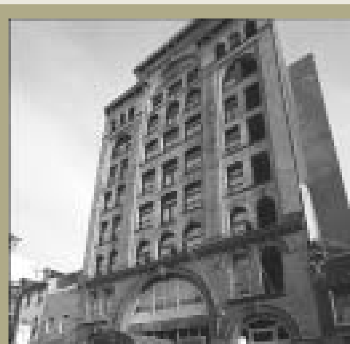
Hersha Hospitality Trust Annual Report 2001

HERSHA




Hersha Hospitality Trust (HT) is a self-advised Maryland real estate investment trust (REIT) that invests in income producing hotel real estate, particularly premium limited service, full service and extended stay hotels. Qualification as a REIT under the Internal Revenue Code enables the Company to distribute income to shareholders without federal income tax liability to the Company. Hersha trades under the symbol HT on the American Stock Exchange.

The Company's investment goals are: high current cash flow for dividend distribution to shareholders; growth in cash flow through increases in revenues of leased properties; and capital appreciation in the residual value of investment properties.

As of December 31, 2001, the Company owned 18 mid-priced hotels in New York, Pennsylvania, and metropolitan Atlanta, Georgia.

Hersha Financial Highlights

Hersha Hospitality Trust

In thousands except per share data.	Year Ended December 31, 2001	2000	1999[4]
OPERATING DATA:			
Lease Revenues	$ 13,901	$ 12,773	$ 7,264
Total Revenues	14,087	12,824	7,370
Net Income Available for Common Shareholders	834	847	1,338
Funds from Operations (FFO) [1]	7,054	6,647	5,109
Cash Available for Distributions (CAD) [2]	3,840	3,483	2,525
Distributions to Common Shareholders [3]	1,638	1,638	1,524
PER SHARE DATA:			
FFO	$ 0.97	$ 0.99	$ 0.79
CAD	1.69	1.53	1.11
Common Distributions	0.72	0.72	0.67
Common Distributions as a Percentage of CAD	43%	47%	60%
Weighted Average Common Shares Outstanding	2,275,000	2,275,000	2,275,000
BALANCE SHEET DATA (as of December 31):			
Real Estate Properties, at Cost	$ 88,100	$ 87,671	$ 51,908
Total Assets	96,017	94,531	56,382
Total Debt	61,535	61,450	27,754
Total Shareholder's Equity	10,210	11,014	11,805

(1) Funds from Operations (FFO) represents net income (loss) (computed in accordance with generally accepted accounting principals), excluding gains (or losses) from debt structuring or sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures.

(2) Cash available for distribution is net income plus depreciation and amortization, minus cash reserves for capital improvements to properties.

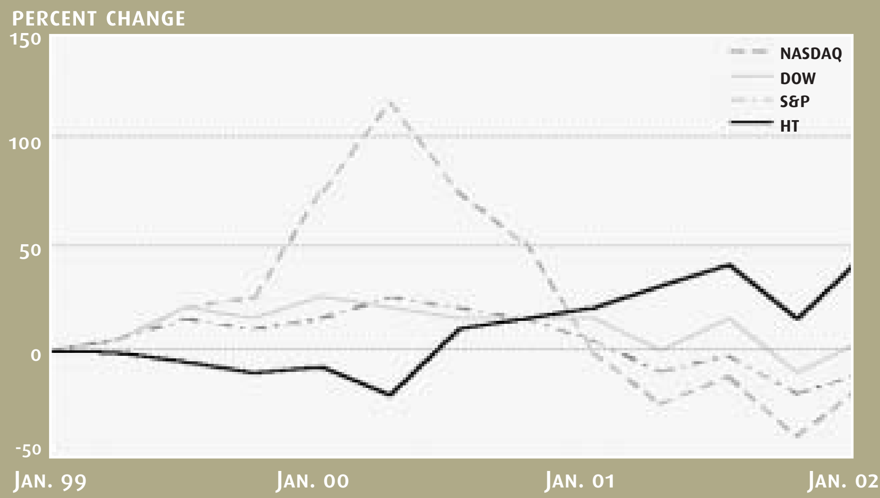
(3) Distributions presented include distributions declared with respect to the period shown for the Priority Class A common shares.

(4) Operations commenced January 26, 1999.

Hotel Operating Results[a]

In thousands except per share data.	Year Ended December 31, 2001	2000	1999	1998
Total Revenues	$ 30,755	$ 32,828	$ 25,299	$ 18,086
Net Operating Income	$ 10,970	$ 11,802	$ 8,314	$ 5,577
Average Daily Rate	$ 76.91	$ 74.60	$ 69.10	$ 68.55
Occupancy	61.70%	61.30%	57.12%	59.84%
Revenue Per Available Room	$ 47.44	$ 45.73	$ 39.47	$ 41.02

(a) Pertains to hotels owned at the end of the fiscal year.



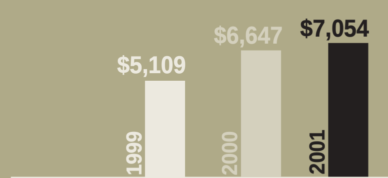
HERSHA

Hersha Versus Indices

Hersha vs. Comparable REITs

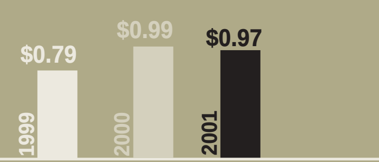
Hersha Financial Performance

Funds From Operations (FFO) ($000's)



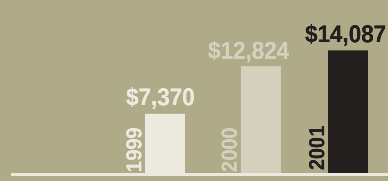
Compounded Annual Growth Rate 17.5%

FFO Per Diluted Share



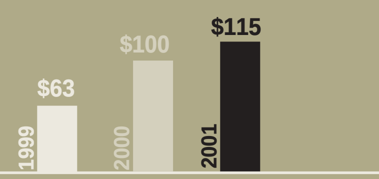
Compounded Annual Growth Rate 10.8%

Total Revenues ($000's)



Compounded Annual Growth Rate 38.3%

Total Asset Value ($mm)



Compounded Annual Growth Rate 35.1%

To the Shareholders of Hersha Hospitality Trust

It has been a very busy and intense year. It was a year of unprecedented turbulence and tragedy. We are deeply upset and saddened by the events of this year – but take comfort in the resilience of our national spirit.

In light of the economic malaise and disruptions in travel plaguing our industry, we remain pleased with our financial results. We remain particularly cautious and focused on the recovery, but we feel that we have weathered the worst of the storm.

❖ **RECOVERY:** Reduced demand for lodging had a significant impact on hotel operations as same store occupancy dropped to 62%. Our newest properties experienced a slower ramp-up, but our leases produced fixed returns to support our cash flow. Our lessees reacted quickly to maintain profitability at the property level. A strong direct sales effort and the resilience of our 'drive to' markets protected cash flow. On a same store basis, we ultimately experienced a slight increase in average daily rate. Although RevPar did fall, FFO increased 6.1% for the year.

❖ **DIVIDENDS:** Our portfolio showed a surprising resilience, and our lease and capital structure protected the dividend. We were one of the few lodging REITs that continued to pay its full quarterly dividend of $0.18 per share. This marks our 12th consecutive dividend payment of this amount since our initial public offering. Even in this challenging environment, a shareholder investing in HT at the beginning of 2001 realized an approximate 15% return on their investment, including dividends.

Across the year, we continued to execute on our business plan to increase the value and growth rate of HT.

❖ **ASSET VALUE:** We continued to actively manage our portfolio to take advantage of attractive acquisitions. We sold several properties in smaller, tertiary markets to acquire newly built hotels in the metropolitan Philadelphia

and New York markets. Our asset sales maintain a portfolio that boasts a median age of only three years, and clearly enhances long-term growth. We are hopeful that our market value will soon reflect the growth prospects and premium asset value of our portfolio.

❖ **TAXABLE REIT SUBSIDIARIES (TRS):** Many Hotel REITs have purchased their leases and assumed operating risk into their business model.

We believe that our investors seek more consistent returns from their investment in HT. At this time, the assumption of leases by a TRS would introduce significant volatility to our cash flows and expose our shareholders to additional risk. We structure leases to capture both base and percentage revenues, and our returns exceed the overall market and the lodging REIT sector – why take on additional risk?

❖ **ACQUISITION PIPELINE**: Across the year, we have also identified an attractive pipeline of acquisitions. Many are newly built assets in our target markets of metropolitan New York, Philadelphia, Boston, and Washington DC. We are currently evaluating our strategic capital raising activities to enable these accretive and growth oriented acquisitions.

Periods of economic uncertainty test the fundamentals of a business model and the quality of its execution. During our first three years of operation we have been challenged by numerous unforeseen events and have proven that we can still produce consistently market-leading returns. HT's quarterly yield alone beats the market, but as capital appreciates and our trading multiple expands, we are executing on our business plan and should emerge with an optimally positioned portfolio of assets in the highest value markets in the U.S.

As you may know, my family and long term business partners are the largest shareholders of HT. We believe in our business model and *will* execute it. Prior to our financial data this year, I have included a discussion on our strategy and plan for the coming 12-18 months. I believe that transparency is the most persuasive style. It is a privilege to have you as a shareholder, and I hope your investments and value grow over time.

Sincerely yours,

Hasu P. Shah

Chairman and CEO

HERSHA

Producing Premium Returns

A well-located hotel portfolio, acquired at an attractive cost basis, will produce above market returns if effectively leased or managed. The business model is centered around the high cash flows of mid-priced hotels, but is refined – its volatility reduced and value enhanced – by its leasing and capital decisions.

1. Resilient Portfolios - Markets, Brands, Asset Quality

In my twenty years of real estate experience, I have found that mid-priced hotels produce more cash flow than upscale hotels, apartments, and office buildings. Mid-priced hotels not only have a loyal customer base in road warriors and leisure travelers, but also benefit from "trading down" by increasing numbers of corporate travellers.

Several risks have prevented large- scale public ownership in the sector before. HT systematically reduces this risk:

❖ **Supply Risk**: HT focuses investments in high barrier to entry markets – markets that are difficult to build in and expensive to acquire. New York City, Philadelphia, Boston, and Washington DC are our primary targets across the next 12-18 months. We strive for clusters of assets in central business districts, primary suburban office locations, and select market leaders in 'drive-to' regional markets. These markets preserve growth and offer premium rents.

❖ **Obsolescence**: Many mid-priced hotels suffer from mediocre construction, disrepair, and ultimately lower economic uses. HT invests in newly built premium hotels and aggressively manages its portfolio to maintain a new and vibrant collection of assets. Our operators must reserve 4-6% of annual hotel revenues to fund on-going capital expenditures to maintain institutional-grade quality in our portfolio.

❖ **Commoditization**: Every reader must have had the rather unpleasant experience of driving down a nameless interstate with imposing signs for every chain hotel under the sun. In an age of mass segmentation, it is not enough to

have a brand. To ensure robust returns you need a 'category-killer.' Brands like Hampton Inn, Holiday Inn, and Comfort Suites earn differentiated, premium returns over time.

2. Prudent Investing - Strict Underwriting

Our investment strategy breaks the compromise between current cash flow and long term growth. I have always been an overly discerning buyer, and this personal 'problem' has carried into HT's underwriting criteria. You have to make your money going *into* the deal.

The cost-basis in our properties is low enough and potential lease income high enough to produce steady yields. We only purchase ‘accretive’ hotels – hotels throwing off sufficient lease income to maintain level dividends to shareholders for the investment. Economic cycles and unforeseen events are a part of the economy forever – prices need to reflect long term demand.

We garner opportunities for growth through our relationships rather than through development risk or momentum pricing. Our relationships with leading hotel developers and operators provide access to recently built or repositioned hotels with growth above premium quarterly distributions. We price hotels at their current yield but buy hotels with upside. It is an underwritten, nearly transparent method to generate growth and current cash flow.

3. Structured Leasing – Entrepreneurial Operators

Our lease structure reduces a significant portion of the volatility encountered in the earnings stream for lodging assets.

Our leases are structured to yield largely fixed lease revenues during a property's initial ramp-up – when cash flows are more uncertain and less accretive. As a property matures, percentage leases and incentive thresholds are triggered to provide revenue growth for the REIT and incentive for the operator.

Our affiliate Hersha Hospitality Management, LP, leases the majority of our hotels. HHMLP has emerged as one of the strongest management companies in the Northeast and is establishing a strong presence in New York and Philadelphia – two of our primary markets.

The sale-leaseback arrangement we entered into with Noble Investment Group in Atlanta will be a model for future growth. Top regional operators, driven by profits not revenue, produce strong, consistent returns for HT. In turn, entrepreneurial operators enjoy a 'refinancing' of their equity for their next project – and HT's next acquisition.

Management has proven across the last three years that it can execute this business model to produce consistently, premium returns. We plan to extend this business model and continue our promise in the coming years. We hope you will join us.

HERSHA

HERSHA

Hersha Hospitality Trust & Subsidiaries
Consolidated Balance Sheets

In thousands except share amounts.	December 31, 2001	December 31, 2000
Assets		
Cash and Cash Equivalents	$ 167	$ —
Investment in Hotel Properties, Net of Accumulated Depreciation	88,100	87,671
Escrow Deposits	1,647	1,178
Lease Payments Receivable, Related Party	2,376	2,877
Intangibles, Net of Accumulated Amortization	1,515	1,720
Due to Related Party	1,884	849
Other Assets	328	236
Total Assets:	$ 96,017	$ 94,531
Liabilities & Shareholders' Equity		
Line of Credit	$ 7,058	$ 11,400
Deposits Payable	1,000	1,000
Mortgages Payable	54,477	50,050
Dividends Payable	1,325	1,209
Due to Related Party	1,093	1,650
Accounts Payable and Accrued Expenses	418	529
Total Liabilities:	$ 65,371	$ 65,838
Minority Interest:	$ 20,436	$ 17,679
Commitments and Contingencies:	—	—
Shareholders' Equity:		
Preferred Shares, $.01 Par Value; 10,000,000 Shares authorized; None Issued and Outstanding	—	—
Common Shares - Priority Class A, $.01 Par Value; 50,000,000 Shares Authorized; 2,275,000 Shares Issued and Outstanding at December 31, 2001 and 2000; (Aggregate Liquidation Preference $13,650)	23	23
Common Shares -Class B, $.01 Par Value, 50,000,000 Shares Authorized; -0- Shares Issued and Outstanding at December 31, 2001 and 2000	—	—
Additional Paid-In Capital	11,968	11,968
Distributions in Excess of Net Earnings	(1,781)	(977)
Total Shareholders' Equity:	$ 10,210	$ 11,014
Total Liabilities & Shareholders' Equity:	$ 96,017	$ 94,531

Hersha Hospitality Trust & Subsidiaries

Consolidated Statements of Operations

Years Ended December 31, 2001, 2000 and 1999(1)

In thousands except share and per share amounts.	2001	2000	1999
Revenue			
Percentage Lease Revenues	$ 13,901	$ 12,773	$ 7,264
Interest	165	50	78
Interest - Related Party	21	1	28
Total Revenue:	14,087	12,824	7,370
Expenses			
Interest Expense	5,422	4,712	1,428
Land Lease - Related Party	13	15	20
Real Estate and Personal Property Taxes and Property Insurance	1,044	753	450
General and Administrative	554	590	363
Early Payment Penalty	—	107	—
Depreciation and Amortization	4,476	3,892	2,064
Total Expenses	11,509	10,069	4,325
Income Before Gain on Sale of Assets	2,578	2,755	3,045
Gain on Sale of Assets	598	—	—
Income Before Minority Interest	3,176	2,755	3,045
Income Allocated to Minority Interest	2,342	1,908	1,707
Net Income	$ 834	$ 847	$ 1,338
Basic Earnings Per Common Share	$ 0.37	$ 0.37	$ 0.59
Diluted Earnings Per Common Share and Units	$ 0.37	$ 0.37	$ 0.48
Weighted Average Shares			
Basic	2,275,000	2,275,000	2,275,000
Diluted	7,296,596(2)	6,715,996(2)	6,326,690(2)

(1) Operations commenced on January 26, 1999.

(2) Includes 5,093,220, 4,440,996 and 4,205,970 units of limited partnership interest that are redeemable on a one-for-one basis for Class B Common Shares.

Hersha Hospitality Trust & Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31, 2001, 2000 and 1999[1]

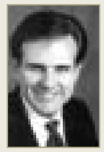
In thousands except share and per share amounts.	2001	2000	1999
Operating Activities			
Net Income	$ 834	$ 847	$ 1,338
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation and Amortization	4,476	3,892	2,064
Gain on Sale of Assets	(598)	—	—
Income Allocated to Minority Interest	2,342	1,908	1,707
Change in Assets and Liabilities (Increase) Decrease in:			
Escrow Deposits	(469)	(1,178)	—
Lease Payments Receivable - Related Party	501	(761)	(2,116)
Other Assets	(92)	115	(351)
Due from Related Party	122	(21)	—
Increase (Decrease):			
Due to Related Parties	(179)	54	188
Accounts Payable and Accrued Expenses	(109)	176	245
Total Adjustments	5,994	4,185	1,737
Net Cash Provided by Operating Activities	$ 6,828	$ 5,032	$ 3,075
Investing Activities			
Purchase of Hotel Property Assets	(5,017)	(13,017)	(7,209)
Sale of Hotel Property Assets	12,599	—	—
Purchase of Intangible Assets	(69)	(1,078)	(940)
Loans to Related Party	(2,000)	(800)	(1,000)
Net Cash Provided by/(Used in) Investing Activities	5,513	(14,895)	(9,149)
Financing Activities			
Net Proceeds from Issuance of Stock	—	—	11,991
Proceeds from Borrowings Under Line of Credit	10,766	5,496	6,096
Repayment of Borrowings Under Line of Credit	(15,108)	—	—
Borrowings from Mortgages Payable	—	25,050	—
Principal Repayment of Mortgages Payable	(2,729)	(17,016)	(5,460)
Dividends Paid	(1,638)	(1,638)	(1,114)
Limited Partnership Unit Distributions Paid	(3,495)	(3,561)	(1,580)
Borrowings from Related Party	30	1,408	—
Repayment of Related Party Loans	—	—	(3,735)
Net Cash Provided by/ (Used in) Financing Activities	(12,174)	9,739	6,198
Net Increase (Decrease) in Cash & Cash Equivalents	167	(124)	124
Cash & Cash Equivalents - Beginning of Year	—	124	—
Cash & Cash Equivalents - End of Year	$ 167	$ —	$ 124

(1) Operations commenced on January 26, 1999.

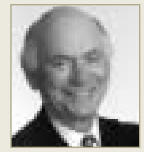
Board of Trustees

Hasu P. Shah
Chairman
Hersha Hospitality Trust

Thomas S. Capello
Founder & Principal
First Capital Equities



Donald J. Landry
Former CEO and President
Sunburst Hospitality, Inc.



Michael A. Leven
Chairman & CEO
US Franchise Systems, Inc.

L. McCarthy Downs, III
Chairman
Anderson & Strudwick

William Lehr, Jr.
Former Senior Vice President
Hershey Foods Corporation

K.D. Patel
President
Hersha Hospitality
Management, L.P.

Corporate Officers

Hasu P. Shah
Chief Executive Officer

Ashish R. Parikh
Chief Financial Officer

Kiran P. Patel
Corporate Secretary

Rajendra O. Gandhi
Treasurer

Contact Information

CORPORATE HEADQUARTERS
148 Sheraton Drive, Box A
New Cumberland, PA 17070
Telephone: (717) 770-2405
Fax: (717) 774-7383

INDEPENDENT AUDITORS
Moore Stephens, P.C.
331 Madison Avenue
New York, NY 10071

LEGAL COUNSEL
Hunton & Williams
951 East Byrd Street
Richmond, Virginia 23219

REGISTRAR AND STOCK TRANSFER AGENT
First Union National Bank
1525 West W.T. Harris Boulevard, 3C3
Charlotte, North Carolina 28288-1179
Telephone: (800) 829-8432

COMMON STOCK INFORMATION
The Common Stock of Hersha Hospitality Trust is traded on the American Stock Exchange under the symbol "HT"

WWW.HERSHA.COM

Hersha Hospitality Trust
One Forty Eight Sheraton Drive
New Cumberland, PA 17070
Telephone. 717.770.2405
Facsimile. 717.774.7383