at December 31:

| | 2005 | 2004 |
|---|---|---|
| Land | $ 21,514 | $ 16,759 |
| Buildings and improvements | 147,082 | 117,402 |
| Furniture and equipment | 35,534 | 29,661 |
| Construction-in-progress | 1,039 | 69 |
| | 205,169 | 163,891 |
| Less accumulated depreciation | 55,399 | 49,346 |
| | $ 149,770 | $ 114,545 |

### Note 4. Net Gains (Losses) on Sales of Properties, Impairment Losses and Discontinued Operations

In accordance with SFAS 144, gains, losses and impairment losses on hotel properties sold or classified as held for sale on or after January 1, 2002 are presented in discontinued operations. Gains (losses) on sales of hotel properties and impairment losses on hotel properties are summarized as follows:

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

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Continuing Operations | | | |
| Sales of Properties | $ — | $ — | $ — |
| Impairment Losses | — | — | — |
| Income Taxes | — | — | (525) |
| Loss on sale of assets | (2) | (12) | (18) |
| | (2) | (12) | (543) |
| Discontinued Operations | — | — | — |
| Sales of Properties | — | 1,031 | 2,383 |
| Impairment Losses | — | — | (2,069) |
| Income Taxes | — | (286) | 647 |
| | — | 745 | 961 |
| Total | $ (2) | $ 733 | $ 418 |

In 2005, the Company did not sell any hotels. In 2004, the Company recognized net gains on the disposition of assets of approximately $733, due primarily to net gains on the sale of five hotels ($745, net of built-in gain taxes of $286). In 2003, the Company recognized net gains on the disposition of assets of approximately $418, due primarily to net gains on the sale of seven of the hotels classified for sale ($961, net of built-in gain taxes of $178,) and a provision for built-in gain taxes which was reduced by $300 based on a tax planning strategy implemented in 2003 that resulted in a change in the allocation of hotel sales proceeds between the Company to the TRS Lessee.

In 2005 and 2004, no impairment charges were recorded. In 2003, the Company recorded impairment charges on three of the hotels classified for sale for $1,152 and two additional hotels which did not meet the Company's criteria for classification as held for sale at December 31, 2003 for $917, which were later sold during 2004.

The operating results of hotel properties included in discontinued operations are summarized as follows:

| | 2004 | 2003 |
|---|---|---|
| Revenues | $ 635 | $ 4,499 |
| Hotel and property operations expenses | (636) | (3,788) |
| Interest expense | (24) | (542) |
| Depreciation and amortization expense | (75) | (461) |
| Net gain on dispositions of assets | 745 | 3,030 |
| Provision for impairment loss | — | (2,069) |
| Income tax benefit | 33 | 59 |
| | $ 678 | $ 728 |

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

## Note 5. Long-Term Debt

Long-term debt consisted of the following notes and mortgages payable at December 31:

| | 2005 | 2004 |
|---|---|---|
| Mortgage loan payable to Regions Bank, N.A., evidenced by a promissory note dated August 5, 1998, in the amount of $3 million. The note bears interest during a five-year period beginning August 2003 at 4.875% per annum and thereafter during the remaining term at a rate equal to 250 basis points over the index rate as defined in the promissory note. The interest rate will be adjusted every fifth anniversary. Monthly principal and interest payments are payable through maturity on August 5, 2018, at which point the remaining principal and accrued interest are due. | $ 2,334 | $ 2,465 |
| Mortgage loan payable to Susquehanna Bank, evidenced by a promissory note dated February 8, 1999, in the amount of approximately $5 million. The note bears interest at 7.75% per annum. Monthly principal and interest payments are payable through maturity on February 8, 2009, at which point the remaining principal and accrued interest are due. | $ 4,506 | $ 4,607 |
| Mortgage loan payable to Greenwich Capital Financial Products, Inc. (“Greenwich”), evidenced by a promissory note dated November 26, 2002, in the amount of $40 million. The note bears interest at 7.50% per annum. Monthly principal and interest payments are payable through maturity on December 1, 2012, at which point the remaining principal and accrued interest are due. | $ 37,238 | $ 38,232 |
| Mortgage loan payable to First National Bank of Omaha evidenced by a promissory note in the amount of $15 million dated October 20, 1999. The note bears interest at 8.4% per annum. Monthly principal and interest payments are payable through maturity on November 1, 2009, at which point the remaining principal and accrued interest are due. | $ 11,283 | $ 11,859 |
| Term loan credit facility from U.S. Bank National Association (“U.S. Bank”) evidenced by a promissory note in the amount of $13 million dated October 20, 1999. The note bore interest at 8.31% per annum for the first three years and at LIBOR plus 2.25% in the fourth and fifth years, determined by U.S. Bank at the beginning of each respective year. The interest rate at December 31, 2004 was 4.67%. Monthly principal and interest payments were payable through maturity on January 15, 2005, at which point the remaining principal and accrued interest were due. This loan was repaid on January 13, 2005 with the proceeds from a revolving credit facility obtained from Great Western Bank. | — | $ 6,225 |
| Revolving credit facility from U.S. Bank evidenced by a promissory note dated October 20, 1999 for up to $10 million bearing interest at the U.S. Bank National Association Prime Rate (5.00%) at December 31, 2004, payable monthly with the outstanding principal and accrued interest payable in full on December 31, 2005. This note was repaid on January 13, 2005 with the proceeds from a revolving credit facility obtained from Great Western Bank. | — | $ 4,520 |
| Mortgage loans payable to First Citizens National Bank evidenced by promissory notes totaling approximately $1 million. The loan obligations were assumed on October 19, 2000 in conjunction with the acquisition of hotel assets. The sole remaining note bears interest at 6.92% per annum. Principal and interest payments are due in monthly installments, with the note maturing on July 20, 2012. | $ 457 | $ 493 |
| Mortgage loan payable to Security State Bank evidenced by a promissory note in the amount of approximately $0.2 million. The loan obligation was assumed on October 20, 2000 in conjunction with the acquisition of hotel assets. The note bears interest at 8.5% per annum. Principal and interest payments were due in monthly installments with the outstanding principal and interest payable in full on November 1, 2005. Effective October 31, 2005 an extension agreement was signed to extend the remaining balance to January 1, 2006. This note was paid in full December 30, 2005 with funds from our revolving credit facility from Great Western Bank. | — | $ 153 |

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

| | | |
|---|---|---|
| Mortgage loans payable to Small Business Administration evidenced by promissory notes in the aggregate amounts of approximately $0.9 million. The loan obligations were assumed on October 23, 2000, October 19, 2000 and October 20, 2000, respectively, in conjunction with the acquisition of hotel assets. The notes bear interest at 8.12%, 8.95%, and 6.71% per annum, respectively. Principal and interest payments are due in monthly installments to January 1, 2017, December 11, 2011 and May 1, 2013, respectively. Two notes were paid off with the remaining maturity of May 1, 2013. | $ 169 | $ 185 |
| Loan payable to Village Bank formerly known as Southern Community Bank & Trust evidenced by a promissory note in the amount of $2.7 million dated November 1, 2004. A letter of credit dated November 1, 2004 in the amount of $0.2 million with Great Western Bank is funished as additional collateral. The note bears interest at an initial interest rate of 6.50%, which will remain in effect for the first 36 months, then adjusted to the three year Treasury Rate plus 3.75% every 36 months over the remaining life of the loan. The loan will have a floor of 6.50% and a ceiling of 11.00%. Principal and interest payments are due in monthly installments to November 1, 2024. | $ 2,611 | $ 2,679 |
| Revolving credit facility from Great Western Bank evidenced by a promissory note dated January 13, 2005 for up to $22 million (with a step-down to $20 million as of February 1, 2006) bearing interest at the daily prime rate. Principal is due on January 13, 2007 and interest is payable monthly. On February 17, 2006, the Company entered into a First Amendment to Loan Agreement with Great Western Bank which extends (a) the maturity date of the Loan Agreement dated January 13, 2005 between the parties from January 13, 2007 to January 13, 2008 and (b) the date on which the loan limit of the Loan Agreement is reduced from $22 million to $20 million from February 1, 2006 to February 13, 2007. | $ 7,664 | — |
| Revolving credit facility from Wells Fargo evidenced by a promissory note dated December 1, 2005 with a maturity of December 1, 2007, bearing a variable interest rate 0.125 below the lenders Prime Rate. As of December 31, 2005 the rate charged was 7.125% per annum, payable monthly. | $ 1,978 | — |
| Mortgage loan payable to Citigroup Global Markets Realty Corp., evidenced by a promissory note dated November 7, 2005, in the amount of $14.8 million. The note bears interest at 5.97% per annum. Principal and interest payments are due in monthly installments with the outstanding principal and interest payable in full on November 11, 2015. | $ 14,809 | — |
| Mortgage loan payable to GE Capital Franchise Finance Corporation ("GE"), evidenced by a promissory note dated May 30, 2002 with an original principal amount of $6.8 million, assumed as of November 30, 2005 with a remaining principal amount of $6.1 million. The note bears interest at a variable rate of one-month LIBOR plus 3.32%, reset monthly, the rate as of December 31, 2005 was 7.61%. Principal and interest payments are due in monthly installments with the outstanding principal and interest payable in full on June 1, 2012. | $ 6,114 | — |
| Loan payable to Independent Property Operators of America, LLC ("IPOA"), evidenced by a promissory note dated November 30, 2005 in the amount of $3 million due in full at the maturity date of November 30, 2006. The note does not bear interest. Therefore, an imputed interest rate was assessed of 5.97%, providing an original discount amount of $169. | $ 2,845 | — |
| | $ 92,008 | $ 71,418 |

The long-term debt is secured by 75, 69 and 69 of the Company's hotel properties, for the years ended 2005, 2004 and 2003, respectively. In addition, the Company's chairman and another director guaranteed, jointly and severally with the Company, the payment of interest and principal on $5 million of certain of the Company's outstanding long-term debt with US Bank. As of December 31, 2003, the Company had indemnified these individuals should the respective lenders call on these guarantees. Effective January 13, 2005 in conjunction with the repayment in full of the US Bank debt, the personal guarantees were terminated. The Company's debt agreements contain requirements as to the maintenance of minimum levels of debt service coverage and loan-to-value ratios and net worth, and place certain restrictions on distributions.

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

The Company files quarterly loan compliance certificates with certain of its lenders. The Company requested and received under its term loan and revolving credit facility with US Bank, a waiver, which was effective from December 31, 2002 until the Company terminated the facility in January 2005, which permitted it to maintain a higher income to debt ratio than permitted under the loan covenants.

As of September 30, 2004 the Company requested and received a loan to value and a debt service ratio waiver with respect to a term loan with First National Bank of Omaha N.A. Ten of its hotels secure the $12 million term loan. The Company had a loan to value ratio of 63% and a debt service ratio of 1.46:1 as compared to the covenant requirements of the term loan of 60% and 1.5:1. The bank has agreed that through and including June 30, 2006, the loan to value ratio will be determined using a capitalization rate of 11% for valuing the hotels (versus an original rate of 12%) and the debt service coverage ratio will be 1.35:1.

Aggregate annual principal payments and payments to bond sinking funds for the next five years and thereafter are as follows:

| | |
|---|---|
| 2006 | $ 5,373 |
| 2007 | 12,366 |
| 2008 | 2,923 |
| 2009 | 15,609 |
| 2010 | 2,387 |
| Thereafter | 53,350 |
| | $ 92,008 |

On January 13, 2005, the Company completed a $22,000 revolving credit facility with Great Western Bank. The borrowings from the new credit facility were used to pay the maturing US Bank term note and the US Bank revolving credit facility with balances of $6,225 and $4,520 respectively, as of December 31, 2004. The remainder of the maturities in 2005 consisted of principal amortization on other mortgage loans.

At December 31, 2005, 2004 and 2003 , the estimated fair values of long-term debt were approximately $95,800, 76,500 and $77,600, respectively. The fair values were estimated by discounting future cash payments to be made at rates that approximate rates currently offered for loans with similar maturities.

Interest expense on debt that is to be assumed by the buyer and interest expense on debt that is required to be repaid as a result of a disposal transaction is allocated to discontinued operations.

**Note 6. Income Taxes**

The RMA was included in the Tax Relief Extension Act of 1999, which was enacted into law on December 17, 1999. The RMA includes numerous amendments to the provisions governing the qualification and taxation of REITs, and these amendments were effective January 1, 2001. One of the principal provisions included in the Act provides for the creation of TRS. TRS are corporations that are permitted to engage in nonqualifying REIT activities. A REIT is permitted to own up to 100% of the voting stock in a TRS. Previously, a REIT could not own more than 10% of the voting stock of a corporation conducting nonqualifying activities. Relying on this legislation, in November 2001, the Company formed the TRS Lessee.

As a REIT, the Company generally will not be subject to corporate level Federal income tax on taxable income it distributes currently to stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to Federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, it may be subject to certain state and local taxes on its income and property and to Federal income and excise taxes on its undistributed taxable income. In addition, taxable income of a TRS is subject to Federal, state and local income taxes.

In connection with the Company's election to be taxed as a REIT, it has also elected to be subject to the "built-in gain" rules on the assets formerly held by the old Supertel. Under these rules, taxes will be payable at the time and to the extent that the net unrealized gains on assets at the date of conversion to REIT status are recognized in taxable dispositions of such assets in the ten-year period following conversion.

At December 31, 2005, the income tax bases of the Company's assets and liabilities excluding those of TRS were approximately $120,254 and $79,273, respectively; December 31, 2004 were approximately $83,014 and $62,791, respectively.

The TRS net operating loss carryforward from December 31, 2005 as determined for Federal income tax purposes was approximately $867. The availability of such loss carryforward will begin to expire in 2023.

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

Income tax expense (benefit) for the years ended December 31, 2005, 2004 and 2003 consists of the following:

| | 2005 | | | 2004 | | | 2003 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Federal | State | Total | Federal | State | Total | Federal | State | Total |
| Current | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Deferred | (26) | (5) | (31) | (227) | (48) | (275) | (99) | (21) | (120) |
| Total | $ (26) | $ (5) | $ (31) | $ (227) | $ (48) | $ (275) | $ (99) | $ (21) | $ (120) |

The actual income tax expense of the TRS for the years ended December 31, 2005, 2004 and 2003 differs from the "expected" income tax expense (computed by applying the appropriate U.S. Federal income tax rate of 34% to earnings before income taxes) as a result of the following:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Computed "expected" income tax benefit | $ (49) | $ (237) | $ (103) |
| State income taxes, net Federal income tax benefit | (3) | (32) | (14) |
| Other | 21 | (6) | (3) |
| | $ (31) | $ (275) | $ (120) |

(Dollars in thousands, except per share data)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and the deferred tax liability at December 31, 2005, 2004 and 2003 follows:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Deferred Tax Assets: | | | |
| Expenses accrued for consolidated financial statement purposes, nondeductible for tax return purposes | $ 92 | $ 137 | $ 134 |
| Net operating losses carried forward for federal income tax purposes | 347 | 251 | 24 |
| Total deferred tax assets | 439 | 388 | 158 |
| Deferred Liabilities: | | | |
| Tax depreciation in excess of book depreciation | 853 | 833 | 878 |
| Total deferred tax liabilities | 853 | 833 | 878 |
| Net deferred tax liabilities | $ 414 | $ 445 | $ 720 |

In assessing the reliability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections of future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences. There is no valuation allowance at December 31, 2005, 2004 or 2003.

**Note 7. Commitments and Contingencies and Other Related Party Transactions**

Effective July 31, 2004, the TRS Lessee terminated its hotel management agreement with HHM, paying HHM a $500 early termination fee in addition to agreeing to reimburse HHM for certain employment-related severance costs of approximately $189.

At December 31, 2003 and 2002, accounts payable and accrued expense includes $888, and $79, respectively, due to HHM. On January 1, 2002, the TRS Lessee purchased accounts receivable aggregating approximately $781 from HHM in exchange for a note payable to HHM of the same amount, originally due April 30, 2002 and bearing interest at a rate of 4%. The note was repaid in full in July 2003.

On August 1, 2004, the TRS Lessee entered into a hotel management agreement with Royal Host Management, Inc., a publicly owned real estate investment trust. Royal Host, the parent of Royal Host Management, is an owner, franchisor and manager of limited and focused service hotel properties in the United States and Canada.

The principal provisions of the agreement are as follows:

- Royal Host Management is paid a base fee equal to 4.75% of gross hotel income on 70 hotels and 4.00% of gross hotel income on 6 hotels;
- if annual net operating income exceeds 10% of the Company's total investment in the hotels, then Royal Host receives an incentive fee of 10% of the excess net operating income up to the first $1 million, and 20% of excess net operating income above $1 million;
- the agreement runs through December 31, 2009 and is automatically extended for five years thereafter if specific net operating income levels are achieved, subject to Royal Host Management's option not to extend the agreement;
- either party may terminate the agreement if net operating income is not at least 8.5% of the Company's total investment in the hotels or if the Company undergoes a change in control (if TRS Lessee terminates the agreement for a change in control, then Royal Host Management is paid a termination fee equal to 50% of its basic management fee for the prior 12 months);
- TRS Lessee may terminate the agreement if any of the hotels fails three successive franchisor inspections if the deficiencies are within the reasonable control of Royal Host Management; and
- TRS Lessee may also terminate the agreement if tax laws change to allow a hotel REIT to self manage its properties (in which event we would pay Royal Host Management a termination fee equal to 50% of its basic management fee for the prior 12 months).

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

In January 2003, the Company obtained a $780 loan from Southern Community Bank & Trust ("Southern"). George R. Whittemore, Director of the Company, is a member of the Board of Directors of Southern. Further information about the loan from Southern is presented in Note 5.

From January 2003 until August 2004, the Company paid rents and other charges to HHM for the office space it occupied in Columbia, MD. The Company paid base rents of $62 and $71 to HHM for 2004 and 2003, respectively.

The Company assumed land lease agreements in conjunction with purchases of two hotels. One lease requires monthly payments of the greater of $2 or 5% of room revenue through November 2091. The second lease requires an annual payment of $35 through May 2025. Land lease expense totaled approximately $89, $ 86 and $83 in 2005, 2004 and 2003, respectively, and is included in property operating expense.

As of December 31, 2005, the future minimum lease payments applicable to non-cancelable land leases are as follows:

| | Total |
|---|---|
| 2006 | $ 59 |
| 2007 | 59 |
| 2008 | 59 |
| 2009 | 59 |
| 2010 | 59 |
| Thereafter | 2,447 |
| | $ 2,742 |

**Note 8. Capital Stock and Operating Partnership Units**

The Company's common stock is duly authorized, full paid and non-assessable. At December 31, 2005, members of the Board of Directors owned approximately 23% of the Company's outstanding common stock.

At December 31, 2005, 372,195 of SLP's common operating partnership units ("Common OP Units") and 195,610 of SLP's preferred operating partnership units ("Preferred OP Units") were outstanding. Each limited partner of SLP may, subject to certain limitations, require that SLP redeem all or a portion of his or her Common OP Units or Preferred OP Units, at any time after a specified period following the date he or she acquired the units, by delivering a redemption notice to SLP. When a limited partner tenders his or her Common OP Units to SLP for redemption, the Company can, in its sole discretion, choose to purchase the units for either (1) a number of shares of Company common stock equal to the number of units redeemed (subject to certain adjustments) or (2) cash in an amount equal to the market value of the number of shares of Company common stock the limited partner would have received if the Company chose to purchase the units for common stock. The Preferred OP Units are convertible by the holders into Common OP Units on a one-for-one basis or may be redeemed for cash at $10 per unit until October 2009. The Preferred OP Units receive a preferred dividend distribution of $1.10 per preferred unit annually, payable on a monthly basis and do not participate in the allocations of profits and losses of SLP. During 2005 and 2004, 4,434 and 10,479 respectively, Common OP Units were redeemed for common shares of SHI and no preferred units were redeemed for cash or converted to common stock. In addition, the Company agreed to allow the redemption of 127,439 Preferred OP Units at any time, subject to a 60-day notification period.

On January 3, 2003, James I. Humphrey, Jr., a director of the Company at that time and the sole shareholder of HHM at December 31, 2003, exercised his redemption rights and caused SHI to redeem his Common OP Units in exchange for 731,234 shares of common stock of the Company. Following the redemption, Mr. Humphrey held 5,279 Common OP Units through a company he controlled (Humphrey Associates, Inc.). These Common OP Units are also subject to redemption.

On December 30, 2005 the Company offered and sold 1,521,258 shares of 8% Series A Convertible Preferred Stock. The shares were sold for $10.00 per share and bear a liquidation preference of $10.00 per share. Underwriting and other costs of the offering totaled $1.2 million. The proceeds were used to reduce borrowings under the Company's revolving credit facility with Great Western Bank.

Dividends on the Series A Convertible Preferred stock are cumulative and are payable monthly in arrears on the last day of each month, at the annual rate of 8% of the $10.00 liquidation preference per share, equivalent to a fixed annual amount of $.80 per share. Dividends on the Series A Convertible Preferred Stock accrue regardless of whether or not the Company has earnings, whether there are funds legally available for the payment of such dividends and whether or not such dividends are declared. Unpaid dividends will accumulate and earn additional dividends at 8%, compounded monthly.

The Series A convertible preferred stock with respect to dividend rights and rights upon the Company's liquidation, dissolution or winding up, ranks senior to all classes or series of the Company's common stock, senior or on parity with all other classes or series of preferred stock and junior to all of the Company's existing and future indebtedness. Upon liquidation all preferred stock will be entitled to $10.00 per share plus accrued but unpaid dividends. The Company will not pay any distributions, or set aside any funds for the payment of distributions, on its common shares unless it has also paid (or set aside for payment) the full cumulative distributions on the preferred shares for the current and all past dividend periods. The outstanding preferred shares do not have any maturity date, and are not subject to mandatory redemption.

Each share of Series A convertible preferred stock is convertible in whole or in part, at any time at the option of the holders thereof, into common stock at a conversion price of $5.66 per share of common stock (equivalent to a conversion rate of 1.77 shares of common stock for each share of Series A convertible preferred stock) subject to certain adjustments. The Company may not optionally redeem the Series A preferred shares prior to January 1, 2009, except in limited circumstances to preserve its status as a REIT.

The conversion rights of the holders of the Series A convertible preferred stock are subject to cancellation on or after December 31, 2008 if the closing price of the Company common stock on the Nasdaq National Market exceeds $7.36 for at least 20 trading days within any period of 30 consecutive trading days. The Company will issue a conversion cancellation notice to holder of the Series A convertible preferred stock specifying the date the conversion rights will be deemed cancelled if the holder chooses to exercise this option. In the event the Company issues a conversion cancellation notice, the Series A convertible preferred stock will be redeemable on or after January 1, 2009 for cash, at the Company's option, in whole or from time to time in part, at $10.00 per share, plus accrued and unpaid dividends to the redemption date. Otherwise the Series A convertible preferred stock will be redeemable for cash, at the Company's option in whole or from time to time in part, at:

$10.80 per share on or after January 1, 2009
$10.40 per share on or after January 1, 2010; and
$10.00 per share on or after January 1, 2011,

plus accrued and unpaid dividends to the redemption date.

On December 30, 2005, the Company issued warrants to Anderson & Strudwick Incorporated, the selling agent for the Company in its public offering of the Series A Preferred Stock, to purchase 126,311 shares of Series A convertible preferred stock. The warrants will be exercisable until December 31, 2010 at $12.00 per share of Series A convertible preferred stock. The warrants may not be sold, transferred, pledged, assigned or hypothecated for a period of one year after their issuance, except to officers of the selling agent.

Supertel Hospitality, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
December 31, 2005, 2004 and 2003
(Dollars in thousands, except per share data)

**Note 9. Supplementary Data**

The following table presents our unaudited quarterly results of operations:

| | Quarters Ended | | | |
|---|---|---|---|---|
| | March 31, 2005 | June 30, 2005 | September 30, 2005 | December 31, 2005 |
| **2005** | | | | |
| Revenues | $ 12,307 | $ 16,126 | $ 17,372 | $ 14,890 |
| Expenses | 13,020 | 14,399 | 14,969 | 15,332 |
| Earnings (loss) before net gains (losses) on sales of properties, impairment losses and minority interest | (713) | 1,727 | 2,403 | (442) |
| Net gains (losses) on sales of properties | (1) | 1 | 1 | (3) |
| Impairment losses | — | — | — | — |
| Minority Interest | (53) | (55) | (73) | (45) |
| Earnings (loss) from continuing operations before income taxes | (767) | 1,673 | 2,331 | (490) |
| Income tax expense (benefit) | (376) | 239 | 372 | (266) |
| Net earnings (loss) | (391) | 1,434 | 1,959 | (224) |
| Preferred Stock dividend | — | — | — | (6) |
| Net earnings (loss) available to common shareholders | $ (391) | $ 1,434 | $ 1,959 | $ (230) |
| Net earnings (loss) per common share - basic and diluted | $ (0.03) | $ 0.12 | $ 0.16 | $ (0.02) |

## Supertel Hospitality, Inc. and Subsidiaries
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED
## December 31, 2005, 2004 and 2003
## (Dollars in thousands, except per share data)

| | Quarters Ended | | | |
|---|---|---|---|---|
| | March 31, 2004 | June 30, 2004 | September 30, 2004 | December 31, 2004 |
| **2004** | | | | |
| Revenues | $ 12,182 | $ 15,781 | $ 16,841 | $ 13,005 |
| Expenses | 13,264 | 14,298 | 15,709 | 13,253 |
| Earnings (loss) before net gains (losses) on sales of properties, impairment losses and minority interest | (1,082) | 1,483 | 1,132 | (248) |
| Net gains (losses) on sales of properties | (9) | 1 | (1) | (3) |
| Minority Interest | (51) | (57) | (55) | (53) |
| Earnings (loss) from continuing operations before income taxes | (1,142) | 1,427 | 1,076 | (304) |
| Income tax expense (benefit) | (573) | 202 | 200 | (71) |
| Earnings (loss) from continuing operations | (569) | 1,225 | 876 | (233) |
| Discontinued operations | (115) | 380 | 405 | 8 |
| Net earnings (loss) available to common shareholders | $ (684) | $ 1,605 | $ 1,281 | $ (225) |
| Net earnings (loss) per common share - basic and diluted | | | | |
| Continuing operations | $ (0.05) | $ 0.10 | $ 0.08 | $ (0.02) |
| Discontinued operations | (0.01) | 0.03 | 0.03 | 0.00 |
| Net earnings (loss) | $ (0.06) | $ 0.13 | $ 0.11 | $ (0.02) |

There were no impairment losses and no sale of properties for 2005.

There were no impairment losses recorded for 2004. The amounts of gain on sales of properties are $67 ($.01 per share), $329 ($.03 per share), $347 ($.03 per share) and $2 ($.00 per share) for quarters ended March 31, 2004, June 30, 2004, September 30, 2004 and December 31, 2004, respectively.

**Note 10. Subsequent Event**

On February 17, 2006, the Company entered into a First Amendment to Loan Agreement with Great Western Bank which extends (a) the maturity date of the Loan Agreement dated January 13, 2005 between the parties from January 13, 2007 to January 13, 2008 and (b) the date on which the loan limit of the Loan Agreement is reduced from $22 million to $20 million from February 1, 2006 to February 13, 2007.

On January 13, 2006, the Company acquired a hotel located in Clarinda, IA, under the franchise of Super 8. The acquisition amount was $1.3 million, which was funded from our revolving credit facility with Great Western Bank.

**Supertel Hospitality, Inc. and Subsidiaries**
**SCHEDULE III – REAL ESTATE AND ACCUMULATED DEPRECIATION**
**As of December 31, 2005**

| Hotel and Location | Encum- brance | Initial Cost | | Costs Subsequent to Acquisition | | Gross Amount at December 31, 2005 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Land | Buildings & Improvements | Land | Buildings & Improvements | Land | Buildings & Improvements | Accumulated Depreciation | Net Book Value |
| **Comfort Inns:** | | | | | | | | | |
| Minocqua, Wisconsin | GWB | $ 214,505 | $ 1,458,389 | $ — | 247,109 | $ 214,505 | $ 1,705,498 | $ (631,125) | $ 1,288,878 |
| Sheboygan, Wisconsin | GWB | 286,970 | 1,716,782 | — | 297,725 | 286,970 | 2,014,507 | (737,649) | 1,563,828 |
| Chambersburg, Pennsylvania | GRW | 89,000 | 2,346,362 | — | 144,852 | 89,000 | 2,491,214 | (550,366) | 2,029,848 |
| Culpeper, Virginia | GRW | 182,264 | 2,142,652 | — | 448,283 | 182,264 | 2,590,935 | (611,708) | 2,161,491 |
| Dahlgren, Virginia | VB | 327,514 | 2,489,390 | — | 173,115 | 327,514 | 2,662,505 | (858,990) | 2,131,029 |
| Dublin, Virginia | VB | 152,239 | 3,700,710 | — | 573,792 | 152,239 | 4,274,502 | (1,446,118) | 2,980,623 |
| Farmville, Virginia | GRW | 253,618 | 2,162,087 | — | 435,760 | 253,618 | 2,597,847 | (783,756) | 2,067,709 |
| Gettysburg, Pennsylvania | SUS | — | 4,158,453 | — | 166,048 | — | 4,324,501 | (1,008,985) | 3,315,516 |
| Morgantown, West Virginia | GRW | 398,322 | 3,853,651 | — | 659,376 | 398,322 | 4,513,027 | (1,325,200) | 3,586,149 |
| New Castle, Pennsylvania | GRW | 56,648 | 4,101,254 | — | 457,874 | 56,648 | 4,559,128 | (1,123,157) | 3,492,619 |
| Princeton, West Virginia | GRW | 387,567 | 1,774,501 | — | 528,737 | 387,567 | 2,303,238 | (746,253) | 1,944,552 |
| Rocky Mount, Virginia | GRW | 193,841 | 2,162,429 | — | 24,110 | 193,841 | 2,186,539 | (576,159) | 1,804,221 |
| Solomons, Maryland | GRW | 2,303,990 | 2,988,255 | — | 1,699,163 | 2,303,990 | 4,687,418 | (1,696,780) | 5,294,628 |
| Fayetteville, North Carolina | CITI | 725,000 | 3,910,514 | | 780 | 725,000 | 3,911,294 | (31,638) | 4,604,656 |
| Fayetteville Car Wash, North Carolina | CITI | | 164,128 | | — | | 164,128 | (1,997) | 162,131 |
| **Super 8:** | | | | | | | | | |
| Creston, Iowa | GRW | 56,000 | 840,580 | 89,607 | 2,105,377 | 145,607 | 2,945,957 | (1,337,627) | 1,753,937 |
| Columbus, Nebraska | GWB | 51,716 | 571,178 | 51,666 | 652,811 | 103,382 | 1,223,989 | (709,862) | 617,509 |
| O'Neill, Nebraska | GRW | 75,000 | 667,074 | 46,075 | 1,031,689 | 121,075 | 1,698,763 | (816,533) | 1,003,305 |
| Omaha, Nebraska | FNB | 164,034 | 1,053,620 | — | 1,122,026 | 164,034 | 2,175,646 | (1,374,825) | 964,855 |
| Lincoln, Nebraska (West "O") | GWB | 139,603 | 1,234,988 | 63,153 | 835,373 | 202,756 | 2,070,361 | (1,134,721) | 1,138,396 |
| Lincoln, Nebraska (Cornhusker) | GWB | 226,174 | 1,068,520 | 271,817 | 1,709,438 | 497,991 | 2,777,958 | (1,377,604) | 1,898,345 |
| Keokuk, Iowa | GRW | 55,000 | 642,783 | 71,175 | 574,694 | 126,175 | 1,217,477 | (682,447) | 661,205 |
| Iowa City, Iowa | GRW | 227,290 | 1,280,365 | — | 437,447 | 227,290 | 1,717,812 | (1,036,213) | 908,889 |
| Omaha, Nebraska (Ak-sar-ben) | GWB | 203,453 | 1,054,497 | — | 184,643 | 203,453 | 1,239,140 | (742,351) | 700,242 |

**Supertel Hospitality, Inc. and Subsidiaries**
**SCHEDULE III – REAL ESTATE AND ACCUMULATED DEPRECIATION - CONTINUED**
**As of December 31, 2005**

| | | Initial Cost | | Costs Subsequent to Acquisition | | Gross Amount at December 31, 2005 | | | |
|---|---|---|---|---|---|---|---|---|---|
| Hotel and Location | Encum-brance | Land | Buildings & Improvements | Land | Buildings & Improvements | Land | Buildings & Improvements | Accumulated Depreciation | Net Book Value |
| Kirksville, Missouri | GWB | 151,225 | 830,457 | — | 209,410 | 151,225 | 1,039,867 | (618,585) | 572,507 |
| Burlington, Iowa | GRW | 145,000 | 867,116 | — | 266,662 | 145,000 | 1,133,778 | (645,729) | 633,049 |
| Sedalia, Missouri | GWB | 185,025 | 917,809 | — | 572,640 | 185,025 | 1,490,449 | (784,367) | 891,107 |
| Hays, Kansas | FNB | 317,762 | 1,133,765 | 19,519 | 249,338 | 337,281 | 1,383,103 | (843,265) | 877,119 |
| Moberly, Missouri | GWB | 60,000 | 1,075,235 | — | 268,994 | 60,000 | 1,344,229 | (771,701) | 632,528 |
| Pittsburg, Kansas | GRW | 130,000 | 852,131 | — | 199,147 | 130,000 | 1,051,278 | (602,922) | 578,356 |
| Manhattan, Kansas | FNB | 261,646 | 1,254,175 | (10,000) | 355,834 | 251,646 | 1,610,009 | (871,557) | 990,098 |
| Clinton, Iowa | GRW | 135,153 | 805,067 | (46,089) | 221,228 | 89,064 | 1,026,295 | (607,351) | 508,008 |
| Mt. Pleasant, Iowa | GRW | 85,745 | 536,064 | 21,507 | 458,587 | 107,252 | 994,651 | (544,779) | 557,124 |
| Wichita, Kansas | FNB | 435,087 | 1,806,979 | — | 594,296 | 435,087 | 2,401,275 | (1,292,314) | 1,544,048 |
| Kingdom City, Missouri | FNB | 176,970 | 877,287 | — | 163,803 | 176,970 | 1,041,090 | (580,684) | 637,376 |
| Lenexa, Kansas | GWB | 454,113 | 1,722,866 | — | 366,530 | 454,113 | 2,089,396 | (1,150,001) | 1,393,508 |
| Pella, Iowa | GRW | 61,853 | 664,610 | — | 126,037 | 61,853 | 790,647 | (428,227) | 424,273 |
| Storm Lake, Iowa | GRW | 90,033 | 819,202 | 33,394 | 468,994 | 123,427 | 1,288,196 | (586,976) | 824,647 |
| West Plains, Missouri | GWB | 112,279 | 861,178 | — | 133,430 | 112,279 | 994,608 | (502,088) | 604,799 |
| Jefferson City, Missouri | GWB | 264,707 | 1,206,886 | — | 268,703 | 264,707 | 1,475,589 | (760,452) | 979,844 |
| El Dorado, Kansas | FNB | 96,764 | 418,333 | 467 | 511,189 | 97,231 | 929,522 | (443,420) | 583,333 |
| Wayne, Nebraska | FNB | 79,127 | 685,135 | — | 119,432 | 79,127 | 804,567 | (381,484) | 502,210 |
| Batesville, Arkansas | GWB | 81,483 | 811,371 | — | 118,687 | 81,483 | 930,058 | (409,499) | 602,042 |
| Fayetteville, Arkansas | GWB | 255,731 | 1,549,271 | — | 143,926 | 255,731 | 1,693,197 | (761,818) | 1,187,110 |
| Omaha, Nebraska (West Dodge) | GWB | 593,518 | 1,758,275 | — | 167,891 | 593,518 | 1,926,166 | (831,334) | 1,688,350 |
| Watertown, South Dakota | FNB | 51,237 | 1,296,312 | — | 472,633 | 51,237 | 1,768,945 | (679,750) | 1,140,432 |
| Norfolk, Nebraska | GRW | 226,971 | 1,587,581 | — | 407,141 | 226,971 | 1,994,722 | (719,731) | 1,501,962 |
| Park City, Kansas | FNB | 275,962 | 891,933 | — | 442,270 | 275,962 | 1,334,203 | (571,998) | 1,038,167 |

**Supertel Hospitality, Inc. and Subsidiaries**
**SCHEDULE III – REAL ESTATE AND ACCUMULATED DEPRECIATION - CONTINUED**
**As of December 31, 2005**

| | | Initial Cost | | Costs Subsequent to Acquisition | | Gross Amount at December 31, 2005 | | | |
|---|---|---|---|---|---|---|---|---|---|
| Hotel and Location | Encum-brance | Land | Buildings & Improvements | Land | Buildings & Improvements | Land | Buildings & Improvements | Accumulated Depreciation | Net Book Value |
| Muscatine, Iowa | GWB | 204,890 | 1,616,090 | — | 220,991 | 204,890 | 1,837,081 | (677,690) | 1,364,281 |
| Fort Madison, Iowa | GWB | 104,855 | 871,075 | — | 153,475 | 104,855 | 1,024,550 | (392,605) | 736,800 |
| Parsons, Kansas | FNB | 167,849 | 1,195,484 | — | 155,415 | 167,849 | 1,350,899 | (445,030) | 1,073,718 |
| Portage, Wisconsin | GRW | 203,032 | 1,839,321 | — | 214,390 | 203,032 | 2,053,711 | (657,458) | 1,599,285 |
| Antigo, Wisconsin | GWB | 234,605 | 1,485,579 | — | 191,798 | 234,605 | 1,677,377 | (602,923) | 1,309,059 |
| Shawano, Wisconsin | GRW | 244,935 | 1,672,123 | — | 186,684 | 244,935 | 1,858,807 | (645,666) | 1,458,076 |
| Tomah, Wisconsin | GWB | 211,975 | 2,079,714 | (59,834) | 293,353 | 152,141 | 2,373,067 | (756,680) | 1,768,528 |
| Menomonie, Wisconsin | GRW | 451,520 | 2,398,446 | — | 205,458 | 451,520 | 2,603,904 | (724,654) | 2,330,770 |
| Neosho, Missouri | NON | 232,000 | 1,416,216 | — | 127,484 | 232,000 | 1,543,700 | (459,722) | 1,315,978 |
| Anamosa, Iowa | SBA | 49,981 | 1,150,688 | — | 110,847 | 49,981 | 1,261,535 | (300,802) | 1,010,714 |
| Charles City, Iowa | FCNB | 95,363 | 1,543,872 | — | 89,335 | 95,363 | 1,633,207 | (432,714) | 1,295,856 |
| **Sleep Inn** | | | | | | | | | |
| Omaha, Nebraska | WF | 400,000 | 3,275,773 | | 10,383 | 400,000 | 3,286,157 | (45,192) | 3,640,965 |
| **Holiday Inn Express** | | | | | | | | | |
| Danville, Kentucky | GRW | 155,717 | 2,971,403 | — | 341,987 | 155,717 | 3,313,390 | (847,258) | 2,621,849 |
| Gettysburg, Pennsylvania | SUS | 59,634 | 1,832,171 | — | 176,913 | 59,634 | 2,009,084 | (529,733) | 1,538,985 |
| Harlan, Kentucky | GRW | — | 2,949,276 | — | 599,736 | — | 3,549,012 | (884,242) | 2,664,770 |
| **Hampton Inn** | | | | | | | | | |
| Cleveland, Tennessee | GRW | 212,914 | 2,370,499 | — | 838,596 | 212,914 | 3,209,095 | (646,748) | 2,775,261 |
| Jackson, Tennessee | GRW | 261,506 | 3,430,541 | — | 415,996 | 261,506 | 3,846,537 | (1,464,137) | 2,643,906 |
| Shelby, North Carolina | GRW | 253,921 | 2,782,042 | — | 854,629 | 253,921 | 3,636,671 | (854,353) | 3,036,239 |
| Brandon, Florida | REG | 322,203 | 3,150,779 | — | 428,915 | 322,203 | 3,579,694 | (769,060) | 3,132,837 |
| **Comfort Suites** | | | | | | | | | |
| Dover, Delaware | GRW | 337,113 | 5,179,187 | — | (39,503) | 337,113 | 5,139,684 | (1,337,472) | 4,139,325 |
| Ft. Wayne, Indiana | CITI | 1,200,000 | 4,803,605 | | 16,000 | 1,200,000 | 4,819,605 | (45,452) | 5,974,153 |
| Lafayette, Indiana | CITI | 850,000 | 3,473,808 | | — | 850,000 | 3,473,808 | (27,051) | 4,296,757 |
| Marion, Indiana | CITI | 430,000 | 1,945,383 | | 528 | 430,000 | 1,945,911 | (20,693) | 2,355,218 |
| South Bend, Indiana | GE | 500,000 | 11,512,314 | | — | 500,000 | 11,512,314 | (37,435) | 11,974,879 |
| Warsaw, Indiana | CITI | 650,000 | 2,500,570 | | 32,443 | 650,000 | 2,533,013 | (22,030) | 3,160,983 |

**Supertel Hospitality, Inc. and Subsidiaries**
**SCHEDULE III – REAL ESTATE AND ACCUMULATED DEPRECIATION - CONTINUED**
**As of December 31, 2005**

| Hotel and Location | Encum-brance | Initial Cost | | Costs Subsequent to Acquisition | | Gross Amount at December 31, 2005 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Land | Buildings & Improvements | Land | Buildings & Improvements | Land | Buildings & Improvements | Accumulated Depreciation | Net Book Value |
| **Suites at Key Largo** | | | | | | | | | |
| Key Largo, Florida | GRW | 339,425 | 3,238,530 | — | 415,340 | 339,425 | 3,653,870 | (957,819) | 3,035,476 |
| **Ramada** | | | | | | | | | |
| Ellenton, Florida | GRW | 546,945 | 2,293,464 | — | 706,979 | 546,945 | 3,000,443 | (1,010,281) | 2,537,107 |
| | | | | | — | | | | — |
| **Shoney's Inn** | | | | | — | | | | — |
| Ellenton, Florida | GRW | 290,373 | 2,102,371 | — | 175,286 | 290,373 | 2,277,657 | (454,423) | 2,113,607 |
| | | | | | — | | | | |
| **Days Inn** | | | | | — | | | | |
| Farmville, Virginia | GRW | 384,591 | 1,967,727 | — | 169,210 | 384,591 | 2,136,937 | (568,494) | 1,953,034 |
| Subtotal Hotel Properties | | 20,892,486 | 151,820,252 | 552,457 | 28,909,692 | 21,444,943 | 180,729,944 | (54,349,913) | 147,824,974 |
| Construction in Progress | | — | — | — | 1,039,392 | — | 1,039,392 | — | 1,039,392 |
| Office building | | 68,765 | 1,516,627 | — | 369,779 | 68,765 | 1,886,406 | (1,049,471) | 905,700 |
| Total | | $ 20,961,251 | $ 153,336,879 | $ 552,457 | $ 30,318,863 | $ 21,513,708 | $ 183,655,742 | $ (55,399,384) | $ 149,770,066 |

Encumbrance codes refer to the following lenders:

GRW = Greenwich Capital Loan
REG = Regions Bank (FL)
GWB = Great Western Bank
VB = Village Bank
NON = Unencumbered
GE = GE Capital Franchise Finance

FNB = First National Bank of Omaha
SUS = Susquehanna Bank
FCNB = First Citizens National Bank
SBA = Small Business Administration
CITI = Citigroup Global Markets Realty
WF = Wells Fargo Bank

## Supertel Hospitality, Inc. and Subsidiaries
## NOTES TO SCHEDULE III – REAL ESTATE AND ACCUMULATED DEPRECIATION
## AS OF DECEMBER 31, 2005

| ASSET BASIS | Total |
|---|---|
| (a) **Balance at December 31, 2002** | $ 183,150,383 |
| Additions to buildings and improvements | 4,642,142 |
| Disposition of buildings and improvements | (16,934,007) |
| Impairment loss | (2,069,000) |
| **Balance at December 31, 2003** | $ 168,789,518 |
| Additions to buildings and improvements | 3,917,677 |
| Disposition of buildings and improvements | (8,816,590) |
| Impairment loss | — |
| **Balance at December 31, 2004** | $ 163,890,605 |
| Additions to buildings and improvements | 42,083,569 |
| Disposition of buildings and improvements | (804,724) |
| Impairment loss | — |
| **Balance at December 31, 2005** | $ 205,169,450 |

| ACCUMULATED DEPRECIATION | Total |
|---|---|
| (b) **Balance at December 31, 2002** | $ 47,471,171 |
| Depreciation for the period ended December 31, 2003 | 6,896,100 |
| Depreciation on assets sold or disposed | (5,772,325) |
| **Balance at December 31, 2003** | $ 48,594,946 |
| Depreciation for the period ended December 31, 2004 | 6,487,831 |
| Depreciation on assets sold or disposed | (5,737,195) |
| **Balance at December 31, 2004** | $ 49,345,582 |
| Depreciation for the period ended December 31, 2005 | 6,850,711 |
| Depreciation on assets sold or disposed | (796,909) |
| **Balance at December 31, 2005** | $ 55,399,384 |

(c) The aggregate cost of land, buildings, furniture and equipment for the Company's hotels for Federal income tax purposes is approximately $204 million.

(d) Depreciation is computed based upon the following useful lives:

| | |
|---|---|
| Buildings and improvements | 20 - 40 years |
| Furniture and equipment | 5 - 12 years |

(e) The Company has mortgages payable on the properties as noted. Additional mortgage information can be found in note 5 to the consolidated financial statements.

### Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

### Item 9A. Controls and Procedures

Evaluation was performed under the supervision of management, with the participation of our Chief Executive Officer and Chief Financial Officer, as of December 31, 2005 of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15 of the rules promulgated under the Securities and Exchange Act of 1934, as amended. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures provide reasonable assurance that such disclosure controls and procedures are effective in timely providing them with material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic Securities and

Exchange Commission filings. No changes in the Company's internal control over financial reporting occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

The unaudited pro forma financial statement of operations for the year ended December 31, 2005 which gives effect to our acquisitions in November 2005 of 6 hotels from Independent Property Operators of America, LLC as if it had occurred as of January 1, 2005 is attached hereto as Exhibit 99.1.

## PART III

**Item 10. Directors and Executive Officers of the Registrant**

Information concerning the directors and executive officers of the Company is incorporated by reference to the Company's Proxy Statement for the 2006 Annual Meeting of Stockholders (the "2006 Proxy Statement") under the captions "Election of Directors," "Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance."

The Board of Directors has determined that Patrick J. Jung is an "audit committee financial expert" as that term is defined in the rules promulgated by the Securities and Exchange Commission pursuant to the Sarbanes-Oxley Act of 2002, and additionally, has determined that Mr. Jung is independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

The Company has adopted a Code of Business Conduct and Ethics that applies to the Company's Chief Executive Officer and Chief Financial Officer and has posted the Code of Business Conduct and Ethics on its Web site. The Company intends to satisfy the disclosure requirement under Item 10 of Form 8-K relating to amendments to or waivers from any provision of the Code of Business Conduct and Ethics applicable to the Company's Chief Executive Officer and Chief Financial Officer by posting that information on the Company's Web site at www.supertelinc.com.

**Item 11. Executive Compensation**

Information regarding executive and director compensation is incorporated by reference to the 2006 Proxy Statement under the captions "Executive Officer Compensation," "Director Compensation" and "Compensation Committee Report." Information regarding the Company's stock performance is incorporated by reference to the 2006 Proxy Statement under the caption "Performance Graph."

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information regarding the stock ownership of each person known to the Company to be the beneficial owner of more than 5% of the Common Stock, of each director and executive officer of Supertel Hospitality, Inc., and all directors and executive officers as a group, is incorporated by reference to the 2006 Proxy Statement under the caption "Ownership of the Company's Common Stock By Management and Certain Beneficial Owners." No securities of the Company are authorized for issuance under equity compensation plans at December 31, 2005.

**Item 13. Certain Relationships and Related Transactions**

Information regarding certain relationships and related transactions is incorporated by reference to the 2006 Proxy Statement under the caption "Certain Relationships and Related Transactions."

**Item 14. Principal Accountant Fees and Services**

The information required by this item is incorporated by reference to the material in the 2006 Proxy Statement under the caption "Principal Accountant Fees and Services" and "Pre-approval Policies."

## PART IV

### Item 15. Exhibits and Financial Statement Schedules

(a) *Financial Statements and Schedules.*



(b) *Exhibits.*

3.1* Second Amended and Restated Articles of Incorporation of the Company, as amended.

3.2 Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004)

10.1* Third Amended and Restated Agreement of Limited Partnership of Supertel Limited Partnership, as amended.

10.2 Form of Master Lease Agreement made as of January 1, 2002 by and between Supertel Limited Partnership, E&P Financing Limited Partnership, Solomons Beacon Inn Limited Partnership and TRS Leasing, Inc. (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001).

10.3 Loan Agreement dated as of November 26, 2002 by and among Solomons Beacon Inn Limited Partnership, TRS Subsidiary, LLC and Greenwich Capital Financial Products, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.4 Promissory Note between Solomons Beacon Inn Limited Partnership, TRS Subsidiary, LLC and Greenwich Capital Financial Products, Inc. dated as of November 26, 2002 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.5 Guaranty of Recourse Obligations made by the Company in favor of Greenwich Capital Financial Products, Inc., dated as of November 26, 2002 (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.6 Pledge and Security Agreement by the Company, Supertel Limited Partnership, TRS Leasing, Inc. and Solomons GP, LLC, for the benefit of Greenwich Capital Financial Products, Inc. dated as of November 26, 2002 (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.7 Master Lease Agreement dated as of November 26, 2002, between Solomons Beacon Inn Limited Partnership and TRS Subsidiary, LLC (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.8 First Amended and Restated Master Lease Agreement dated as of November 26, 2002 between Supertel Limited Partnership, E&P Financing Limited Partnership, TRS Leasing, Inc. and Solomons Beacon Inn Limited Partnership (incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K dated November 26, 2002).

10.9 Form of Preferred Stock Warrant (incorporated by reference to Exhibit 4.6 to the Company's Amendment to Registration Statement on Form S-1/A (333-129376) filed on December 23, 2005).

10.10 Hotel Management Agreement, dated as of August 1, 2004 between TRS Leasing, Inc., TRS Subsidiary, LLC and Royal Host Management, Inc. (incorporated by reference to Exhibit 10.35 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).

10.11 Loan Agreement dated January 13, 2005 by and between the Company and Great Western Bank (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated January 13, 2005).

10.12 Employment Agreement dated as of September 1, 2005 by and between the Company and Paul Schulte (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated August 25, 2005).

10.13 Employment Agreement dated as of September 1, 2005 by and between the Company and Don Heimes (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated August 25, 2005).

21.0* Subsidiaries.

23.1* Consent of KPMG LLP.

31.1* Section 302 Certification of Chief Executive Officer.

31.2* Section 302 Certification of Chief Financial Officer.

32.1* Section 906 Certifications.

99.1* Unaudited Pro Forma Consolidated Financial Data

Pursuant to Item 601 (b)(4) of Regulation S-K, certain instruments with respect to the Company's long-term debt are not filed with this Form 10-K. The Company will furnish a copy of any such long-term debt agreement to the Securities and Exchange Commission upon request.

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* 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.

SUPERTEL HOSPITALITY, INC.

By: /s/ Paul J. Schulte

March 30, 2006

Paul J. Schulte
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated and on the date indicated above.

| | |
|---|---|
| By: /s/ Paul J. Schulte<br>Paul J. Schulte<br>President and Chief Executive Officer<br>(principal executive officer) | By: /s/ Joseph Caggiano<br>Joseph Caggiano<br>Director |
| By: /s/ Donavon A. Heimes<br>Donavon A. Heimes<br>Chief Financial Officer, Treasurer and Corporate Secretary (principal financial and accounting officer) | By: /s/ Jeffrey M. Zwerdling<br>Jeffrey M. Zwerdling<br>Director |
| By: /s/ Paul J. Schulte<br>Paul J. Schulte<br>Chairman of the Board | By: /s/ Allen L. Dayton<br>Allen L. Dayton<br>Director |
| By: /s/ Steve H. Borgmann<br>Steve H. Borgmann<br>Director | By: /s/ George R. Whittemore<br>George R. Whittemore<br>Director |
| By: /s/ Loren Steele<br>Loren Steele<br>Director | By: /s/ Patrick J. Jung<br>Patrick J. Jung<br>Director |

## EXHIBIT INDEX

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99.1* Unaudited Pro Forma Consolidated Financial Data

Pursuant to Item 601 (b)(4) of Regulation S-K, certain instruments with respect to the Company's long-term debt are not filed with this Form 10-K. The Company will furnish a copy of any such long-term debt agreement to the Securities and Exchange Commission upon request.

---

* Filed herewith

**Exhibit 31.1**

**CERTIFICATIONS**

I, Paul J. Schulte, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2005 of Supertel Hospitality, Inc.;

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(s) 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(s) 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.

March 30, 2006

/s/ Paul J. Schulte

Paul J. Schulte
President and Chief Executive Officer

**Exhibit 31.2**

I, Donavon A. Heimes, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2005 of Supertel Hospitality, Inc.;
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(s) 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(s) 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.

March 30, 2006

/s/ Donavon A. Heimes

Donavon A. Heimes
Chief Financial Officer, Treasurer and Secretary

## OFFICERS OF THE COMPANY

**Paul J. Schulte**
President and Chief Executive Officer

**Donavon A. Heimes**
Chief Financial Officer, Treasurer and Corporate Secretary

**Steven C. Gilbert**
Senior Vice President, CAP-EX

**David L. Walter**
Vice President, Compliance and Reporting

**Corrine L. "Connie" Scarpello**
Vice President, Accounting and Finance

## BOARD OF DIRECTORS

**Paul J. Schulte**
Chairman of the Board

**Steve H. Borgmann**
Director

**Loren Steele**
Director

**Joseph Caggiano**
Director

**Jeffrey M. Zwerdling**
Director

**Allen L. Dayton**
Director

**George R. Whittemore**
Director

**Patrick J. Jung**
Director

## CORPORATE HEADQUARTERS

309 N. 5th Street, Norfolk, NE 68701
402.371.2520

## WEBSITE

www.supertelinc.com

## CERTIFIED PUBLIC ACCOUNTANTS

KPMG LLP
Omaha, NE

## STOCK TRANSFER AGENT

American Stock Transfer & Trust Company
59 Maiden Lane, New York, NY 10038
www.amstock.com
1.866.668.6550

## ANNUAL MEETING

The annual meeting of shareholders will be held on Thursday, May 25, 2006 at 10:00 a.m., local time, at the Doubletree Hotel at 1616 Dodge Street, Omaha, Nebraska 68102.

## FORM 10-K

Additional copies of Supertel Hospitality's Form 10-K Annual Report for 2005 may be requested through the Company's website or by contacting the Investor Relations department.

## STOCK EXCHANGE LISTING

Supertel Hospitality's common stock is listed on the Nasdaq National Market system under the symbol SPPR.

## INVESTOR RELATIONS

309 N. 5th Street, Norfolk, NE 68701
402.371.2520

## MANAGEMENT COMPANY OFFICES

Royal Host Management, Inc. (RHM)
309 N. 5th Street, Norfolk, NE 68701
402.371.2520