ASHFORD HOSPITALITY TRUST INC
Form 424B7
July 26, 2007

Table of Contents

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per unit(1)	Proposed maximum aggregate offering price	Amount of registration fee(2)
Common Stock	3,814,842	$ 11.22	$42,802,527	$ 1,314

(1) Estimated solely for the purpose of determining the registration fee pursuant to Rule 457(c), based on the average of the high and low prices of the common stock as reported on the New York Stock Exchange on July 25, 2007.

(2) The filing fee of $1,314 is calculated in accordance with Rule 457(r) under the Securities Act of 1933, as amended. Payment of the registration fee at the time of filing of the registrant s registration statement on Form S-3ASR filed with the Securities and Exchange Commission on April 13, 2007 (File No. 333-142079) was deferred pursuant to Rules 456(b) and 457(r) of the Securities Act. This Calculation of Registration Fee table shall be deemed to update the Calculation of Registration Fee table in the registration statement referenced herein.

PROSPECTUS SUPPLEMENT **Filed Pursuant to Rule 424(b)(7)**
(To Prospectus dated April 13, 2007) **Registration Statement No. 333-142079**

3,814,842 Shares
Common Stock

Ashford Hospitality Trust, Inc. is a real estate investment trust, or REIT, that was formed in May 2003 to invest in the hospitality industry at all levels of the capital structure. We are self-advised and own our lodging investments and conduct our business through Ashford Hospitality Limited Partnership, our operating partnership.

This prospectus supplement relates to the possible issuance, from time to time, of up to 3,814,842 shares of our common stock, par value $0.01 per share, which we may issue in exchange for the redemption of an equal number of units of limited partnership interest, or units, in our operating partnership. We may issue the common stock covered by this prospectus supplement to the holders of these units to the extent that the holders redeem their units and we elect to issue common stock in connection with the redemption. We may also elect to pay cash for redeemed units in lieu of issuing common stock. This prospectus supplement also relates to the offer and resale, from time to time, by the persons receiving shares of our common stock covered by this prospectus supplement upon redemption of units. These persons are referred to in this prospectus supplement as selling stockholders.

We will not receive any proceeds from the issuance of shares of common stock in exchange for units or from the sale of any common stock offered by the selling stockholders, but we have agreed to pay certain registration expenses. The registration of shares of common stock covered by this prospectus supplement and described above does not necessarily mean that any of the units will be submitted for redemption or that any of the shares of common stock that may be issued upon such redemption will be offered or sold by the selling stockholders. This prospectus supplement is being filed pursuant to our contractual obligations.

Our common stock is listed on the New York Stock Exchange under the symbol AHT. The last reported sale price of our common stock on the New York Stock Exchange on July 25, 2007 was $11.29 per share.

To assist us in complying with certain federal income tax requirements applicable to REITs, our charter contains certain restrictions relating to the ownership and transfer of our stock, including an ownership limit of 9.8% on our common stock.

Investing in our common stock involves risks. See Risk Factors beginning on page S-1 of this prospectus supplement and our most recent Annual Report on Form 10-K to read about risks you should consider before buying our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is July 26, 2007

TABLE OF CONTENTS
Prospectus Supplement

Prospectus

You should rely only on the information contained or incorporated by reference in this prospectus supplement or the accompanying prospectus. We have not, and the underwriters have not, authorized anyone else to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. An offer to sell these securities will not be made in any jurisdiction where the offer and sale is not permitted. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus, as well as information we previously filed with the Securities and Exchange Commission and incorporated by reference, is only accurate as of the date on the front cover of this prospectus supplement or accompanying prospectus, as applicable. Our business, financial condition, results of operations and prospects may have changed since that date.

Table of Contents

SECURITIES THAT MAY BE OFFERED

This prospectus supplement relates to the possible issuance or resale, from time to time, of up to 3,814,842 shares of common stock, if and to the extent that the holders of units elect to tender up to an aggregate of 3,814,842 units in our operating partnership for redemption commencing on July 13, 2007. We are registering the shares of common stock covered by this prospectus supplement to permit the holders thereof to sell such shares without restriction in the open market or otherwise, but the registration of these shares does not necessarily mean that any of the units will be tendered for redemption or that any of such shares will be offered or sold by the recipients.

We will not receive any proceeds from the issuance or resale of the shares of common stock covered by this prospectus supplement.

RISK FACTORS

An investment in our securities involves various risks. You should carefully consider the following risk factors and those appearing in our most recent Annual Report on Form 10-K in conjunction with the other information contained in this prospectus supplement and the accompanying prospectus before purchasing our securities. The risks discussed in this prospectus supplement and the accompanying prospectus can adversely affect our business, liquidity, operating results, prospects and financial condition. This could cause the market price of our securities to decline and could cause you to lose all or part of your investment. The risk factors described below are not the only risks that may affect us. Additional risks and uncertainties not presently known to us also may adversely affect our business, liquidity, operating results, prospects and financial condition.

Risks Related to Exchange of Common Units for Common Stock

The exchange of units of limited partnership interest for our common stock is a taxable transaction.

The exchange of units of limited partnership interest for shares of our common stock will be treated for United States federal income tax purposes as a sale of the units by the limited partner making the exchange. A limited partner will recognize gain or loss for United States federal income tax purposes in an amount equal to the difference between the amount realized by the limited partner in the exchange and the limited partner s adjusted tax basis in the units exchanged. Generally, the amount realized by a limited partner on an exchange will be the fair market value of the shares of our common stock received in the exchange, plus the amount of our operating partnership s liabilities allocable to the units being exchanged at the time of the exchange. The recognition of any loss resulting from an exchange of units of limited partnership interest for shares of our common stock is subject to a number of limitations set forth in the Internal Revenue Code of 1986, as amended, or the Code. It is possible that the amount of gain recognized or even the tax liability resulting from the gain could exceed the value of the shares of our common stock received upon the exchange. In addition, the ability of a limited partner to sell a substantial number of shares of our common stock in order to raise cash to pay tax liabilities associated with the exchange of our units may be restricted and, as a result of stock price fluctuations, the price the holder receives for the shares of our common stock may not equal the value of the common units at the time of the exchange. See Redemption of Units Tax Consequences of Redemption below for more information on these tax consequences.

An investment in our common stock is different from an investment in units of limited partnership interest in our operating partnership.

If a limited partner exchanges his or her units of limited partnership interest in our operating partnership for shares of our common stock, he or she will become one of our stockholders rather than a limited partner in our operating partnership. Although the nature of an investment in our common stock is similar to an investment in units, there are also differences between ownership of units of limited partnership interest and ownership of our common stock. These differences, some of which may be material to you, include:

- form of organization;
- management control;

voting and consent rights;

liquidity; and

federal income tax considerations.

These differences are further discussed below in Comparison of Ownership of Units and Common Stock.

USE OF PROCEEDS

We will not receive any of the proceeds from the issuance or resale of the common stock offered by this prospectus supplement and the accompanying prospectus; however, we will pay certain registration expenses related to this offering.

REDEMPTION OF UNITS

General

Each unit holder may, subject to certain limitations, require that our operating partnership redeem all or a portion of the units held by such unit holder for cash, or at the general partner s election, for shares of our common stock (on a one-for-one basis, subject to certain adjustments). The number of shares of common stock which may be redeemed for units is subject to adjustment in the event of stock splits, stock dividends, issuance of certain rights, certain dividends and distributions and similar events.

Each unit holder must notify the general partner of its desire to require the operating partnership to redeem its units by delivering a notice of redemption, in substantially the form attached as an exhibit to the partnership agreement, to the general partner. Such holder shall have the right to receive an amount of cash from the operating partnership equal to the Cash Amount (as defined in the partnership agreement). The operating partnership shall have up to one year following exercise of the redemption right to pay the Cash Amount. However, if the general partner elects to acquire such tendered units in exchange for shares of our common stock, the holder shall have no right to cause the operating partnership to redeem the units for cash. Such an acquisition of the units by the general partner should be treated as a sale of the units by the redeeming unit holders to us for federal income tax purposes. See Tax Consequences of Redemption below. Upon redemption of the units, the holder s right to receive distributions with respect to the units will cease (but if such units are redeemed for shares of our common stock, the holder will have rights as our stockholder from the time of its acquisition of the shares of common stock) and such holder will cease to be a limited partner of the operating partnership as to those units redeemed.

If the general partner elects to satisfy any redemption right exercised by a unit holder through issuance of our common stock, the shares of common stock will be delivered as duly authorized, validly issued, fully paid and nonassessable shares, free of any pledge, lien, encumbrance or restriction, other than those provided in our charter and bylaws, the Securities Act of 1933, as amended, and relevant state securities or blue sky laws with respect to such shares of common stock. Notwithstanding any delay in such delivery, a holder shall be deemed the owner of such shares of common stock and rights for all purposes, including, without limitation, rights to vote or consent, receive dividends, and exercise rights, as of the redemption date.

Certain Conditions to Redemption

Notwithstanding anything contained herein to the contrary, the redemption rights are subject to certain conditions, including, but not limited to, the following:

In order to protect our status as a REIT, no unit holder shall be entitled to effect a redemption, if such redemption would cause such holder or any other person to violate the provisions of our charter.

No unit holder may effect a redemption for less than 1,000 units, or if such holder holds less than 1,000 units, all of the units held by such holder.

Table of Contents

Registration Rights

We are filing this prospectus supplement pursuant to our obligations under a registration rights agreement we entered into in connection with the acquisition of a hotel property. Under the registration rights agreement, we are obligated to use our reasonable efforts to keep the registration statement continuously effective for a period expiring on the date on which all shares of common stock covered by this prospectus supplement (i) have been disposed of by the recipient pursuant to this prospectus supplement; (ii) have been sold pursuant to Rule 144 under the Securities Act of 1933; (iii) may be sold pursuant to Rule 144 under the Securities Act of 1933 and could be sold in one transaction in accordance with the volume limitations contained in Rule 144(e)(1)(i) under the Securities Act of 1933; or (iv) have been otherwise transferred in a transaction that would constitute a sale under the Securities Act, we have delivered a new certificate or other evidence of ownership for such shares not bearing the Securities Act of 1933 restricted stock legend and such shares may be resold without restriction under the Securities Act.

We have no obligation under these agreements to retain any underwriter to effect the sale of the common stock covered by the registration rights agreement, and the registration statement will not be available for use for an underwritten public offering of such shares.

Pursuant to the registration rights agreement, we agreed to pay all expenses of effecting the registration of the shares of common stock covered by this prospectus supplement, other than underwriting fees, discounts and commissions, or any out-of-pocket expenses of the holders of the units or any transfer taxes relating to the registration or sale of the shares of common stock covered by this prospectus supplement and the accompanying prospectus.

Tax Consequences of Redemption

The following discussion summarizes certain federal income tax considerations that may be relevant to a holder who exercises such holder s right to require the redemption of such holder s units. (A holder s right to require the redemption of units is referred to in the remainder of this section as the Redemption Right.) Because the specific tax consequences to a holder exercising such holder s Redemption Right will depend upon the specific circumstances of that holder, we strongly urge each holder considering exercising the Redemption Right to consult such holder s own tax advisor regarding the specific federal, state, local and non-U.S. tax consequences to such holder of the exercise of the Redemption Right in light of such holder s specific circumstances.

Tax Treatment of Redemption of Units

To the extent that we assume and perform the redemption obligation, the redemption likely would be treated for tax purposes as a sale of units to us in a fully taxable transaction, although the matter is not free from doubt. In that event, such sale will be fully taxable to the redeeming holder and such redeeming holder will be treated as realizing for tax purposes an amount equal to the value of the common stock received in the exchange plus the amount of partnership nonrecourse liabilities allocable to the redeemed units at the time of the redemption. The determination of the amount of gain or loss in the event of sale treatment is discussed more fully below.

To the extent that we do not elect to assume the obligation to redeem a holder s units, our operating partnership will redeem such units for cash. If the operating partnership redeems units for cash that we contribute to the partnership to effect such redemption, the redemption of those units likely would be treated for tax purposes as a sale of such units to us in a fully taxable transaction, although the matter is not free from doubt. In that event, the redeeming holder would be treated as realizing an amount equal to the sum of the cash received in the exchange plus the amount of partnership nonrecourse liabilities allocable to the redeemed units at the time of the redemption. The determination of the amount of gain or loss in the event of sale treatment is discussed more fully below.

If, instead, the partnership redeems a holder s units for cash that is not contributed by us to effect the redemption, the tax consequences would be the same as described in the previous paragraph, except that if the holder redeems less than all of a holder s units, the holder would not be permitted to recognize any loss occurring on the transaction and would recognize taxable gain only to the extent that the cash, plus the share of partnership nonrecourse liabilities allocable to the redeemed units, exceeded the holder s adjusted basis in all of such holder s units immediately before the redemption.

Tax Treatment of Disposition of Units by a U.S. Holder Generally

As used in the remainder of this discussion, the term U.S. holder means a beneficial owner of the units that is for United States federal income tax purposes:

a citizen or resident of the United States;

a corporation (including an entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States or of a political subdivision thereof;

an estate whose income is subject to U.S. federal income taxation regardless of its source; or

any trust if (1) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person.

If a partnership, entity or arrangement treated as a partnership for U.S. federal income tax purposes holds a unit, the federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. If you are a partner in a partnership holding units, you should consult your tax advisor regarding the consequences of the purchase, ownership and disposition of units by the partnership. A non-U.S. holder is a holder that is not a partnership and is not a U.S. holder.

If a unit is redeemed from a U.S. holder in a manner that is treated as a sale of the unit, or a U.S. holder otherwise disposes of a unit, the determination of gain or loss from the sale or other disposition will be based on the difference between the amount considered realized for tax purposes and the tax basis in such unit. See Basis of Units below. Upon the sale of a unit, the amount realized will be measured by the sum of the cash and fair market value of other property (e.g., common stock) received plus the portion of partnership nonrecourse liabilities allocable to the unit sold. To the extent that the amount of cash or property received plus the allocable share of partnership nonrecourse liabilities exceeds the holder s basis for the unit disposed of, such holder will recognize gain. It is possible that the amount of gain recognized or even the tax liability resulting from such gain could exceed the amount of cash and the value of any other property (e.g., shares of common stock) received upon such disposition. A U.S. holder generally will not have an amount realized with respect to a partnership recourse liability unless the U.S. holder has personal liability for repayment of that liability.

Except as described below, any gain recognized by a unit holder, other than a dealer in units, upon a redemption of units held for more than one year will generally be treated as capital gain or loss. To the extent, however, that the amount realized upon the sale of a unit attributable to a holder s share of unrealized receivables of the partnership (as defined in Section 751 of the Code) exceeds the basis attributable to those assets, such excess will be treated as ordinary income. Unrealized receivables include, to the extent not previously included in partnership income, any rights to payment for services rendered or to be rendered. Unrealized receivables also include amounts that would be subject to recapture as ordinary income, such as depreciation recapture, if the partnership had sold its assets at their fair market value at the time of the transfer of a unit. Each holder is strongly urged to consult such holder s own tax advisor regarding the specific federal, state, local and non-U.S. tax consequences to such holder resulting from a redemption of units.

Tax Treatment of Disposition of Units by a Non-U.S. Holder Generally

If a unit is redeemed by a non-U.S. holder in a manner that is treated as a sale of the unit, or a non-U.S. holder otherwise disposes of a unit, the non-U.S. holder generally will be subject to regular U.S. income tax in the same manner as a taxable U.S. holder to the extent that either (a) the assets held by our operating partnership constitute either U.S. real property interests within the meaning of the Foreign Investments in Real Property Tax Act of 1980 (FIRPTA) or (b) the assets are considered to be effectively connected with the partnership s U.S. trade or business. Most of the assets of our operating partnership will be U.S. real property interests and some of its remaining assets that are not U.S. real property interests will be considered to be effectively connected with a U.S. trade or business. As a result, a non-U.S. holder will be subject to regular U.S. income tax in the same manner as a taxable U.S. holder with respect to most, if not all, of the gain recognized on such sale.

Further, the purchaser of the units from a non-U.S. holder (including us in the case of a redemption) will be required to withhold 10% of the amount realized from the sale. As noted previously, the amount realized is equal to the sum of the cash price paid to the seller, the fair market value of other property transferred to the seller (e.g., common stock) and the outstanding amount of any liability assumed by the purchaser or to which the U.S. real property interest is subject immediately before and after the transfer (e.g., the portion of partnership nonrecourse liabilities allocated to the units sold). As a result, we will withhold at least a portion of the cash or common stock that would have been otherwise been paid to the non-U.S. holder upon a redemption by the non-U.S. holder to satisfy this withholding requirement. This withholding requirement does not relieve the non-U.S. holder from filing any U.S. federal income tax return that may have otherwise been required. However, any amounts withheld under these withholding rules will be allowed as a credit against the non-U.S. holder s U.S. federal income tax and may entitle the non-U.S. holder to a refund, provided that the required information is furnished to the Internal Revenue Service. A party redeeming the units may seek a determination from the Internal Revenue Service regarding that party s maximum tax liability that may reduce the amount required to be withheld. A party that desires to seek such a determination should consult such party s own tax advisor.

Basis of Units

In general, a holder who received units upon liquidation of a partnership had an initial tax basis in such units (Initial Basis) equal to the basis in the liquidated partnership interest at the time of such liquidation. Similarly, in general, a holder who contributed a partnership interest or other property in exchange for units had an Initial Basis in the units equal to the basis in the contributed partnership interest or property. A holder s Initial Basis in units generally is increased by (a) such holder s share of partnership taxable income, (b) increases in such holder s share of liabilities of the partnership and (c) such holder s subsequent contributions. Generally, such holder s Initial Basis in units is decreased (but not below zero) by (i) its share of partnership distributions, (ii) decreases in such holder s share of liabilities of the partnership, (iii) such holder s share of losses of the partnership, and (iv) such holder s share of nondeductible expenditures of the partnership that are not chargeable to capital.

Potential Application of the Disguised Sale Regulations to a Redemption of Units

In the case of a limited partner who contributed property to the partnership in exchange for units, there is a possibility that a redemption of units might cause the original transfer of property to the partnership in exchange for units to be treated as a disguised sale of property. The Code and the Treasury regulations thereunder (the Disguised Sale Regulations) generally provide that, unless one of the prescribed exceptions is applicable, a partner s contribution of property to a partnership and a simultaneous or subsequent transfer of money or other consideration (including the assumption of or taking subject to a liability) from the partnership to the partner will be presumed to be a sale, in whole or in part, of such property by the partner to the partnership. The Disguised Sale Regulations also provide, however, that if two years have passed between the transfer of money or other consideration (for example, common stock) and the contribution of property, the transactions will not be presumed to be a sale unless the facts and circumstances clearly establish that the transfers constitute a sale. If two years have not passed between the transfer of money or other consideration (for example, common stock) and the contribution of property, the transactions will be presumed to be a sale unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Accordingly, if the partnership redeems a unit, the IRS could contend that the redemption should be treated as a disguised sale because the redeeming unit holder will receive cash or shares of common stock after having contributed property to the partnership. If the IRS took that position successfully, the issuance of the units in exchange for the contributed property could be taxable as a disguised sale under the Disguised Sale Regulations. Each holder should consult with such holder s own tax advisor to determine whether a redemption of units could be subject to the Disguised Sale Regulations.

Table of Contents

SELLING STOCKHOLDERS

This prospectus supplement relates to the issuance or resale, from time to time, of up to 3,814,842 shares of our common stock by the selling stockholders described below.

We may issue up to 3,814,842 shares of the common stock covered by this prospectus supplement in exchange for units of limited partnership interest in our operating partnership if and to the extent that the holders of the units redeem the units and we elect to issue shares of common stock in exchange for such units. The persons receiving shares of our common stock upon the redemption of units, and their respective pledgees, donees, and other successors in interest, may offer and resell such shares from time to time pursuant to this prospectus supplement and the accompanying prospectus.

The following table sets forth certain information with respect to the selling stockholders and their ownership of shares of our common stock as of the date hereof. The registration statement of which this prospectus supplement and the accompanying prospectus are part of shall also cover any additional shares of our common stock which become issuable in connection with the shares registered for sale by such registration statement by reason of any stock dividend, stock split, recapitalization or other similar transaction effected without the receipt of consideration which results in an increase in the number of our outstanding shares of common stock. Although the selling stockholders may sell none, some or all of the shares offered hereby, and although there are currently no agreements, arrangements or understandings with respect to the sale of any of such shares, for purposes of the table set forth below, we have assumed that each selling stockholder will sell all of the shares of such stockholder offered by this prospectus supplement.

Selling Stockholder[1]	Number of Shares Owned Prior to the Offering[2]	Number of Shares Offered Hereby[3]	Shares Owned Following the Offering	
			Shares	Percent
Lawrence D. Barkman	37,343	37,343		
Arthur A. Birney	263	263		
Washington Brick & Terra Cotta Company	1,848,489	1,848,489		
Barbara Fleischmann	29,875	29,875		
Lawrence A. Fleischman Non-Exempt Trust	29,875	29,875		
Laura Glassman	1,726	1,726		
Paul Glassman	1,726	1,726		
Kogod Family Holding Group LLC	316,263	316,263		
Arlese R. Kogod	145,585	145,585		
Lauren Sue Kogod	56,015	56,015		
Leslie Susan Kogod	56,015	56,015		
Robert P. Kogod	144,980	144,980		
Stuart Allan Kogod	56,015	56,015		
Robert H. Smith	450,249	450,249		
MC II Associates	246,465	246,465		
Eads, LLC	36,818	36,818		
Eads Associates Limited Partnership	357,140	357,140		
	3,814,842	3,814,842		

(1) Each of the named selling stockholders

was a recipient of units in the original transaction pursuant to which the units were issued.

(2) Represents shares of our common stock currently owned by the selling stockholder or issuable in exchange for an equal number of currently redeemable units of limited partnership interest in our operating partnership owned by the selling stockholder.

(3) Assumes that all units held by the selling stockholder are exchanged for shares of common stock and that all such shares of common stock are being resold pursuant to this prospectus supplement.

Table of Contents

COMPARISON OF OWNERSHIP OF UNITS AND COMMON STOCK

Although the nature of an investment in our common stock is similar to an investment in units, there are also differences between ownership of units of limited partnership interest and ownership of our common stock. The information below highlights a number of the significant differences between the partnership and the company relating to, among other things, form of organization, policies and restrictions, management structure, compensation and fees, voting rights, liability of investors, liquidity and federal income tax considerations. These comparisons are intended to assist holders of units in understanding how their investment will be changed if they exchange their units for shares of our common stock.

THE FOLLOWING DISCUSSION IS A SUMMARY AND DOES NOT CONSTITUTE A COMPLETE DISCUSSION OF THESE MATTERS, AND HOLDERS OF UNITS SHOULD CAREFULLY REVIEW THE BALANCE OF THIS PROSPECTUS SUPPLEMENT, THE ACCOMPANYING PROSPECTUS, THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS IS A PART, THE PARTNERSHIP AGREEMENT AND OUR CHARTER FOR ADDITIONAL IMPORTANT INFORMATION ABOUT US.

PARTNERSHIP	COMPANY
Form of Organization and Purposes	
The partnership is organized as a Delaware limited partnership. The partnership s purpose is to conduct any business that may be lawfully conducted by a limited partnership organized pursuant to the Delaware Revised Uniform Limited Partnership Act, provided that such business is to be limited to and conducted in such a manner as to permits us at all times to be qualified as a REIT under the Code unless our board of directors determines to cease to qualify as a REIT. The general partner may cause the partnership to take, or to refrain from taking, any action that, in the good faith belief of the general partner, is necessary or advisable in order (i) to protect the ability of the company to continue to qualify as a REIT, or (ii) to prevent the company from incurring any taxes under Section 857 or Section 4981 of the Code.	We are a Maryland corporation. We have elected to be taxed as a REIT under the Code and intend to maintain our qualification as a REIT. Under our charter, we may engage in any lawful act or activity for which corporation may be organized under the MGCL.
Length of Investment	
The partnership has a perpetual term and intends to continue operations for an indefinite time period.	We have a perpetual term and intend to continue our operations for an indefinite time period.

Additional Equity

The partnership is authorized to issue units in exchange for additional capital contributions as determined by the general partner, in its sole discretion. In exchange for such capital contributions, the partnership may issue partnership interests to the general partner, may issue additional units to existing limited partners, and may admit third parties as additional limited partners.

The board of directors may issue, in its discretion, additional equity securities consisting of common stock or preferred stock; provided, that the total number of shares issued does not exceed the authorized number of shares of stock set forth in our charter.

Borrowing Policies

The partnership has no restrictions on borrowings, and the general partner has full power and authority to borrow money on behalf of the partnership; provided that the term of any loan from the general partner or any affiliate of the general partner must be substantially equivalent to the terms that could be obtained from a third party on an arm s-length basis.

Neither our charter nor our bylaws impose any restrictions on our ability to incur borrowings. However, our revolving credit facilities and secured tem loan facilities may contain certain financial covenants and operating covenants, including, among other things, limitations on our ability to incur secured and unsecured debt.

Other Investment Restrictions

Other than restrictions precluding investments by the partnership that would adversely affect our qualification as a REIT and restrictions on transactions with affiliates, the partnership agreement does not generally restrict the partnership s authority to enter into certain transactions, including, among others, making investments, lending partnership funds, or reinvesting the partnership s cash flow and net sale or refinancing proceeds.

Neither our charter nor our bylaws impose any restrictions upon the types of investments made by us.

Management Control

All management powers over the business and affairs of the partnership are vested in the general partner, and generally no limited partner of the partnership has any right to participate in or exercise control or management power over the business and affairs of the partnership, except as otherwise set forth in the partnership agreement. The general partner may not be removed by the limited partners of the partnership with or without cause.

The board of directors has exclusive control over our business and affairs subject only to the restrictions in our charter and bylaws. At each annual meeting of the stockholders, the stockholders elect directors. The policies adopted by the board of directors may be altered or eliminated without a vote of the stockholders. Accordingly, except for their vote in the elections of directors, stockholders have no control over our ordinary business policies.

Fiduciary Duties of General Partners and Directors

Under Delaware law, the general partner of the partnership is accountable to the partnership as a fiduciary and, consequently, is required to exercise good faith and integrity in all of its dealings with respect to partnership affairs. However, under the partnership agreement, the general partner is not liable for monetary damages for losses sustained, liabilities incurred or benefits not derived by partners as a result of errors in judgment or of any act or omission, provided that the general partner has acted in good faith.	Under the MGCL, the directors must perform their duties in good faith, in a manner that they reasonably believe to be in the best interests of the company and with the care of an ordinarily prudent person in a like position. Any director who acts in such a manner generally will not be liable to the company for monetary damages arising from his or her activities as a director of the company.

Management Liability and Indemnification

As a matter of Delaware law, the general partner has liability for the payment of the obligations and debts of the partnership unless limitations upon such liability are stated in the document or instrument evidencing the obligations. Under the partnership agreement, the partnership has agreed to indemnify the general partner and any director, officer, employee or agent of the partnership or the general partner from and against all losses, claims, damages, liabilities (joint or several), expenses (including legal fees and expenses), judgments, fines, settlements and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil, criminal, administrative or investigative, that relate to the operations of the partnership, unless: (i) the act or omission was material to the matter giving rise to the proceeding and with was committed in bad faith or was the result of active and deliberate dishonesty; (ii) the party actually received an improper personal benefit in money, property or services; or (iii) in the case of any criminal proceeding, the party had reasonable cause to believe that the act or omission was unlawful. The reasonable expenses incurred by an indemnitee may be reimbursed by the partnership in advance of the final disposition of the proceeding upon receipt by the partnership of (i) a written affirmation by the indemnitee of his, her or its good faith belief that the standard of conduct necessary for indemnification has been met and (ii) a written undertaking by or on behalf of the indemnitee to repay the amount if it is determined that the standard of conduct was not met.

Our charter contains a provision which eliminates the liability of our directors and officers to the company and its stockholders to the maximum extent permitted by Maryland law. Our bylaws require us, to the maximum extent permitted by Maryland law, to indemnify and, without a preliminary determination of the ultimate entitlement to indemnification, pay or reimburse reasonable expenses in advance of final disposition of a proceeding to (i) any individual who is a present or former director or officer of the company and (ii) any individual who, while a director or officer of the company and at the request of the company, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or any other enterprise as a director, officer, partner or trustee.

Anti-takeover Provisions

Except in limited circumstances (see Voting Rights below), the general partner of the partnership has exclusive management power over the business and affairs of the partnership. The general partner may not be removed by the limited partners with or without cause. Except with respect to certain limited partners and after certain specified dates, a limited partner may generally transfer its limited partnership interest only with the approval of the general partner, and the general partner may, in its sole discretion, prevent the admission to the partnership of

Our charter and bylaws contain a number of provisions that may have the effect of delaying or discouraging an unsolicited proposal for the acquisition of the company or the removal of incumbent management. These provisions include, among others: (i) authorized stock that may be issued as preferred stock in the discretion of the board of directors, with superior voting or other rights to the common stock; and (ii) provisions designed to avoid concentration of share ownership in a manner that would jeopardize our status as a REIT under the

substituted limited partners.	Code. The MGCL also contains certain provisions which could have the effect of delaying, deferring or preventing a change in control of the company or other transaction. See Material Provisions of Maryland Law and of Our Charter and Bylaws.

Voting Rights

Under the partnership agreement, the limited partners have voting rights in limited circumstances, including as to the election of a new general partner upon the dissolution or withdrawal of the existing general partner and as to certain amendments to the partnership agreement, as described more fully below. Otherwise, all decisions relating to the operation and management of the partnership are made by the general partner.

Our business and affairs are managed under the direction of our board of directors. Each director is to be elected by the stockholders at annual meetings. The MGCL requires that certain major corporate transactions, including most amendments to our charter, may not be consummated without the approval of stockholders as set forth below. All shares of our common stock and all shares of our Series B-1 preferred stock have one vote per share, and our charter permits the board of directors to classify and issue preferred stock in one or more series having voting power which may differ from that of the common stock.

The following is a comparison of the voting rights of the holders of units and our stockholders as they relate to certain major transactions:

Amendment of the Partnership Agreement or our Charter

The partnership agreement may be amended by the general partner without the approval of any limited partner if such amendment (i) is for the purpose of clarification or is of an inconsequential nature; or (ii) is to reflect the admission, substitution or withdrawal of limited partners or to reflect the issuance of additional partnership interests or to amend the calculation of the Cash Amount and the Conversion Factor (as such terms are defined in the partnership agreement) following a merger or consolidation of the partnership with another entity. Amendments that adversely affect the limited liability of the limited partners, impose on the limited partners any obligation to make additional capital contributions, change the method of allocation of profit and loss or the distribution provisions, seek to impose personal liability on the limited partners or affect the operation of the conversion factor of the redemption right must be approved by limited partners holding more than 66 2/3% of the outstanding units. Any other amendment to the partnership agreement must be approved by the general partner and by limited partners holding a majority in interest of the units.

Under the MGCL and our charter, amendments to our charter generally must be advised by the board of directors and approved by the holders of at least a majority of the votes entitled to be cast on the matter.

Vote Required to Dissolve the Partnership or the Company

The partnership will be dissolved upon (i) an event of bankruptcy as to the general partner or the dissolution or withdrawal of the general partner (unless within 90 days thereafter limited partners holding more than 50% of the units elect to continue the partnership and elect a new general partner), (ii) 90 days following the sale of all or substantially all of the partnership s assets, (iii) the redemption of all units (other than any units held by the general partner or the company), or (iv) the election by the general partner (but only in accordance with and as permitted by applicable law).	Under the MGCL and our charter, dissolution of the Company must be advised by the board of directors and approved by the holders of at least a majority of the votes entitled to be cast on the matter.

S-10

Vote Required to Sell Assets or Merge

Under the partnership agreement, the general partner has the full power and authority to effectuate the sale, transfer, exchange or other disposition of any of the partnership s assets or the merger, consolidation, reorganization or other combination of the partnership with or into another entity.

Under the MGCL and our charter, the sale of all or substantially all of our assets, or our merger or consolidation, requires the approval of the board of directors and the holders of at least a majority of the votes entitled to be cast on the matter. No approval is required for the sale of less than all or substantially all of our assets.

Compensation and Fees

The general partner does not receive any compensation for its services as general partner of the partnership. The partnership will reimburse the general partner for all expenses incurred relating to the ongoing operation of the partnership.

Our officers and outside directors receive compensation for their services.

Liability of Investors

Under the partnership agreement and applicable Delaware law, the liability of the limited partners for the partnership s debts and obligations is generally limited to the amount of their investment in the partnership.

Under Maryland law, stockholders generally are not personally liable for the debts or obligations of the Company.

Potential Dilution of Rights

The general partner of the partnership is authorized, in its sole discretion and without limited partner approval, to cause the partnership to issue additional limited partnership interests for any partnership purpose at any time to the limited partners or to other persons (including the general partner).

The board of directors may issue, in its discretion, additional shares of common stock or preferred stock, or securities convertible into shares of its common or preferred stock. The issuance of additional shares of either common stock or preferred stock or other convertible securities may result in the dilution of the interests of the stockholders.

Liquidity

Except with respect to certain limited partners and after certain specified dates, a limited partner may generally transfer its limited partnership interest only with the approval of the general partner, and the general partner may, in its sole discretion, prevent the admission to the partnership of substituted limited partners.

The shares of common stock issued upon redemption of the units will be freely transferable as registered securities under the Securities Act of 1933. Our common stock is listed on the New York Stock Exchange under the symbol AHT. The breadth and strength of this secondary market will depend, among other things, upon the number of shares of common stock outstanding, our financial condition, performance and prospects, the market for similar securities issued by REITs, and our dividend yield compared to that of other debt and equity securities.

Table of Contents

Federal Income Taxation

The partnership itself is not subject to federal income taxes. Instead, each holder of units includes its allocable share of the partnership s taxable income or loss in determining its individual federal income tax liability. The maximum federal income tax rate for individuals under current law is 35%.	We have elected to be taxed as a REIT for federal income tax purposes. A REIT generally is not subject to federal income tax on the income that it distributes to stockholders if it meets the applicable REIT distribution requirements and other requirements for qualification as a REIT. Even a REIT, however, is subject to federal income tax on income that is not distributed and also may be subject to federal income and excise taxes in certain circumstances. The maximum federal income tax rate for corporations under current law is 35%. Stockholders generally will be subject to taxation on dividends (other than designated capital gains dividends and qualified dividend income) at rates applicable to ordinary income, instead of at lower capital gain rates that generally apply to dividends received from a regular C corporation.
Depending on certain facts, a unit holder s allocable share of income and loss from the partnership may be subject to the passive activity limitations. Under the passive activity rules, a unit holder s allocable share of income and loss from the partnership that is considered passive income generally can be offset against a holder s income and loss from other investments that constitute passive activities. Cash distributions from the partnership are generally not taxable to a holder of units except to the extent they exceed such holder s basis in its interest in the partnership (which will include such holder s allocable share of the partnership s nonrecourse debt). See Basis of Units.	Dividends paid by us will be treated as portfolio income and generally cannot be offset with losses from passive activities. Distributions made by us to our taxable domestic stockholders out of current or accumulated earnings and profits (and not designated as capital gain dividends) will be taken into account by them as ordinary income. Distributions that are properly designated by us as capital gain dividends or qualified dividend income may be taxed at long-term capital gain rates, subject to certain exceptions. Distributions (not designated as capital gain dividends) in excess of current and accumulated earnings and profits will first be treated as a non-taxable return of capital to the extent of a stockholder s adjusted basis in its stock, with the excess taxed as capital gain (if the stock has been held as a capital asset). See Federal Income Tax Consequences of our Status as a REIT Taxation of Taxable U.S. Stockholders.
Holders of units are required, in some cases, to file state income tax returns and/or pay state income taxes in the states in which the partnership owns property, even if they are not residents of those states.	Stockholders who are individuals generally will not be required to file state income tax returns and/or pay state income taxes outside of their state of residence with respect to our operations and distributions. We may be required to pay state income taxes in certain states.

PLAN OF DISTRIBUTION

This prospectus supplement and the accompanying prospectus relates to the possible issuance or sale of up to 3,814,842 shares of our common stock if, and to the extent that, the holders of an equal number of units in our operating partnership submit such units for redemption and we issue shares of common stock in exchange for such redeemed units. We will not receive any proceeds from any issuance of common stock in exchange for the units or from the sale of the common stock by the selling stockholder.

We are registering the shares of common stock covered by this prospectus supplement and the accompanying prospectus to permit the selling stockholders, or their pledgees, donees, transferees or other successors in interest, to sell such shares without restriction, in the open market or otherwise. Registration does not, however, necessarily mean that any of the units will be submitted for redemption or that any of the shares of common stock to be issued upon such redemption will be offered or sold by the selling stockholders.

The selling stockholders, or their pledgees, donees, transferees or other successors in interest, may offer and sell the common stock covered by this prospectus supplement and the accompanying prospectus in the following manner:

- on the New York Stock Exchange or other national exchange or quotation system on which our shares of common stock are listed or traded at the time of sale;
- in the over-the-counter market;
- in privately negotiated transactions;
- in underwritten transactions; or
- otherwise, at prices then prevailing or related to the then current market price or at negotiated prices.

The offering price of the shares of common stock covered by this prospectus supplement and the accompanying prospectus and offered from time to time will be determined by the selling stockholders and, at the time of determination, may be higher or lower than the market price of the common stock on the New York Stock Exchange.

The selling stockholders also may resell all or a portion of the common stock covered by this prospectus supplement and the accompanying prospectus in open market transactions in reliance upon Rule 144 under the Securities Act of 1933, provided they meet the criteria and conform to the requirements of such rule.

In connection with an underwritten offering, underwriters or agents may receive compensation in the form of discounts, concessions or commissions from a selling stockholder or from purchasers of offered shares of common stock for whom they may act as agents, and underwriters may sell offered shares of common stock to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers from whom they may act as agents.

Offered shares of common stock may be sold directly or through broker-dealers acting as principal or agent, or pursuant to a distribution by one or more underwriters on a firm commitment or best-efforts basis. The methods by which common stock may be sold include:

- a block trade in which the broker-dealer so engaged will attempt to sell common stock as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by such broker-dealer for its own account pursuant to this prospectus supplement and the accompanying prospectus;
- ordinary brokerage transactions and transactions in which the broker solicits purchases;
- an exchange distribution in accordance with the rules of the exchange or quotation system;
- privately negotiated transactions; and

underwritten transactions.

Table of Contents

The selling stockholders and any underwriters, dealer or agents participating in the distribution of offered common stock may be deemed to be underwriters within the meaning of the Securities Act of 1933. Any profit on the sale of offered shares of common stock by the selling stockholders and any commissions received by any such broker-dealers may be deemed to be underwriting commissions under the Securities Act of 1933.

When a selling shareholder elects to make a particular offer of shares of common stock, a prospectus supplement, if required, will be distributed that identifies any underwriters, dealers or agents and any discounts, commissions and other terms constituting compensation from such selling stockholder and any other required information.

In order to comply with state securities laws, if applicable, offered shares of common stock may be sold only through registered or licensed brokers or dealers. In addition, in certain states, offered shares of common stock may not be sold unless they have been registered or qualified for sale in such state or an exemption from such registration or qualification requirement is available and complied with.

We have agreed to pay all costs and expenses incurred in connection with the registration under the Securities Act of 1933 of the shares of common stock covered by this prospectus supplement and the accompanying prospectus, including, but not limited to, all registration and filing fees, printing expenses and fees and disbursements of our legal counsel and accountants. The selling stockholders will pay any brokerage fees and commissions, fees and disbursements of legal counsel for the selling stockholders and stock transfer and other taxes attributable to the sale of shares of common stock covered by this prospectus supplement and the accompanying prospectus.

Table of Contents

PROSPECTUS

COMMON STOCK

PREFERRED STOCK

DEBT SECURITIES

WARRANTS TO PURCHASE COMMON STOCK OR PREFERRED STOCK

Under this prospectus, we may offer, from time to time, in one or more series or classes, the securities described in this prospectus.

We will provide the specific terms of any securities we may offer in a supplement to this prospectus. You should carefully read this prospectus and any applicable prospectus supplement before deciding to invest in these securities. Our common stock is listed on the New York Stock Exchange under the symbol AHT.

We may offer and sell these securities to or through one or more underwriters, dealers and agents, or directly to purchasers, on a continuous or delayed basis. The prospectus describes some of the general terms that may apply to these securities. The specific terms of any securities to be offered will be described in a supplement to this prospectus.

Investing in our securities involves risks. See Risk Factors on page 2 for information regarding risks associated with an investment in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is April 13, 2007.

TABLE OF CONTENTS

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone else to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. An offer to sell these securities will not be made in any jurisdiction where the offer and sale is not permitted. You should assume that the information appearing in this prospectus, as well as information we previously filed with the Securities and Exchange Commission and incorporated by reference, is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operations and prospects may have changed since that date.

OUR COMPANY

We are a Maryland corporation that was formed in May 2003 to invest in the hospitality industry at all levels of the capital structure. Since our initial public offering in August 2003, we have actively acquired hotel assets. Our portfolio currently includes 130 hotel properties in 31 states, Washington, D.C. and Canada with 30,201 rooms, one office building and approximately $95.0 million of debt investments. Our hotel investments are currently focused on the upscale and upper-upscale lodging segments and are concentrated among Marriott, Hilton, Hyatt and Starwood brands.

We currently focus our investment strategies on the upscale and upper-upscale segments within the lodging industry. However, we also believe that as supply, demand and capital market cycles change, we will be able to shift our investment strategies to take advantage of newly created lodging-related investment opportunities as they develop. Currently, we do not limit our acquisitions to any specific geographical market.

We intend to continue to invest in a variety of lodging-related assets based upon our evaluation of diverse market conditions. Our target investments include (i) direct hotel investments; (ii) mezzanine financing through origination or through acquisition in secondary markets; (iii) first lien mortgage financing through origination or through acquisition in secondary markets; and (iv) sale-leaseback transactions.

We are self-advised and own our lodging investments and conduct our business through Ashford Hospitality Limited Partnership, our operating partnership. We are the sole general partner of our operating partnership.

We have elected to be treated as a real estate investment trust, or REIT, for federal income tax purposes. Because of limitations imposed on REITs in operating hotel properties, third-party managers manage each of our hotel properties. Our employees perform, directly through our operating partnership, various acquisition, development, redevelopment and corporate management functions. All persons employed in the day-to-day operations of our hotels are employees of the management companies engaged by our lessees, and are not our employees. Our principal executive offices are located at 14185 Dallas Parkway, Suite 1100, Dallas, Texas 75254. Our telephone number is (972) 490-9600. Our website is http://www.ahtreit.com. The contents of our website are not a part of this prospectus. Our shares of common stock are traded on the New York Stock Exchange, or the NYSE, under the symbol AHT.

RISK FACTORS

An investment in our securities involves various risks. You should carefully consider the risk factors incorporated by reference to our most recent Annual Report on Form 10-K and the other information contained in this prospectus, as updated by our subsequent filings under the Securities Exchange Act of 1934, as amended, and the risk factors and other information contained in the applicable prospectus supplement before acquiring any of our securities.

ABOUT THIS PROSPECTUS

This prospectus is part of a shelf registration statement. We may sell, from time to time, in one or more offerings, any combinations of the securities described in this prospectus. This prospectus only provides you with a general description of the securities we may offer. Each time we sell securities under this prospectus, we will provide a prospectus supplement that contains specific information about the terms of the securities. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement together with the additional information described below under the heading Where You Can Find More Information.

FORWARD-LOOKING STATEMENTS

We make forward-looking statements in this prospectus, and in the information incorporated by reference into it, that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. Statements regarding the following subjects are forward-looking by their nature:

- our business and investment strategy;
- our projected operating results;
- completion of any pending transactions;
- our ability to obtain future financing arrangements;
- our understanding of our competition;
- market trends;
- projected capital expenditures; and
- the impact of technology on our operations and business.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. You should carefully consider this risk when you make an investment decision concerning our securities. Additionally, the following factors could cause actual results to vary from our forward-looking statements:

the factors discussed in this prospectus, and in the information incorporated by reference into it, including those set forth under the section titled Risk Factors;

general volatility of the capital markets and the market price of our securities;

changes in our business or investment strategy;

availability, terms and deployment of capital;

availability of qualified personnel;

changes in our industry and the market in which we operate, interest rates or the general economy; and

the degree and nature of our competition.

When we use the words will likely result, may, anticipate, estimate, should, expect, believe, intend, or s
expressions, we intend to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

Unless otherwise indicated in a prospectus supplement, we expect to use the net proceeds from the sale of these securities for general corporate purposes, which may include acquisitions of additional properties as suitable opportunities arise, the repayment of outstanding indebtedness, capital expenditures, the expansion, redevelopment or improvement of properties in our portfolio, working capital and other general purposes. Further details regarding the use of the net proceeds of a specific series or class of the securities will be set forth in the applicable prospectus supplement.

RATIO OF EARNINGS TO FIXED CHARGES AND EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS

Our historical ratio of earnings to fixed charges, as adjusted for discontinued operations, and our ratio of earnings to combined fixed charges and preferred stock dividends, as adjusted for discontinued operations, for each of the years ended December 31, 2006, 2005 and 2004 are set forth below. The amount of coverage deficiency between earnings and fixed charges for the period August 29, 2003 to December 31, 2003 was $1,836,744, and we had no preferred stock outstanding during that period.

	Year Ended December 31,		
	2006	**2005**	**2004**
Ratio of earnings to fixed charges	1.65	1.04	1.22
Ratio of earnings to combined fixed charges and preferred stock dividends	1.35	*	1.09

* The amount of coverage deficiency for this period was approximately $7,571,000.

For purposes of computing the ratio of earnings to fixed charges and of earnings to combined fixed charges and preferred stock dividends and the amount of coverage deficiency, earnings have been calculated by adding fixed charges, excluding capitalized interest, to income (loss) from continuing operations before income taxes, gains or losses on property sales and (if applicable) minority interest in our operating partnership. Fixed charges consist (if applicable) of interest costs, whether expensed or capitalized, the interest component of rental expense and amortization of debt issuance costs and dividends to Class B unit holders and excludes write-off of debt issuance costs related to early termination of debt and loss on debt extinguishment.

DESCRIPTION OF OUR CAPITAL STOCK

General

We were formed under the laws of the State of Maryland. Rights of our stockholders are governed by the Maryland General Corporation Law, or MGCL, our charter and our bylaws. The following is a summary of the material provisions of our capital stock. Copies of our charter and bylaws are filed as exhibits to the registration statement of which this prospectus is a part. See Where You Can Find More Information.

Authorized Stock

Our charter provides that we may issue up to 200 million shares of voting common stock, par value $.01 per share, and 50 million shares of preferred stock, par value $.01 per share.

Table of Contents

Power to Issue Additional Shares of Our Common Stock and Preferred Stock

We believe that the power of our board of directors, without stockholder approval, to issue additional authorized but unissued shares of our common stock or preferred stock and to classify or reclassify unissued shares of our common stock or preferred stock and thereafter to cause us to issue such classified or reclassified shares of stock provides us with flexibility in structuring possible future financings and acquisitions and in meeting other needs which might arise. The additional classes or series, as well as the common stock, will be available for issuance without further action by our stockholders, unless stockholder consent is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Although our board of directors does not intend to do so, it could authorize us to issue an additional class or series of stock that could, depending upon the terms of the particular class or series, delay, defer or prevent a transaction or a change of control of our company that might involve a premium price for our stockholders or otherwise be in their best interest.

Restrictions on Ownership and Transfer

In order for us to qualify as a REIT under the Internal Revenue Code or Code, not more than 50% of the value of the outstanding shares of our stock may be owned, actually or constructively, by five or fewer individuals (as defined in the Code to include certain entities) during the last half of a taxable year (other than the first year for which an election to be a REIT has been made by us). In addition, if we, or one or more owners (actually or constructively) of 10% or more of us, actually or constructively owns 10% or more of a tenant of ours (or a tenant of any partnership in which we are a partner), the rent received by us (either directly or through any such partnership) from such tenant will not be qualifying income for purposes of the REIT gross income tests of the Code. Our stock must also be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months or during a proportionate part of a shorter taxable year (other than the first year for which an election to be a REIT has been made by us).

Our charter contains restrictions on the ownership and transfer of our capital stock that are intended to assist us in complying with these requirements and continuing to qualify as a REIT. The relevant sections of our charter provide that, subject to the exceptions described below, no person or persons acting as a group may own, or be deemed to own by virtue of the attribution provisions of the Code, more than (i) 9.8% of the lesser of the number or value of shares of our common stock outstanding or (ii) 9.8% of the lesser of the number or value of the issued and outstanding preferred or other shares of any class or series of our stock. We refer to this restriction as the ownership limit.

The ownership attribution rules under the Code are complex and may cause stock owned actually or constructively by a group of related individuals and/or entities to be owned constructively by one individual or entity. As a result, the acquisition of less than 9.8% of our common stock (or the acquisition of an interest in an entity that owns, actually or constructively, our common stock) by an individual or entity, could, nevertheless cause that individual or entity, or another individual or entity, to own constructively in excess of 9.8% of our outstanding common stock and thereby subject the common stock to the ownership limit.

Our board of directors may, in its sole discretion, waive the ownership limit with respect to one or more stockholders if it determines that such ownership will not cause any individual s beneficial ownership of shares of our capital stock to jeopardize our status as a REIT (for example, by causing any tenant of ours to be considered a related party tenant for purposes of the REIT qualification rules).

As a condition of our waiver, our board of directors may require an opinion of counsel or IRS ruling satisfactory to our board of directors, and/or representations or undertakings from the applicant with respect to preserving our REIT status.

In connection with the waiver of the ownership limit or at any other time, our board of directors may decrease the ownership limit for all other persons and entities; provided, however, that the decreased ownership limit will not be effective for any person or entity whose percentage ownership in our capital stock is in excess of such decreased ownership limit until such time as such person or entity s percentage of our capital stock equals or falls below the decreased ownership limit, but any further acquisition of our capital stock in excess of such percentage ownership of our capital stock will be in violation of the ownership limit. Additionally, the new ownership limit may not allow five or fewer individuals (as defined for purposes of the REIT ownership restrictions under the Code) to beneficially own more than 49.5% of the value of our outstanding capital stock.

Our charter provisions further prohibit:

- any person from actually or constructively owning shares of our capital stock that would result in us being closely held under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT; and

- any person from transferring shares of our capital stock if such transfer would result in shares of our stock being beneficially owned by fewer than 100 persons (determined without reference to any rules of attribution).

Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of shares of our common stock that will or may violate any of the foregoing restrictions on transferability and ownership will be required to give notice immediately to us and provide us with such other information as we may request in order to determine the effect of such transfer on our status as a REIT. The foregoing provisions on transferability and ownership will not apply if our board of directors determines that it is no longer in our best interests to qualify, or to continue to qualify, as a REIT.

Pursuant to our charter, if any purported transfer of our capital stock or any other event would otherwise result in any person violating the ownership limits or the other restrictions in our charter, then any such purported transfer will be void and of no force or effect with respect to the purported transferee or owner (collectively referred to hereinafter as the purported owner) as to that number of shares in excess of the ownership limit (rounded up to the nearest whole share). The number of shares in excess of the ownership limit will be automatically transferred to, and held by, a trust for the exclusive benefit of one or more charitable organizations selected by us. The trustee of the trust will be designated by us and must be unaffiliated with us and with any purported owner. The automatic transfer will be effective as of the close of business on the business day prior to the date of the violative transfer or other event that results in a transfer to the trust. Any dividend or other distribution paid to the purported owner, prior to our discovery that the shares had been automatically transferred to a trust as described above, must be repaid to the trustee upon demand for distribution to the beneficiary of the trust and all dividends and other distributions paid by us with respect to such excess shares prior to the sale by the trustee of such shares shall be paid to the trustee for the beneficiary. If the transfer to the trust as described above is not automatically effective, for any reason, to prevent violation of the applicable ownership limit, then our charter provides that the transfer of the excess shares will be void. Subject to Maryland law, effective as of the date that such excess shares have been transferred to the trust, the trustee shall have the authority (at the trustee s sole discretion and subject to applicable law) (i) to rescind as void any vote cast by a purported owner prior to our discovery that such shares have been transferred to the trust and (ii) to recast such vote in accordance with the desires of the trustee acting for the benefit of the beneficiary of the trust, provided that if we have already taken irreversible action, then the trustee shall not have the authority to rescind and recast such vote.

Shares of our capital stock transferred to the trustee are deemed offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price paid by the purported owner for the shares (or, if the event which resulted in the transfer to the trust did not involve a purchase of such shares of our capital stock at market price, the market price on the day of the event which resulted in the transfer of such shares of our capital stock to the trust) and (ii) the market price on the date we, or our designee, accepts such offer. We have the right to accept such offer until the trustee has sold the shares of our capital stock held in the trust pursuant to the clauses discussed below. Upon a sale to us, the interest of the charitable beneficiary in the shares sold terminates and the trustee must distribute the net proceeds of the sale to the purported owner and any dividends or other distributions held by the trustee with respect to such capital stock will be paid to the charitable beneficiary.

If we do not buy the shares, the trustee must, within 20 days of receiving notice from us of the transfer of shares to the trust, sell the shares to a person or entity designated by the trustee who could own the shares without violating the ownership limits. After that, the trustee must distribute to the purported owner an amount equal to the lesser of (i) the net price paid by the purported owner for the shares (or, if the event which resulted in the transfer to the trust did not involve a purchase of such shares at market price, the market price on the day of the event which resulted in

Table of Contents

the transfer of such shares of our capital stock to the trust) and (ii) the net sales proceeds received by the trust for the shares. Any proceeds in excess of the amount distributable to the purported owner will be distributed to the beneficiary.

Our charter also provides that Benefit Plan Investors (as defined in our charter) may not hold, individually or in the aggregate, 25% or more of the value of any class or series of shares of our capital stock to the extent such class or series does not constitute Publicly Offered Securities (as defined in our charter).

All persons who own, directly or by virtue of the attribution provisions of the Code, more than 5% (or such other percentage as provided in the regulations promulgated under the Code) of the shares of our outstanding capital stock must give written notice to us within 30 days after the end of each calendar year. In addition, each stockholder will, upon demand, be required to disclose to us in writing such information with respect to the direct, indirect and constructive ownership of shares of our stock as our board of directors deems reasonably necessary to comply with the provisions of the Code applicable to a REIT, to comply with the requirements or any taxing authority or governmental agency or to determine any such compliance.

All certificates representing shares of our capital stock bear a legend referring to the restrictions described above.

These ownership limits could delay, defer or prevent a transaction or a change of control of our company that might involve a premium price over the then prevailing market price for the holders of some, or a majority, of our outstanding shares of common stock or which such holders might believe to be otherwise in their best interest.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock and preferred stock is Computershare Trust Company, N.A.

DESCRIPTION OF OUR COMMON STOCK

The following description of our common stock sets forth certain general terms and provisions of our common stock to which any prospectus supplement may relate, including a prospectus supplement providing that common stock will be issuable upon conversion or exchange of our debt securities or preferred stock or upon the exercise of warrants to purchase our common stock.

All shares of our common stock covered by this prospectus will be duly authorized, fully paid and nonassessable. Subject to the rights of any other class or series of stock and to the provisions of the charter regarding the restrictions on transfer of stock, holders of shares of our common stock are entitled to receive dividends on such stock when, as and if authorized by our board of directors out of funds legally available therefor and declared by us and to share ratably in the assets of our company legally available for distribution to our stockholders in the event of our liquidation, dissolution or winding up after payment of or adequate provision for all known debts and liabilities of our company, including the preferential rights on dissolution of any class or classes of preferred stock.

Subject to the provisions of our charter regarding the restrictions on transfer of stock and except as provided with respect to any other class or series of stock, each outstanding share of our common stock entitles the holder to one vote on all matters submitted to a vote of stockholders, including the election of directors and the holders of shares of our common stock will possess the exclusive voting power. There is no cumulative voting in the election of our board of directors, which means that the holders of a plurality of the outstanding shares of our common stock can elect all of the directors then standing for election and the holders of the remaining shares will not be able to elect any directors.

Holders of shares of our common stock have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any securities of our company. Subject to the provisions of the charter regarding the restrictions on transfer of stock, shares of our common stock will have equal dividend, liquidation and other rights.

Under the MGCL, a Maryland corporation generally cannot dissolve, amend its charter, merge, consolidate, transfer all or substantially all of its assets, engage in a statutory share exchange or engage in similar transactions outside the ordinary course of business unless declared advisable by the board of directors and approved by the

Table of Contents

affirmative vote of stockholders holding at least two-thirds of the shares entitled to vote on the matter unless a lesser percentage (but not less than a majority of all of the votes entitled to be cast on the matter) is set forth in the corporation s charter. Our charter does not provide for a lesser percentage for these matters. However, Maryland law permits a corporation to transfer all or substantially all of its assets without the approval of the stockholders of the corporation to one or more persons if all of the equity interests of the person or persons are owned, directly or indirectly, by the corporation. Because operating assets may be held by a corporation s subsidiaries, as in our situation, this may mean that a subsidiary of a corporation can transfer all of its assets without a vote of the corporation s stockholders.

Our charter authorizes our board of directors to reclassify any unissued shares of our common stock into other classes or series of classes of stock and to establish the number of shares in each class or series and to set the preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications or terms or conditions of redemption for each such class or series.

DESCRIPTION OF OUR PREFERRED STOCK

Our charter authorizes our board of directors to classify any unissued shares of preferred stock and to reclassify any previously classified but unissued shares of any series. Prior to issuance of shares of each series, our board of directors is required by the MGCL and our charter to set the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each such series. Thus, our board of directors could authorize the issuance of shares of preferred stock with terms and conditions that could have the effect of delaying, deferring or preventing a transaction or a change of control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interest. As of the date hereof, 2,300,000 shares of Series A Preferred Stock, 7,447,865 shares of Series B-1 Preferred Stock, and 8,000,000 shares of Series C Preferred Stock are outstanding. Our preferred stock will, when issued, be fully paid and nonassessable and will not have, or be subject to, any preemptive or similar rights.

The prospectus supplement relating to the series of preferred stock offered by that supplement will describe the specific terms of those securities, including:

- the title and stated value of that preferred stock;
- the number of shares of that preferred stock offered, the liquidation preference per share and the offering price of that preferred stock;
- the dividend rate(s), period(s) and payment date(s) or method(s) of calculation thereof applicable to that preferred stock;
- whether dividends will be cumulative or non-cumulative and, if cumulative, the date from which dividends on that preferred stock will accumulate;
- the voting rights applicable to that preferred stock;
- the procedures for any auction and remarketing, if any, for that preferred stock;
- the provisions for a sinking fund, if any, for that preferred stock;
- the provisions for redemption including any restriction thereon, if applicable, of that preferred stock;

any listing of that preferred stock on any securities exchange;

the terms and conditions, if applicable, upon which that preferred stock will be convertible into shares of our common stock, including the conversion price (or manner of calculation of the conversion price) and conversion period;

a discussion of federal income tax considerations applicable to that preferred stock;

any limitations on issuance of any series of preferred stock ranking senior to or on a parity with that series of preferred stock as to dividend rights and rights upon liquidation, dissolution or winding up of our affairs;

Table of Contents

- in addition to those limitations described above under DESCRIPTION OF CAPITAL STOCK Restrictions on Ownership and Transfer, any other limitations on actual and constructive ownership and restrictions on transfer, in each case as may be appropriate to preserve our status as a REIT; and

- any other specific terms, preferences, rights, limitations or restrictions of that preferred stock.

Rank

Unless otherwise specified in the applicable prospectus supplement, the preferred stock will, with respect to dividend rights and rights upon liquidation, dissolution or winding up of our affairs rank:

- senior to all classes or series of common stock and to all equity securities ranking junior to the preferred stock with respect to dividend rights or rights upon liquidation, dissolution or winding up of our affairs;

- on a parity with all equity securities issued by us the terms of which specifically provide that those equity securities rank on a parity with the preferred stock with respect to dividend rights or rights upon liquidation, dissolution or winding up of our affairs; and

- junior to all equity securities issued by us the terms of which specifically provide that those equity securities rank senior to the preferred stock with respect to dividend rights or rights upon liquidation, dissolution or winding up of our affairs.

The term equity securities does not include convertible debt securities.

Dividends

Subject to the preferential rights of any other class or series of stock and to the provisions of the charter regarding the restrictions on transfer of stock, holders of shares of our preferred stock will be entitled to receive dividends on such stock when, as and if authorized by our board of directors out of funds legally available therefor and declared by us, at rates and on dates as will be set forth in the applicable prospectus supplement.

Dividends on any series or class of our preferred stock may be cumulative or noncumulative, as provided in the applicable prospectus supplement. Dividends, if cumulative, will be cumulative from and after the date set forth in the applicable prospectus supplement. If our board of directors fails to authorize a dividend payable on a dividend payment date on any series or class of preferred stock for which dividends are noncumulative, then the holders of that series or class of preferred stock will have no right to receive a dividend in respect of the dividend period ending on that dividend payment date, and we will have no obligation to pay the dividend accrued for that period, whether or not dividends on such series or class are declared or paid for any future period.

If any shares of preferred stock of any series or class are outstanding, no dividends may be authorized or paid or set apart for payment on the preferred stock of any other series or class ranking, as to dividends, on a parity with or junior to the preferred stock of that series or class for any period unless:

- the series or class of preferred stock has a cumulative dividend, and full cumulative dividends have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment of those dividends is set apart for payment on the preferred stock of that series or class for all past dividend periods and the then current dividend period; or the series or class of preferred stock does not have a cumulative dividend, and full dividends for the then current dividend period have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment of those dividends is set apart for the payment on the preferred stock of that series or class.

When dividends are not paid in full (or a sum sufficient for the full payment is not set apart) upon the shares of preferred stock of any series or class and the shares of any other series or class of preferred stock ranking on a parity as to dividends with the preferred stock of that series or class, then all dividends authorized on shares of preferred stock of that series or class and any other series or class of preferred stock ranking on a parity as to dividends with that preferred stock shall be authorized pro rata so that the amount of dividends authorized per share on the preferred stock of that series or class and other series or class of preferred stock will in all cases bear to each other the same ratio that accrued dividends per share on the shares of preferred stock of that series or class (which will not include any accumulation in respect of unpaid dividends for prior dividend periods if the preferred stock does not have a cumulative dividend) and that other series or class of preferred stock bear to each other. No interest, or sum of money in lieu of interest, will be payable in respect of any dividend payment or payments on preferred stock of that series or class that may be in arrears.

Redemption

We may have the right or may be required to redeem one or more series of preferred stock, in whole or in part, in each case upon the terms, if any, and at the time and at the redemption prices set forth in the applicable prospectus supplement.

If a series of preferred stock is subject to mandatory redemption, we will specify in the applicable prospectus supplement the number of shares we are required to redeem, when those redemptions start, the redemption price, and any other terms and conditions affecting the redemption. The redemption price will include all accrued and unpaid dividends, except in the case of noncumulative preferred stock. The redemption price may be payable in cash or other property, as specified in the applicable prospectus supplement. If the redemption price for preferred stock of any series or class is payable only from the net proceeds of the issuance of our stock, the terms of that preferred stock may provide that, if no such stock shall have been issued or to the extent the net proceeds from any issuance are insufficient to pay in full the aggregate redemption price then due, that preferred stock shall automatically and mandatorily be converted into shares of our applicable stock pursuant to conversion provisions specified in the applicable prospectus supplement.

Liquidation Preference

Upon any voluntary or involuntary liquidation or dissolution of us or winding up of our affairs, then, before any distribution or payment will be made to the holders of common stock or any other series or class of stock ranking junior to any series or class of the preferred stock in the distribution of assets upon any liquidation, dissolution or winding up of our affairs, the holders of that series or class of preferred stock will be entitled to receive out of our assets legally available for distribution to shareholders liquidating distributions in the amount of the liquidation preference per share (set forth in the applicable prospectus supplement), plus an amount equal to all dividends accrued and unpaid on the preferred stock (which will not include any accumulation in respect of unpaid dividends for prior dividend periods if the preferred stock does not have a cumulative dividend). After payment of the full amount of the liquidating distributions to which they are entitled, the holders of preferred stock will have no right or claim to any of our remaining assets.

If, upon any voluntary or involuntary liquidation, dissolution or winding up, the legally available assets are insufficient to pay the amount of the liquidating distributions on all outstanding shares of any series or class of preferred stock and the corresponding amounts payable on all shares of other classes or series of our stock of ranking on a parity with that series or class of preferred stock in the distribution of assets upon liquidation, dissolution or winding up, then the holders of that series or class of preferred stock and all other classes or series of capital stock will share ratably in any distribution of assets in proportion to the full liquidating distributions to which they would otherwise be respectively entitled.

If liquidating distributions have been made in full to all holders of any series or class of preferred stock, our remaining assets will be distributed among the holders of any other classes or series of stock ranking junior to that series or class of preferred stock upon liquidation, dissolution or winding up, according to their respective rights and preferences and in each case according to their respective number of shares. For these purposes, the consolidation or merger of us with or into any other entity, or the sale, lease, transfer or conveyance of all or substantially all of our property or business, will not be deemed to constitute a liquidation, dissolution or winding up of our affairs.

Voting Rights

Holders of preferred stock will not have any voting rights, except as set forth below or as indicated in the applicable prospectus supplement.

Unless provided otherwise for any series or class of preferred stock, so long as any shares of preferred stock of a series or class remain outstanding, we will not, without the affirmative vote or consent of the holders of at least a majority of the shares of that series or class of preferred stock outstanding at the time, given in person or by proxy, either in writing or at a meeting (such series or class voting separately as a class):

- authorize or create, or increase the authorized or issued amount of, any class or series of stock ranking prior to that series or class of preferred stock with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up or reclassify any authorized stock into any of those shares, or create, authorize or issue any obligation or security convertible into or evidencing the right to purchase any of those shares; or
- amend, alter or repeal the provisions of our charter or articles supplementary for such series or class of preferred stock, whether by merger, consolidation or otherwise, so as to materially and adversely affect any right, preference, privilege or voting power of that series or class of preferred stock or the holders of the preferred stock.

However, any increase in the amount of the authorized preferred stock or the creation or issuance of any other series or class of preferred stock, or any increase in the amount of authorized shares of such series or class or any other series or class of preferred stock, in each case ranking on a parity with or junior to the preferred stock of that series or class with respect to payment of dividends or the distribution of assets upon liquidation, dissolution or winding up, will not be deemed to materially and adversely affect such rights, preferences, privileges or voting powers.

These voting provisions will not apply if, at or prior to the time when the act with respect to which that vote would otherwise be required will be effected, all outstanding shares of that series or class of preferred stock have been redeemed or called for redemption upon proper notice and sufficient funds have been deposited in trust to effect that redemption.

Conversion Rights

The terms and conditions, if any, upon which shares of any series or class of preferred stock are convertible into shares of common stock will be set forth in the applicable prospectus supplement. The terms will include:

- the number of shares of common stock into which the preferred stock is convertible;
- the conversion price (or manner of calculation of the conversion price);
- the conversion period;
- provisions as to whether conversion will be at the option of the holders of the preferred stock or us,
- the events requiring an adjustment of the conversion price; and
- provisions affecting conversion in the event of the redemption of the preferred stock.

Series A Preferred Stock

Our board of directors has classified and designated 3,000,000 shares of Series A Preferred Stock, of which 2,300,000 shares are currently outstanding. The Series A Preferred Stock generally provides for the following rights, preferences and obligations.

Dividend Rights. The Series A Preferred Stock accrues a cumulative cash dividend at an annual rate of 8.55% on the $25.00 per share liquidation preference.

Liquidation Rights. Upon any voluntary or involuntary liquidation, dissolution or winding up of our company, the holders of Series A Preferred Stock will be entitled to receive a liquidation preference of $25.00 per share, plus any accumulated, accrued and unpaid dividends (whether or not earned or declared), before any payment or distribution will be made or set aside for holders of any junior stock.

Redemption Provisions. The Series A Preferred Stock is not redeemable prior to September 22, 2009, except in certain limited circumstances relating to our ability to qualify as a REIT. On and after September 22, 2009, we may redeem Series A Preferred Stock, in whole or from time to time in part, at a cash redemption price equal to 100% of the liquidation preference plus all accrued and unpaid dividends to the date fixed for redemption. The Series A Preferred Stock has no stated maturity and is not subject to any sinking fund or mandatory redemption provisions.

Voting Rights. Holders of Series A Preferred Stock generally have no voting rights, except in certain circumstances when our board of directors will be expanded by two seats and the holders of Series A Preferred Stock, voting together as a single class with the holders of all other series of preferred stock that has been granted similar voting rights and is considered parity stock with the Series A Preferred Stock, will be entitled to elect these two directors. In addition, the issuance of senior shares or certain changes to the terms of the Series A Preferred Stock that would be materially adverse to the rights of holders of Series A Preferred Stock cannot be made without the affirmative vote of holders of at least 662/3% of the outstanding Series A Preferred Stock and shares of any class or series of shares ranking on a parity with the Series A Preferred Stock which are entitled to similar voting rights, if any, voting as a single class.

Conversion and Preemptive Rights. The Series A Preferred Stock is not convertible or exchangeable for any of our other securities or property, and holders of shares of our Series A Preferred Stock have no preemptive rights to subscribe for any securities of our company.

Series B-1 Preferred Stock

Our board of directors has classified and designated 7,447,865 shares of Series B-1 Preferred Stock, all of which are currently outstanding. The Series B-1 Preferred Stock generally provides for the following rights, preferences and obligations.

Dividend Rights. Holders of Series B-1 Preferred Stock are entitled to receive cumulative cash dividends equal to the greater of $0.14 per share or the prevailing common stock dividend. Additionally, if we breach certain contractual obligations we have to the holders of the Series B-1 Preferred Stock or if we fail to pay dividends on the Series B-1 Preferred Stock for four quarterly dividend periods, the holders of Series B-1 Preferred Stock will be entitled to an additional dividend equal to $0.05015 per share. Under certain circumstances, in the event we declare a special or extraordinary cash dividend or distribution, holders of Series B-1 Preferred Stock will be entitled to a special dividend of Series B-1 Preferred Stock.

Liquidation Rights. Upon any voluntary or involuntary liquidation, dissolution or winding up of our company, the holders of Series B-1 Preferred Stock will be entitled to receive a liquidation preference of $10.07 per share, plus an amount equal to all accumulated, accrued and unpaid dividends (whether or not earned or declared) to the date of liquidation, dissolution or winding up of the affairs of our company, before any payment or distribution will be made to or set apart for the holders of any junior stock.

Redemption Provisions. We have certain limited redemption rights with respect to the Series B-1 Preferred Stock from January 2, 2008 through June 14, 2008 (based on the trading price of our common stock) and full redemption rights thereafter, in each case provided we are in compliance with all financial covenants included in the Series B purchase agreement during the period commencing on the date we give our redemption notice through the redemption date. Any such redemption will be made at a redemption price equal to the liquidation preference of $10.07 per share, plus an amount equal to all accumulated, accrued and unpaid dividends (whether or not earned or declared).

Each holder of Series B-1 Preferred Stock is entitled to require us to redeem the Series B-1 Preferred Stock for 100% of its liquidation value, plus accrued and unpaid distributions whether or not declared, if a change of control occurs. If we fail to continue to qualify as a REIT or we cease to be listed for trading on the NYSE, the NASDAQ National Market system or the American Stock Exchange, then we are also required to redeem the Series B-1 Preferred Stock and the redemption price will be equal to (i) 110% of the liquidation value of the Series B-1 Preferred Stock, plus accrued and unpaid dividends, whether or not earned or declared, if such repurchase occurs prior to June 15, 2008 or (ii) 100% of the liquidation value, plus accrued and unpaid dividends, whether or not earned or declared, if such repurchase occurs on or after such date.

Voting Rights. Holders of Series B-1 Preferred Stock are entitled to vote on (i) all matters submitted to the holders of our common stock together with the holders of our common stock as a single class and (ii) certain matters affecting the Series B-1 Preferred Stock as a separate class. In certain circumstances, our board of directors will be expanded by two seats and the holders of Series B-1 Preferred Stock will be entitled to elect these two directors.

So long as any share of Series B-1 Preferred Stock is outstanding, in addition to any other vote or consent of stockholders required by law or by our charter, the affirmative vote of the holders of 662/3% of the outstanding shares of Series B-1 Preferred Stock, voting together as a class, given in person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(a) any amendment, alteration or repeal of any of the provisions of the charter or the articles supplementary creating the Series B-1 Preferred Stock that materially and adversely affects the voting powers, rights, preferences or other terms of the holders of the Series B-1 Preferred Stock;

(b) any issuance of (a) any capital stock or other equity security to which the Series B-1 Preferred Stock would be junior as to the payment of dividends or as to the distribution of assets upon liquidation, dissolution or winding up or (b) any capital stock or other equity security which has redemption rights which are more favorable in any material respect to the holder of such security than the redemption rights granted to the holders of the Series B-1 Preferred Stock; and

(c) any merger or consolidation of our company and another entity in which the we are not the surviving corporation and each holder of Series B-1 Preferred Stock does not receive shares of the surviving corporation with substantially similar rights, preferences, powers and other terms in the surviving corporation as the Series B-1 Preferred Stock have with respect to us.

Conversion and Preemptive Rights. Each share of Series B-1 Preferred Stock is convertible, at the option of the holder, at any time into the number of shares of our common stock obtained by dividing $10.07 by the conversion price then in effect. The conversion price is currently $10.07 and is subject to certain adjustments as provided in our charter. Holders of shares of our Series B-1 Preferred Stock have no preemptive rights to subscribe for any securities of our company.

Series C Preferred Stock

Our board of directors has classified and designated 8,000,000 shares of Series C Preferred Stock, all of which are currently outstanding. The Series C Preferred Stock generally provides for the following rights, preferences and obligations.

Dividend Rights. Through October 10, 2008, holders of Series C Preferred Stock are entitled to receive cumulative cash dividends equal to three-month LIBOR plus 2.5%. After October 10, 2008, the dividend rate will increase to three-month LIBOR plus a margin equal to either 4.25%, 5.00% or 8.00%, depending on our then-current net debt to total assets ratio. Additionally, if there is a change of control of our company or shares of Series C Preferred Stock are delisted after having been listed on the New York Stock Exchange, the American Stock Exchange or NASDAQ, the then-effective dividend rate for the Series C Preferred Stock will increase by 2% per year.

Liquidation Rights. Upon any voluntary or involuntary liquidation, dissolution or winding up of our company, the holders of Series C Preferred Stock will be entitled to receive a liquidation preference of $25.00 per share, plus an amount equal to all accumulated, accrued and unpaid dividends (whether or not earned or declared) to the date of liquidation, dissolution or winding up of the affairs of our company, before any payment or distribution will be made to or set apart for the holders of any junior stock.

Redemption Provisions. The Series C Preferred Stock may be redeemed by our company at any time prior to the October 11, 2008 or after October 11, 2013. Between October 11, 2008 and October 11, 2013, we will have certain limited redemption rights if (i) a change of control occurs, (ii) after having been listed on the NYSE, the NASDAQ National Market system or the American Stock Exchange, the Series C Preferred Stock ceases to be so listed or (iii) if redemption of the Series C Preferred Stock becomes necessary to preserve our REIT status.

At any time it is redeemable by us, we may redeem all or a portion of the Series C Preferred Stock by paying its holders a redemption price equal to the liquidation value of $25.00 per share, plus accumulated, accrued and unpaid dividends, whether or not earned or declared.

Voting Rights. Holders of Series C Preferred Stock generally have no voting rights, except in certain circumstances when our board of directors will be expanded by two seats and the holders of Series C Preferred Stock, voting together as a single class with the holders of all other series of preferred stock that has been granted similar voting rights and is considered parity stock with the Series C Preferred Stock, will be entitled to elect these two directors. In addition, the issuance of senior shares or certain changes to the terms of the Series C Preferred Stock that would be materially adverse to the rights of holders of Series C Preferred Stock cannot be made without the affirmative vote of holders of at least 662/3% of the outstanding Series C Preferred Stock and shares of any class or series of shares ranking on a parity with the Series C Preferred Stock which are entitled to similar voting rights, if any, voting as a single class.

Conversion and Preemptive Rights. The Series C Preferred Stock is not convertible or exchangeable for any of our other securities or property, and holders of shares of our Series C Preferred Stock have no preemptive rights to subscribe for any securities of our company.

DESCRIPTION OF OUR DEBT SECURITIES

The following description, together with the additional information we include in any applicable prospectus supplements, summarizes the material terms and provisions of the debt securities that we may offer under this prospectus. While the terms we have summarized below will apply generally to any future debt securities we may offer, we will describe the particular terms of any debt securities that we may offer in more detail in the applicable prospectus supplement. If we indicate in a prospectus supplement, the terms of any debt securities we offer under that prospectus supplement may differ from the terms we describe below.

The debt securities will be our direct unsecured general obligations and may include debentures, notes, bonds or other evidences of indebtedness. The debt securities will be either senior debt securities or subordinated debt securities. The debt securities will be issued under one or more separate indentures. Senior debt securities will be issued under a senior indenture, and subordinated debt securities will be issued under a subordinated indenture. We use the term indentures to refer to both the senior indenture and the subordinated indenture. The indentures will be qualified under the Trust Indenture Act. We use the term trustee to refer to either the senior trustee or the subordinated trustee, as applicable.

The following summaries of material provisions of the debt securities and indentures are subject to, and qualified in their entirety by reference to, all the provisions of the indenture applicable to a particular series of debt securities.

General

We will describe in each prospectus supplement the following terms relating to a series of debt securities:

- the title;
- any limit on the amount that may be issued;
- whether or not we will issue the series of debt securities in global form, the terms and who the depository will be;

the maturity date;

the annual interest rate, which may be fixed or variable, or the method for determining the rate and the date interest will begin to accrue, the dates interest will be payable and the regular record dates for interest payment dates or the method for determining such dates;

whether or not the debt securities will be secured or unsecured, and the terms of any secured debt;

the terms of the subordination of any series of subordinated debt;

the place where payments will be payable;

our right, if any, to defer payment of interest and the maximum length of any such deferral period;

the date, if any, after which, and the price at which, we may, at our option, redeem the series of debt securities pursuant to any optional redemption provisions;

the date, if any, on which, and the price at which we are obligated, pursuant to any mandatory sinking fund provisions or otherwise, to redeem, or at the holder s option to purchase, the series of debt securities;

whether the indenture will restrict our ability to pay dividends, or will require us to maintain any asset ratios or reserves;

whether we will be restricted from incurring any additional indebtedness;

a discussion on any material or special United States federal income tax considerations applicable to the debt securities;

the denominations in which we will issue the series of debt securities, if other than denominations of $1,000 and any integral multiple thereof; and

any other specific terms, preferences, rights or limitations of, or restrictions on, the debt securities.

Conversion or Exchange Rights

We will set forth in the prospectus supplement the terms on which a series of debt securities may be convertible into or exchangeable for shares of common stock or other securities of ours. We will include provisions as to whether conversion or exchange is mandatory, at the option of the holder or at our option. We may include provisions pursuant to which the number of shares of common stock or other securities of ours that the holders of the series of debt securities receive would be subject to adjustment.

Consolidation, Merger or Sale

The indentures do not contain any covenant which restricts our ability to merge or consolidate, or sell, convey, transfer or otherwise dispose of all or substantially all of our assets. However, any successor to or acquirer of such assets must assume all of our obligations under the indentures or the debt securities, as appropriate.

Events of Default Under the Indenture

The following are events of default under the indentures with respect to any series of debt securities that we may issue:

if we fail to pay interest when due and our failure continues for a number of days to be stated in the indenture and the time for payment has not been extended or deferred;

if we fail to pay the principal, or premium, if any, when due and the time for payment has not been extended or delayed;

if we fail to observe or perform any other covenant contained in the debt securities or the indentures, other than a covenant specifically relating to another series of debt securities, and our failure continues for a number of days to be stated in the indenture after we receive notice from the trustee or holders of at least 25% in aggregate principal amount of the outstanding debt securities of the applicable series; and

if specified events of bankruptcy, insolvency or reorganization occur as to us.

If an event of default with respect to debt securities of any series occurs and is continuing, the trustee or the holders of at least 25% in aggregate principal amount of the outstanding debt securities of that series, by notice to us in writing, and to the trustee if notice is given by such holders, may declare the unpaid principal of, premium, if any, and accrued interest, if any, due and payable immediately.

The holders of a majority in principal amount of the outstanding debt securities of an affected series may waive any default or event of default with respect to the series and its consequences, except defaults or events of default regarding payment of principal, premium, if any, or interest, unless we have cured the default or event of default in accordance with the indenture. Any waiver shall cure the default or event of default.

Subject to the terms of the indentures, if an event of default under an indenture shall occur and be continuing, the trustee will be under no obligation to exercise any of its rights or powers under such indenture at the request or direction of any of the holders of the applicable series of debt securities, unless such holders have offered the trustee reasonable indemnity. The holders of a majority in principal amount of the outstanding debt securities of any series will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee, or exercising any trust or power conferred on the trustee, with respect to the debt securities of that series, provided that:

- the direction so given by the holder is not in conflict with any law or the applicable indenture; and

- subject to its duties under the Trust Indenture Act, the trustee need not take any action that might involve it in personal liability or might be unduly prejudicial to the holders not involved in the proceeding.

A holder of the debt securities of any series will only have the right to institute a proceeding under the indentures or to appoint a receiver or trustee, or to seek other remedies if:

- the holder has given written notice to the trustee of a continuing event of default with respect to that series;

- the holders of at least 25% in aggregate principal amount of the outstanding debt securities of that series have made written request, and such holders have offered reasonable indemnity to the trustee to institute the proceeding as trustee; and

- the trustee does not institute the proceeding, and does not receive from the holders of a majority in aggregate principal amount of the outstanding debt securities of that series other conflicting directions within 60 days after the notice, request and offer.

These limitations do not apply to a suit instituted by a holder of debt securities if we default in the payment of the principal, premium, if any, or interest on, the debt securities.

We will periodically file statements with the trustee regarding our compliance with specified covenants in the indentures.

Modification of Indenture; Waiver

We and the trustee may change an indenture without the consent of any holders with respect to specific matters, including:

- to fix any ambiguity, defect or inconsistency in the indenture; and

- to change anything that does not materially adversely affect the interests of any holder of debt securities of any series.

In addition, under the indentures, the rights of holders of a series of debt securities may be changed by us and the trustee with the written consent of the holders of at least a majority in aggregate principal amount of the outstanding debt securities of each series that is affected. However, we and the trustee may only make the following changes with the consent of each holder of any outstanding debt securities affected:

- extending the fixed maturity of the series of debt securities;
- reducing the principal amount, reducing the rate of or extending the time of payment of interest, or any premium payable upon the redemption of any debt securities; or
- reducing the percentage of debt securities, the holders of which are required to consent to any amendment.

Table of Contents

Discharge

Each indenture provides that we can elect to be discharged from our obligations with respect to one or more series of debt securities, except for obligations to:

- register the transfer or exchange of debt securities of the series;
- replace stolen, lost or mutilated debt securities of the series;
- maintain paying agencies;
- hold monies for payment in trust;
- compensate and indemnify the trustee;
- and appoint any successor trustee.

In order to exercise our rights to be discharged, we must deposit with the trustee money or government obligations sufficient to pay all the principal of, any premium, if any, and interest on, the debt securities of the series on the dates payments are due.

Form, Exchange and Transfer

We will issue the debt securities of each series only in fully registered form without coupons and, unless we otherwise specify in the applicable prospectus supplement, in denominations of $1,000 and any integral multiple thereof. The indentures provide that we may issue debt securities of a series in temporary or permanent global form and as book-entry securities that will be deposited with, or on behalf of, The Depository Trust Company or another depository named by us and identified in a prospectus supplement with respect to that series.

At the option of the holder, subject to the terms of the indentures and the limitations applicable to global securities described in the applicable prospectus supplement, the holder of the debt securities of any series can exchange the debt securities for other debt securities of the same series, in any authorized denomination and of like tenor and aggregate principal amount.

Subject to the terms of the indentures and the limitations applicable to global securities set forth in the applicable prospectus supplement, holders of the debt securities may present the debt securities for exchange or for registration of transfer, duly endorsed or with the form of transfer endorsed thereon duly executed if so required by us or the security registrar, at the office of the security registrar or at the office of any transfer agent designated by us for this purpose. Unless otherwise provided in the debt securities that the holder presents for transfer or exchange, we will make no service charge for any registration of transfer or exchange, but we may require payment of any taxes or other governmental charges.

We will name in the applicable prospectus supplement the security registrar, and any transfer agent in addition to the security registrar, that we initially designate for any debt securities. We may at any time designate additional transfer agents or rescind the designation of any transfer agent or approve a change in the office through which any transfer agent acts, except that we will be required to maintain a transfer agent in each place of payment for the debt securities of each series.

If we elect to redeem the debt securities of any series, we will not be required to:

- issue, register the transfer of, or exchange any debt securities of that series during a period beginning at the opening of business 15 days before the day of mailing of a notice of redemption of any debt securities that may be selected for redemption and ending at the close of business on the day of the mailing; or

- register the transfer of or exchange any debt securities so selected for redemption, in whole or in part, except the unredeemed portion of any debt securities we are redeeming in part.

Information Concerning the Trustee

The trustee, other than during the occurrence and continuance of an event of default under an indenture, undertakes to perform only those duties as are specifically set forth in the applicable indenture. Upon an event of default under an indenture, the trustee must use the same degree of care as a prudent person would exercise or use in the conduct of his or her own affairs. Subject to this provision, the trustee is under no obligation to exercise any of the powers given it by the indentures at the request of any holder of debt securities unless it is offered reasonable security and indemnity against the costs, expenses and liabilities that it might incur.

Payment and Paying Agents

Unless we otherwise indicate in the applicable prospectus supplement, we will make payment of the interest on any debt securities on any interest payment date to the person in whose name the debt securities, or one or more predecessor securities, are registered at the close of business on the regular record date for the interest.

We will pay principal of and any premium and interest on the debt securities of a particular series at the office of the paying agents designated by us, except that unless we otherwise indicate in the applicable prospectus supplement, we will make interest payments by check which we will mail to the holder. Unless we otherwise indicate in a prospectus supplement, we will designate the corporate trust office of the trustee in the City of New York as our sole paying agent for payments with respect to debt securities of each series. We will name in the applicable prospectus supplement any other paying agents that we initially designate for the debt securities of a particular series. We will maintain a paying agent in each place of payment for the debt securities of a particular series.

All money we pay to a paying agent or the trustee for the payment of the principal of or any premium or interest on any debt securities which remains unclaimed at the end of two years after such principal, premium or interest has become due and payable will be repaid to us, and the holder of the security thereafter may look only to us for payment thereof.

Governing Law

The indentures and the debt securities will be governed by and construed in accordance with the laws of the State of New York, except to the extent that the Trust Indenture Act is applicable.

Subordination of Subordinated Notes

The subordinated notes will be unsecured and will be subordinate and junior in priority of payment to certain of our other indebtedness to the extent described in a prospectus supplement. The subordinated indenture does not limit the amount of subordinated notes which we may issue. It also does not limit us from issuing any other secured or unsecured debt.

DESCRIPTION OF OUR WARRANTS

This section describes the general terms and provisions of our securities warrants. The applicable prospectus supplement will describe the specific terms of the securities warrants offered through that prospectus supplement as well as any general terms described in this section that will not apply to those securities warrants.

We may issue securities warrants for the purchase of our debt securities, preferred stock, or common stock. We may issue warrants independently or together with other securities, and they may be attached to or separate from the other securities. Each series of securities warrants will be issued under a separate warrant agreement that we will enter into with a bank or trust company, as warrant agent, as detailed in the applicable prospectus supplement. The warrant agent will act solely as our agent in connection with the securities warrants and will not assume any obligation, or agency or trust relationship, with you.

The prospectus supplement relating to a particular issue of securities warrants will describe the terms of those securities warrants, including, where applicable:

- the aggregate number of the securities covered by the warrant;
- the designation, amount and terms of the securities purchasable upon exercise of the warrant;
- the exercise price for our debt securities, the amount of debt securities upon exercise you will receive, and a description of that series of debt securities;

the exercise price for shares of our preferred stock, the number of shares of preferred stock to be received upon exercise, and a description of that series of our preferred stock;

the exercise price for shares of our common stock and the number of shares of common stock to be received upon exercise;

the expiration date for exercising the warrant;

the minimum or maximum amount of warrants that may be exercised at any time;

a discussion of U.S. federal income tax consequences; and

any other material terms of the securities warrants.

After the warrants expire they will become void. The prospectus supplement will describe how to exercise securities warrants. A holder must exercise warrants for our preferred stock or common stock through payment in U.S. dollars. All securities warrants will be issued in registered form. The prospectus supplement may provide for the adjustment of the exercise price of the securities warrants.

Until a holder exercises warrants to purchase our debt securities, preferred stock, or common stock, that holder will not have any rights as a holder of our debt securities, preferred stock, or common stock by virtue of ownership of warrants.

BOOK-ENTRY SECURITIES

The securities offered by means of this prospectus may be issued in whole or in part in book-entry form, meaning that beneficial owners of the securities will not receive certificates representing their ownership interests in the securities, except in the event the book-entry system for the securities is discontinued. Securities issued in book entry form will be evidenced by one or more global securities that will be deposited with, or on behalf of, a depositary identified in the applicable prospectus supplement relating to the securities. We expect that The Depository Trust Company will serve as depository. Unless and until it is exchanged in whole or in part for the individual securities represented by that security, a global security may not be transferred except as a whole by the depository for the global security to a nominee of that depository or by a nominee of that depository to that depository or another nominee of that depository or by the depository or any nominee of that depository to a successor depository or a nominee of that successor. Global securities may be issued in either registered or bearer form and in either temporary or permanent form. The specific terms of the depositary arrangement with respect to a class or series of securities that differ from the terms described here will be described in the applicable prospectus supplement.

Unless otherwise indicated in the applicable prospectus supplement, we anticipate that the provisions described below will apply to depository arrangements.

Upon the issuance of a global security, the depository for the global security or its nominee will credit on its book-entry registration and transfer system the respective principal amounts of the individual securities represented by that global security to the accounts of persons that have accounts with such depository, who are called participants. Those accounts will be designated by the underwriters, dealers or agents with respect to the securities or by us if the securities are offered and sold directly by us. Ownership of beneficial interests in a global security will be limited to the depository s participants or persons that may hold interests through those participants. Ownership of beneficial interests in the global security will be shown on, and the transfer of that ownership will be effected only through, records maintained by the applicable depository or its nominee (with respect to beneficial interests of participants) and records of the participants (with respect to beneficial interests of persons who hold through participants). The laws of some states require that certain purchasers of securities take physical delivery of such securities in definitive form. These limits and laws may impair the ability to own, pledge or transfer beneficial interest in a global security.

So long as the depository for a global security or its nominee is the registered owner of such global security, that depository or nominee, as the case may be, will be considered the sole owner or holder of the securities represented by that global security for all purposes under the applicable indenture or other instrument defining the rights of a holder of the securities. Except as provided below or in the applicable prospectus supplement, owners of beneficial interest in a global security will not be entitled to have any of the individual securities of the series represented by that global security registered in their names, will not receive or be entitled to receive physical delivery of any such securities in definitive form and will not be considered the owners or holders of that security under the applicable indenture or other instrument defining the rights of the holders of the securities.

Payments of amounts payable with respect to individual securities represented by a global security registered in the name of a depository or its nominee will be made to the depository or its nominee, as the case may be, as the registered owner of the global security representing those securities. None of us, our officers and directors or any trustee, paying agent or security registrar for an individual series of securities will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the global security for such securities or for maintaining, supervising or reviewing any records relating to those beneficial ownership interests.

We expect that the depository for a series of securities offered by means of this prospectus or its nominee, upon receipt of any payment of principal, premium, interest, dividend or other amount in respect of a permanent global security representing any of those securities, will immediately credit its participants accounts with payments in amounts proportionate to their respective beneficial interests in the principal amount of that global security for those securities as shown on the records of that depository or its nominee. We also expect that payments by participants to owners of beneficial interests in that global security held through those participants will be governed by standing instructions and customary practices, as is the case with securities held for the account of customers in bearer form or registered in street name. Those payments will be the responsibility of these participants.

If a depository for a series of securities is at any time unwilling, unable or ineligible to continue as depository and a successor depository is not appointed by us within 90 days, we will issue individual securities of that series in exchange for the global security representing that series of securities. In addition, we may, at any time and in our sole discretion, subject to any limitations described in the applicable prospectus supplement relating to those securities, determine not to have any securities of that series represented by one or more global securities and, in that event, will issue individual securities of that series in exchange for the global security or securities representing that series of securities.

MATERIAL PROVISIONS OF MARYLAND LAW AND OF OUR CHARTER AND BYLAWS

The following is a summary of certain provisions of Maryland law and of our charter and bylaws. Copies of our charter and bylaws are filed as exhibits to the registration statement of which this prospectus is a part. See Where You Can Find More Information.

The Board of Directors

Our bylaws provide that the number of directors of our company may be established by our board of directors but may not be fewer than the minimum number permitted under the MGCL nor more than 15. Any vacancy will be filled, at any regular meeting or at any special meeting called for that purpose, by a majority of the remaining directors.

Pursuant to our charter, each member of our board of directors will serve one year terms and until their successors are elected and qualified. Holders of shares of our common stock will have no right to cumulative voting in the election of directors. Consequently, at each annual meeting of stockholders at which our board of directors is elected, the holders of a plurality of the shares of our common stock will be able to elect all of the members of our board of directors.

Business Combinations

Maryland law prohibits business combinations between a corporation and an interested stockholder or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, statutory share exchange, or, in circumstances specified in the statute, certain transfers of assets, certain stock issuances and transfers, liquidation plans and reclassifications involving interested stockholders and their affiliates as asset transfer or issuance or reclassification of equity securities. Maryland law defines an interested stockholder as:

any person who beneficially owns 10% or more of the voting power of our voting stock; or

an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then-outstanding voting stock of the corporation.

A person is not an interested stockholder if the board of directors approves in advance the transaction by which the person otherwise would have become an interested stockholder. However, in approving the transaction, the board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board of directors.

After the five year prohibition, any business combination between a corporation and an interested stockholder generally must be recommended by the board of directors and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of the then outstanding shares of common stock; and

two-thirds of the votes entitled to be cast by holders of the common stock other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or shares held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if certain fair price requirements set forth in the MGCL are satisfied.

The statute permits various exemptions from its provisions, including business combinations that are approved by the board of directors before the time that the interested stockholder becomes an interested stockholder.

Our charter includes a provision excluding the corporation from these provisions of the MGCL and, consequently, the five-year prohibition and the super-majority vote requirements will not apply to business combinations between us and any interested stockholder of ours unless we later amend our charter, with stockholder approval, to modify or eliminate this provision. Any such amendment may not be effective until 18 months after the stockholder vote and may not apply to any business combination involving us and an interested stockholder (or affiliate) who became an interested stockholder on or before the date of the vote. We believe that our ownership restrictions will substantially reduce the risk that a stockholder would become an interested stockholder within the meaning of the Maryland business combination statute.

Control Share Acquisitions

The MGCL provides that control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved at a special meeting by the affirmative vote of two-thirds of the votes entitled to be cast on the matter, excluding shares of stock in a corporation in respect of which any of the following persons is entitled to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors: (i) a person who makes or proposes to make a control share acquisition, (ii) an officer of the corporation or (iii) an employee of the corporation who is also a director of the corporation. Control shares are voting shares of stock which, if aggregated with all other such shares of stock previously acquired by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of voting power: (i) one-tenth or more but less than one-third, (ii) one-third or more but less than a majority, or (iii) a majority or more of all voting power. Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition, upon satisfaction of certain conditions (including an undertaking to pay expenses), may compel our board of directors to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. If no request for a meeting is made, the corporation may itself present the question at any stockholders meeting.

Table of Contents

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then, subject to certain conditions and limitations, the corporation may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of such shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of such appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply (i) to shares acquired in a merger, consolidation or share exchange if the corporation is a party to the transaction or (ii) to acquisitions approved or exempted by the charter or bylaws of the corporation.

Our charter contains a provision exempting from the control share acquisition statute any and all acquisitions by any person of our common stock and, consequently, the applicability of the control share acquisitions unless we later amend our charter, with stockholder approval, to modify or eliminate this provision.

Amendment to Our Charter

Our charter may be amended only if declared advisable by the board of directors and approved by the affirmative vote of the holders of at least two-thirds of all of the votes entitled to be cast on the matter.

Dissolution of Our Company

The dissolution of our company must be declared advisable by the board of directors and approved by the affirmative vote of the holders of not less than two-thirds of all of the votes entitled to be cast on the matter.

Advance Notice of Director Nominations and New Business

Our bylaws provide that:

- with respect to an annual meeting of stockholders, the only business to be considered and the only proposals to be acted upon will be those properly brought before the annual meeting:
  - pursuant to our notice of the meeting;
  - by, or at the direction of, a majority of our board of directors; or
  - by a stockholder who is entitled to vote at the meeting and has complied with the advance notice procedures set forth in our bylaws;
- with respect to special meetings of stockholders, only the business specified in our company s notice of meeting may be brought before the meeting of stockholders unless otherwise provided by law; and
- nominations of persons for election to our board of directors at any annual or special meeting of stockholders may be made only:

by, or at the direction of, our board of directors; or

by a stockholder who is entitled to vote at the meeting and has complied with the advance notice provisions set forth in our bylaws.

Anti-Takeover Effect of Certain Provisions of Maryland Law and of Our Charter and Bylaws

The advance notice provisions of our bylaws could delay, defer or prevent a transaction or a change of control of our company that might involve a premium price for holders of our common stock or otherwise be in their best interest. Likewise, if our company s charter were to be amended to avail the corporation of the business combination provisions of the MGCL or to remove or modify the provision in the charter opting out of the control share acquisition provisions of the MGCL, these provisions of the MGCL could have similar anti-takeover effects.

Table of Contents

Indemnification and Limitation of Directors and Officers Liability

Our charter and the partnership agreement provide for indemnification of our officers and directors against liabilities to the fullest extent permitted by the MGCL, as amended from time to time.

The MGCL permits a corporation to indemnify a director or officer who has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she is made a party by reason of his or her service in that capacity. The MGCL permits a corporation to indemnify its present and former directors and officers, among others, against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities unless it is established that:

- an act or omission of the director or officer was material to the matter giving rise to the proceeding and:
  - was committed in bad faith; or
  - was the result of active and deliberate dishonesty;
- the director or officer actually received an improper personal benefit in money, property or services; or
- in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful.

However, under the MGCL, a Maryland corporation may not indemnify for an adverse judgment in a suit by or in the right of the corporation (other than for expenses incurred in a successful defense of such an action) or for a judgment of liability on the basis that personal benefit was improperly received. In addition, the MGCL permits a corporation to advance reasonable expenses to a director or officer upon the corporation s receipt of:

- a written affirmation by the director or officer of his good faith belief that he has met the standard of conduct necessary for indemnification by the corporation; and
- a written undertaking by the director or on the director s behalf to repay the amount paid or reimbursed by the corporation if it is ultimately determined that the director did not meet the standard of conduct.

The MGCL permits a Maryland corporation to include in its charter a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages except for liability resulting from actual receipt of an improper benefit or profit in money, property or services or active and deliberate dishonesty established by a final judgment as being material to the cause of action. Our charter contains such a provision which eliminates such liability to the maximum extent permitted by Maryland law.

Our bylaws obligate us, to the fullest extent permitted by Maryland law in effect from time to time, to indemnify and, without requiring a preliminary determination of the ultimate entitlement to indemnification, pay or reimburse reasonable expenses in advance of final disposition of a proceeding to:

- any present or former director or officer who is made a party to the proceeding by reason of his or her service in that capacity; or any individual who, while a director or officer of our company and at our request, serves or has served another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or any other enterprise as a director, officer, partner or trustee and who is made a party to the proceeding by reason of his or her service in that capacity.

Our bylaws also obligate us to indemnify and advance expenses to any person who served a predecessor of ours in any of the capacities described in second and third bullet points above and to any employee or agent of our company or a predecessor of our company.

The partnership agreement of our operating partnership provides that we, as general partner, and our officers and directors are indemnified to the fullest extent permitted by law. See Partnership Agreement Exculpation and Indemnification of the General Partner.

Table of Contents

Insofar as the foregoing provisions permit indemnification of directors, officers or persons controlling us for liability arising under the Securities Act, we have been informed that in the opinion of the Securities and Exchange Commission, this indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

PARTNERSHIP AGREEMENT

Management

Ashford Hospitality Limited Partnership, our operating partnership, has been organized as a Delaware limited partnership. One of our wholly-owned subsidiaries is the sole general partner of this partnership, and one of our subsidiaries holds limited partnership units in this partnership. A majority of the limited partnership units not owned by our company are owned by certain of our directors, executive officers and affiliates of such persons. In the future, we may issue additional interests in our operating partnership to third parties.

Pursuant to the partnership agreement of the operating partnership, we, as the sole general partner, generally have full, exclusive and complete responsibility and discretion in the management, operation and control of the partnership, including the ability to cause the partnership to enter into certain major transactions, including acquisitions, developments and dispositions of properties, borrowings and refinancings of existing indebtedness. No limited partner may take part in the operation, management or control of the business of the operating partnership by virtue of being a holder of limited partnership units.

Our subsidiary may not be removed as general partner of the partnership. Upon the bankruptcy or dissolution of the general partner, the general partner shall be deemed to be removed automatically.

The limited partners of our operating partnership have agreed that in the event of a conflict in the fiduciary duties owed (i) by us to our stockholders and (ii) by us, as general partner of the operating partnership, to those limited partners, we may act in the best interests of our stockholders without violating our fiduciary duties to the limited partners of the operating partnership or being liable for any resulting breach of our duties to the limited partners.

Transferability of Interests

General Partner. The partnership agreement provides that we may not transfer our interest as a general partner (including by sale, disposition, merger or consolidation) except:

- in connection with a merger of the operating partnership, a sale of substantially all of the assets of the operating partnership or other transaction in which the limited partners receive a certain amount of cash, securities or property; or

- in connection with a merger of us or the general partner into another entity, if the surviving entity contributes substantially all its assets to the operating partnership and assumes the duties of the general partner under the operating partnership agreement.

Limited Partner. The partnership agreement prohibits the sale, assignment, transfer, pledge or disposition of all or any portion of the limited partnership units without our consent, which we may give or withhold in our sole discretion. However, an individual partner may donate his units to his immediate family or a trust wholly owned by his immediate family, without our consent. In addition, the partnerships contributing our initial hotel properties to us in exchange for units in our operating partnership may transfer those units to their partners, without our consent. The partnership agreement contains other restrictions on transfer if, among other things that transfer:

- would cause us to fail to comply with the REIT rules under the Internal Revenue Code; or
- would cause us to become a publicly-traded partnership under the Internal Revenue Code.

Capital Contributions

The partnership agreement provides that if the partnership requires additional funds at any time in excess of funds available to the partnership from borrowing or capital contributions, we may borrow such funds from a financial institution or other lender and lend such funds to the partnership. Under the partnership agreement, we are obligated to contribute the proceeds of any offering of stock as additional capital to the partnership. The operating partnership is authorized to cause the partnership to issue partnership interests for less than fair market value if we conclude in good faith that such issuance is in both the partnership s and our best interests.

The partnership agreement provides that we may make additional capital contributions, including properties, to the partnership in exchange for additional partnership units. If we contribute additional capital to the partnership and receive additional partnership interests for such capital contribution, our percentage interests will be increased on a proportionate basis based on the amount of such additional capital contributions and the value of the partnership at the time of such contributions. Conversely, the percentage interests of the other limited partners will be decreased on a proportionate basis. In addition, if we contribute additional capital to the partnership and receive additional partnership interests for such capital contribution, the capital accounts of the partners will be adjusted upward or downward to reflect any unrealized gain or loss attributable to our properties as if there were an actual sale of such properties at the fair market value thereof. Limited partners have no preemptive right to make additional capital contributions.

The operating partnership could issue preferred partnership interests in connection with acquisitions of property or otherwise. Any such preferred partnership interests would have priority over common partnership interests with respect to distributions from the partnership, including the partnership interests that our wholly-owned subsidiaries own.

Redemption Rights

Under the partnership agreement, we have granted to each limited partner (other than our subsidiary) the right to redeem their limited partnership units. This right may be exercised at the election of that limited partner by giving us written notice, subject to some limitations. The purchase price for the limited partnership units to be redeemed will equal the fair market value of our common stock. The purchase price for the limited partnership units may be paid in cash, or, in our discretion, by the issuance by us of a number of shares of our common stock equal to the number of limited partnership units with respect to which the rights are being exercised. However, no limited partner will be entitled to exercise its redemption rights to the extent that the issuance of common stock to the redeeming partner would be prohibited under our charter or, if after giving effect to such exercise, would cause any person to own, actually or constructively, more than 9.8% of our common stock, unless such ownership limit is waived by us in our sole discretion.

In all cases, however, no limited partner may exercise the redemption right for fewer than 1,000 partnership units or, if a limited partner holds fewer than 1,000 partnership units, all of the partnership units held by such limited partner.

Currently, the aggregate number of shares of common stock issuable upon exercise of the redemption rights by holders of partnership units is 13,512,425. The number of shares of common stock issuable upon exercise of the redemption rights will be adjusted to account for share splits, mergers, consolidations or similar pro rata share transactions.

Conversion Rights

We have granted the holders of the Class B common units the right to convert the Class B common units into ordinary common units on a one-for-one basis at any time after July 13, 2006. No other limited partners have any conversion rights.

Operations

The partnership agreement requires the partnership to be operated in a manner that enables us to satisfy the requirements for being classified as a REIT, to minimize any excise tax liability imposed by the Internal Revenue

Code and to ensure that the partnership will not be classified as a publicly traded partnership taxable as a corporation under Section 7704 of the Code.

In addition to the administrative and operating costs and expenses incurred by the partnership, the partnership will pay all of our administrative costs and expenses. These expenses will be treated as expenses of the partnership and will generally include:

- all expenses relating to our continuity of existence;
- all expenses relating to offerings and registration of securities;
- all expenses associated with the preparation and filing of any of our periodic reports under federal, state or local laws or regulations;
- all expenses associated with our compliance with laws, rules and regulations promulgated by any regulatory body; and
- all of our other operating or administrative costs incurred in the ordinary course of its business on behalf of the partnership.

Distributions

The partnership agreement provides that the partnership will make cash distributions in amounts and at such times as determined by us in our sole discretion, to us and other limited partners in accordance with the respective percentage interests of the partners in the partnership, except that the holders of our Class B common partnership units are entitled to receive (i) an aggregate preferred distribution of $728,534.73 (approximately $0.190974 per unit) each calendar quarter through September 30, 2009 and (ii) an aggregate preferred distribution of $769,192.09 (approximately $0.201631 per unit) each calendar quarter thereafter. Distributions to our Class B common unit holders have priority over distributions to other common unit holders (including us and, therefore, including holders of our common stock) but distributions to our preferred unit holders will have priority over distributions to our Class B common unit holders.

Upon liquidation of the partnership, after payment of, or adequate provisions for, debts and obligations of the partnership, including any partner loans, any remaining assets of the partnership will be distributed to us and the other limited partners with positive capital accounts in accordance with the respective positive capital account balances of the partners.

Allocations

Profits and losses of the partnership (including depreciation and amortization deductions) for each fiscal year generally are allocated to us and the other limited partners in accordance with the respective percentage interests of the partners in the partnership. All of the foregoing allocations are subject to compliance with the provisions of Internal Revenue Code sections 704(b) and 704(c) and Treasury Regulations promulgated thereunder. The partnership will use the traditional method under Internal Revenue Code section 704(c) for allocating items with respect to which the fair market value at the time of contribution differs from the adjusted tax basis at the time of contribution for a hotel.

Amendments

Generally, we, as the general partner of the operating partnership, may amend the partnership agreement without the consent of any limited partner to clarify the partnership agreement, to make changes of an inconsequential nature, to reflect the admission, substitution or withdrawal of limited partners, to reflect the issuance of additional partnership interests or if, in the opinion of counsel, necessary or appropriate to satisfy the Code with respect to partnerships or REITs or federal or state securities laws. However, any amendment which alters or changes the distribution or redemption rights of a limited partner (other than a change to reflect the seniority of any distribution or liquidation rights of any preferred units issued in accordance with the partnership agreement), changes the method for allocating profits and losses, imposes any obligation on the limited partners to make additional capital contributions or adversely affects the limited liability of the limited partners requires the consent of holders of 662/3% of the limited partnership units, excluding our indirect ownership of limited partnership units. Other amendments require approval of the general partner and holders of 50% of the limited partnership units.

In addition, the operating partnership may be amended, without the consent of any limited partner, in the event that we or any of our subsidiaries engages in a merger or consolidation with another entity and immediately after such transaction the surviving entity contributes to the operating partnership substantially all of the assets of such surviving entity and the surviving entity agrees to assume our subsidiary s obligation as general partner of the partnership. In such case, the surviving entity will amend the operating partnership agreement to arrive at a new method for calculating the amount a limited partner is to receive upon redemption or conversion of a partnership unit (such method to approximate the existing method as much as possible).

Exculpation and Indemnification of the General Partner

The partnership agreement of our operating partnership provides that neither the general partner, nor any of its directors and officers will be liable to the partnership or to any of its partners as a result of errors in judgment or mistakes of fact or law or of any act or omission, if the general partner acted in good faith.

In addition, the partnership agreement requires our operating partnership to indemnify and hold the general partner and its directors, officers and any other person it designates, harmless from and against any and all claims arising from operations of the operating partnership in which any such indemnitee may be involved, or is threatened to be involved, as a party or otherwise, unless it is established that:

- the act or omission of the indemnitee was material to the matter giving rise to the proceeding and was committed in bad faith or was the result of active and deliberate dishonesty;
- the indemnitee actually received an improper personal benefit in money, property or services; or
- in the case of any criminal proceeding, the indemnitee had reasonable cause to believe that the act or omission was unlawful.

No indemnitee may subject any partner of our operating partnership to personal liability with respect to this indemnification obligation as this indemnification obligation will be satisfied solely out of the assets of the partnership.

Term

The partnership has a perpetual life, unless dissolved upon:

- the general partner s bankruptcy or dissolution or withdrawal (unless the limited partners elect to continue the partnership);
- the passage of 90 days after the sale or other disposition of all or substantially all the assets of the partnership;
- the redemption of all partnership units (other than those held by us, if any); or
- an election by us in our capacity as the sole owner of the general partner.

Tax Matters

The general partner is the tax matters partner of the operating partnership. We have the authority to make tax elections under the Internal Revenue Code on behalf of the partnership. The net income or net loss of the operating partnership will generally be allocated to us and the limited partners in accordance with our respective percentage interests in the partnership, subject to compliance with the provisions of the Internal Revenue Code.

FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT

The following discussion is a summary of the material federal income tax considerations that may be relevant to a prospective holder of securities, and, unless otherwise noted in the following discussion, expresses the opinion of Andrews Kurth LLP insofar as it relates to matters of United States federal income tax law and legal conclusions with respect to those matters. The discussion does not address all aspects of taxation that may be relevant to particular investors in light of their personal investment or tax circumstances, or to certain types of investors that are subject to special treatment under the federal income tax laws, such as insurance companies, financial institutions or broker-dealers, tax-exempt organizations (except to the limited extent discussed in Taxation of Tax-Exempt Stockholders), foreign corporations and persons who are not citizens or residents of the United States (except to the limited extent discussed in Taxation of Non-U.S. Holders), investors who hold or will hold securities as part of hedging or conversion transactions, investors subject to federal alternative minimum tax, investors that have a principal place of business or tax home outside the United States and investors whose functional currency is not the United States dollar.

The statements of law in this discussion and the opinion of Andrews Kurth LLP are based on current provisions of the Internal Revenue Code of 1986, as amended, or the Code, existing temporary and final Treasury regulations thereunder, and current administrative rulings and court decisions. No assurance can be given that future legislative, judicial, or administrative actions or decisions, which may be retroactive in effect, will not affect the accuracy of any statements in this prospectus with respect to the transactions entered into or contemplated prior to the effective date of such changes.

We urge you to consult your own tax advisor regarding the specific tax consequences to you of ownership of our securities and of our election to be taxed as a REIT. Specifically, we urge you to consult your own tax advisor regarding the federal, state, local, foreign, and other tax consequences of such ownership and election and regarding potential changes in applicable tax laws.

Taxation of Our Company

We are currently taxed as a REIT under the federal income tax laws. We believe that we are organized and operate in such a manner as to qualify for taxation as a REIT under the Code, and we intend to continue to operate in such a manner, but no assurance can be given that we will operate in a manner so as to continue to qualify as a REIT. This section discusses the laws governing the federal income tax treatment of a REIT and its investors. These laws are highly technical and complex.

Andrews Kurth LLP has acted as our counsel in connection with the offering. In the opinion of Andrews Kurth LLP for the taxable years ending December 31, 2003, December 31, 2004, December 31, 2005 and December 31, 2006, we qualified to be taxed as a REIT pursuant to sections 856 through 860 of the Code, and our organization and present and proposed method of operation will enable us to continue to meet the requirements for qualification and taxation as a REIT under the Code. Investors should be aware that Andrews Kurth LLP s opinion is based upon customary assumptions, is conditioned upon the accuracy of certain representations made by us as to factual matters, including representations regarding the nature of our properties and the future conduct of our business, and is not binding upon the Internal Revenue Service (IRS) or any court. In addition, Andrews Kurth LLP s opinion is based on existing federal income tax law governing qualification as a REIT, which is subject to change either prospectively or retroactively. Moreover, our continued qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual annual operating results, certain qualification tests set forth in the federal tax laws. Those qualification tests include the percentage of income that we earn from specified sources, the percentage of our assets that falls within specified categories, the diversity of our share ownership, and the percentage of our earnings that we distribute. While Andrews Kurth LLP has reviewed those matters in connection with the foregoing opinion, Andrews Kurth LLP will not review our compliance with those tests on a continuing basis. Accordingly, no assurance can be given that the actual results of our operation for any particular taxable year will satisfy such requirements. For a discussion of the tax consequences of our failure to qualify as a REIT, see Failure to Qualify.

If we qualify as a REIT, we generally will not be subject to federal income tax on the taxable income that we distribute to our stockholders. The benefit of that tax treatment is that it avoids the double taxation, or taxation at both the corporate and stockholder levels, that generally results from owning stock in a corporation. However, we will be subject to federal tax in the following circumstances:

We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to our stockholders during, or within a specified time period after, the calendar year in which the income is earned.

Table of Contents

Under certain circumstances, we may be subject to the alternative minimum tax on items of tax preference.

We will pay income tax at the highest corporate rate on (1) net income from the sale or other disposition of property acquired through foreclosure (foreclosure property) that we hold primarily for sale to customers in the ordinary course of business and (2) other non-qualifying income from foreclosure property.

We will pay a 100% tax on net income from sales or other dispositions of property, other than foreclosure property, that we hold primarily for sale to customers in the ordinary course of business.

If we fail to satisfy the 75% gross income test or the 95% gross income test, as described below under Income Tests, and nonetheless continue to qualify as a REIT because we meet other requirements, we will pay a 100% tax on (1) the gross income attributable to the greater of the amounts by which we fail the 75% and 95% gross income tests, multiplied by (2) a fraction intended to reflect our profitability.

If we fail to distribute during a calendar year at least the sum of (1) 85% of our REIT ordinary income for such year, (2) 95% of our REIT capital gain net income for such year, and (3) any undistributed taxable income from prior periods, we will pay a 4% excise tax on the excess of this required distribution over the sum of the amount we actually distributed, plus any retained amounts on which income tax has been paid at the corporate level.

We may elect to retain and pay income tax on our net long-term capital gain. In that case, a U.S. holder, as defined below under Taxation of U.S. Holders, would be taxed on its proportionate share of our undistributed long-term capital gain (to the extent that a timely designation of such gain is made by us to the stockholder) and would receive a credit or refund for its proportionate share of the tax we paid.

If we acquire any asset from a C corporation, or a corporation that generally is subject to full corporate-level tax, in a merger or other transaction in which we acquire a basis in the asset that is determined by reference to the C corporation s basis in the asset, we will pay tax at the highest regular corporate rate applicable if we recognize gain on the sale or disposition of such asset during the 10-year period after we acquire such asset. The amount of gain on which we will pay tax generally is the lesser of: (1) the amount of gain that we recognize at the time of the sale or disposition; or (2) the amount of gain that we would have recognized if we had sold the asset at the time we acquired the asset.

We will incur a 100% excise tax on transactions with a taxable REIT subsidiary (TRS) that are not conducted on an arm s-length basis.

If we fail to satisfy certain asset tests, described below under Asset Tests and nonetheless continue to qualify as a REIT because we meet certain other requirements, we will be subject to a tax of the greater of $50,000 or at the highest corporate rate on the income generated by the non-qualifying assets.

We may be subject to a $50,000 tax for each failure if we fail to satisfy certain REIT qualification requirements, other than income tests or asset tests, and the failure is due to reasonable cause and not willful neglect.

In addition, notwithstanding our qualification as a REIT, we may also have to pay certain state and local income taxes, because not all states and localities treat REITs in the same manner that they are treated for federal income tax purposes. Moreover, as further described below, any TRS in which we own an interest will be subject to federal and state corporate income tax on its taxable income.

Requirements for Qualification

A REIT is a corporation, trust, or association that meets the following requirements:

1. it is managed by one or more trustees or directors;

2. its beneficial ownership is evidenced by transferable shares or by transferable certificates of beneficial interest;

3. it would be taxable as a domestic corporation but for the REIT provisions of the federal income tax laws;

4. it is neither a financial institution nor an insurance company subject to special provisions of the federal income tax laws;

5. at least 100 persons are beneficial owners of its shares or ownership certificates;

6. no more than 50% in value of its outstanding shares or ownership certificates is owned, directly or indirectly, by five or fewer individuals, as defined in the federal income tax laws to include certain entities, during the last half of each taxable year;

7. it elects to be a REIT, or has made such election for a previous taxable year, and satisfies all relevant filing and other administrative requirements established by the IRS that must be met to elect and maintain REIT status;

8. it uses a calendar year for federal income tax purposes and complies with the recordkeeping requirements of the federal income tax laws; and

9. it meets certain other qualification tests, described below, regarding the nature of its income and assets and the amount of its distributions.

We must meet requirements 1 through 4 during our entire taxable year and must meet requirement 5 during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months. If we comply with all the requirements for ascertaining the ownership of our outstanding shares in a taxable year and have no reason to know that we violated requirement 6, we will be deemed to have satisfied requirement 6 for such taxable year. For purposes of determining share ownership under requirement 6, an individual generally includes a supplemental unemployment compensation benefits plan, a private foundation, or a portion of a trust permanently set aside or used exclusively for charitable purposes. An individual, however, generally does not include a trust that is a qualified employee pension or profit sharing trust under the federal income tax laws, and beneficiaries of such a trust will be treated as holding shares of our stock in proportion to their actuarial interests in the trust for purposes of requirement 6.

We have issued sufficient stock with enough diversity of ownership to satisfy requirements 5 and 6 set forth above. In addition, our charter restricts the ownership and transfer of our stock so that we should continue to satisfy requirements 5 and 6. The provisions of our charter restricting the ownership and transfer of the stock are described in Description of Our Capital Stock Restrictions on Ownership and Transfer.

If we comply with regulatory rules pursuant to which we are required to send annual letters to holders of our stock requesting information regarding the actual ownership of our stock, and we do not know, or exercising reasonable diligence would not have known, whether we failed to meet requirement 6 above, we will be treated as having met the requirement.

In addition, we must satisfy all relevant filing and other administrative requirements established by the IRS that must be met to elect and maintain REIT qualification.

A corporation that is a qualified REIT subsidiary is not treated as a corporation separate from its parent REIT. All assets, liabilities, and items of income, deduction, and credit of a qualified REIT subsidiary are treated as assets, liabilities, and items of income, deduction, and credit of the REIT. A qualified REIT subsidiary is a corporation, other than a TRS, all of the capital stock of which is owned by the REIT. Thus, in applying the requirements described in this section, any qualified REIT subsidiary that we own will be ignored, and all assets, liabilities, and items of income, deduction, and credit of that subsidiary will be treated as our assets, liabilities, and items of income, deduction, and credit. Similarly, any wholly owned limited liability company or certain wholly owned partnerships that we own will be disregarded, and all assets, liabilities and items of income, deduction and credit of such limited liability company will be treated as ours.

In the case of a REIT that is a partner in a partnership that has other partners, the REIT is treated as owning its proportionate share of the assets of the partnership and as earning its allocable share of the gross income of the partnership for purposes of the applicable REIT qualification tests. For purposes of the 10% value test (as described below under Asset Tests), our proportionate share is based on our proportionate interest in the equity interests and certain debt securities issued by the partnership. For all of the other asset and income tests, our proportionate share is based on our proportionate interest in the capital interests in the partnership. Our proportionate share of the assets, liabilities, and items of income of our operating partnership and of any other partnership, joint venture, or limited liability company that is treated as a partnership for federal income tax purposes in which we own or will acquire an interest, directly or indirectly (each, a Partnership and, together, the Partnerships), are treated as our assets and gross income for purposes of applying the various REIT qualification requirements.

Subject to restrictions on the value of TRS securities held by the REIT, a REIT is permitted to own up to 100% of the stock of one or more TRSs. A TRS is a fully taxable corporation. The TRS and the REIT must jointly elect to treat the subsidiary as a TRS. A corporation of which a TRS directly or indirectly owns more than 35% of the voting power or value of the stock will be automatically treated as a TRS. A TRS may not directly or indirectly operate or manage any hotels or health care facilities or provide rights to any brand name under which any hotel or health care facility is operated but is permitted to lease hotels from a related REIT as long as the hotels are operated on behalf of the TRS by an eligible independent contractor. Overall, no more than 20% of the value of a REIT s assets may consist of TRS securities. We formed and made a timely election with respect to two TRSs, Ashford TRS Corporation and Ashford TRS VI Corporation (together with their respective subsidiaries, Ashford TRSs). Each of our hotel properties is leased or owned by one of the Ashford TRSs. Additionally, we may form or acquire one or more additional TRSs in the future. See Taxable REIT Subsidiaries.

Income Tests

We must satisfy two gross income tests annually to maintain our qualification as a REIT. First, at least 75% of our gross income for each taxable year must consist of defined types of income that we derive, directly or indirectly, from investments nt-size:1.0pt;">

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5. ASSET IMPAIRMENT AND DISCONTINUED OPERATIONS

As of January 1, 2006, the Company had 11 restaurants that were reported as held for sale in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. During the three months ended April 2, 2006, the Company sold five of these restaurants. Gross proceeds from these transactions were $5,093,000. The Company recognized a net gain related to the sales of the assets of $2,864,000. At April 2, 2006, the remaining six properties, and one additional property that closed during the three months ended April 2, 2006, met the criteria for held for sale as defined in SFAS No. 144. The carrying values of these seven properties of $1,554,000 and $1,628,000 as of April 2, 2006 and January 1, 2006, respectively, were reported as assets held for sale in the accompanying condensed consolidated balance sheets. The carrying values of these properties were not adjusted since the carrying values were less than the estimated fair market values less costs to sell.

The table below identifies the components of the Loss on disposals of other property and equipment, net as shown in the accompanying condensed consolidated statements of operations (in thousands):

	For the Three Months Ended April 2, 2006		For the Three Months Ended April 3, 2005	
Restaurant equipment assets retired due to replacement	$	75	$	52
Loss due to restaurant fire		30		
All other		4		17
Loss on disposals of other property and equipment, net	$	109	$	69

SFAS No. 144 also requires the results of operations of a component of an entity that is classified as held for sale or that has been disposed of to be reported as discontinued operations in the statement of operations if certain conditions are met. These conditions include commitment to a plan of disposal after the effective date of this statement, elimination of the operations and cash flows of the entity component from the ongoing operations of the company and no significant continuing involvement in the operations of the entity component after the disposal transaction.

In accordance with SFAS No. 144, the results of operations of the five properties that were disposed of during the three months ended April 2, 2006 and the related net gain on the disposals, as well as the results of operations of the properties held for sale at April 2, 2006, were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for all periods presented. Operating results for the three months ended April 2, 2006 and the net gain on disposals of the properties as well as operating results that were included in the restaurant segment in the previously issued Quarterly Report on Form 10-Q for the three months ended April 3, 2005 are summarized below (in thousands):

	For the Three Months Ended April 2, 2006		For the Three Months Ended April 3, 2005	
Net sales	$		$	2,985
Operating loss		(248)		(623)
Gain on disposals of property and equipment		2,864		

Income tax benefit				255
Income (loss) from discontinued operations	$	2,616	$	(368)

During the three months ended April 2, 2006, the Company determined that the carrying value of one operating restaurant property exceeded its estimated fair value less costs to sell and the carrying value was reduced by $215,000 accordingly.

6. SEGMENT REPORTING

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision-maker is the Chief Executive Officer and President of the Company. The Company s operating segments include restaurant, foodservice and franchise. The revenues from these segments include both sales to unaffiliated customers and inter-segment sales, which generally are accounted for on a basis consistent with sales to unaffiliated customers. Intersegment sales and other inter-segment transactions have been eliminated in the accompanying condensed consolidated financial statements.

The Company s restaurants target families with kids and adults who desire a reasonably-priced meal in a full-service setting. The Company s menu offers a broad selection of freshly-prepared foods which appeal to customers throughout all dayparts. The menu currently features over 100 items comprised of a broad selection of breakfast, lunch, dinner and afternoon and evening snack items. Foodservice operations manufactures premium ice cream dessert products and distributes such manufactured products and purchased finished goods to Company-operated and franchised restaurants. Additionally, it sells premium ice cream dessert products to distributors and retail locations. The Company s franchise segment includes a royalty based on franchise restaurant revenue. In addition, the Company receives rental income from various franchised restaurants. The Company does not allocate general and administrative expenses associated with its headquarters operations to any business segment. These costs include expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarter activities.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that the financial results for the foodservice operating segment, prior to inter-segment eliminations, have been prepared using a management approach, which is consistent with the basis and manner in which the Company s management internally reviews financial information for the purpose of assisting in making internal operating decisions. Using this approach, the Company evaluates performance based on stand-alone operating segment income (loss) before income taxes and generally accounts for inter-segment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

Adjusted EBITDA represents net income (loss) before (i) (provision for) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) write-downs of property and equipment, (v) net periodic pension cost (benefit) and (vi) other non-cash items. The Company has included information concerning adjusted EBITDA in this Form 10-Q because the Company s management incentive plan pays bonuses based on achieving adjusted EBITDA targets and the Company believes that such information is used by certain investors as one measure of a company s historical ability to service debt. Adjusted EBITDA should not be considered as an alternative to, or more meaningful than, earnings (loss) from operations or other traditional indications of a company s operating performance.

	For the Three Months Ended April 2, 2006	For the Three Months Ended April 3, 2005
	(in thousands)	
Revenues:		
Restaurant	$ 95,276	$ 93,107
Foodservice	54,958	54,163
Franchise	3,545	3,250
Total	$ 153,779	$ 150,520
Intersegment revenues:		
Restaurant	$	$
Foodservice	(28,064)	(28,857)
Franchise		
Total	$ (28,064)	$ (28,857)
External revenues:		
Restaurant	$ 95,276	$ 93,107
Foodservice	26,894	25,306
Franchise	3,545	3,250
Total	$ 125,715	$ 121,663

	For the Three Months Ended	
	April 2, 2006	April 3, 2005
	(in thousands)	
Adjusted EBITDA:		
Restaurant	$ 6,834	$ 7,276
Foodservice	2,547	2,148
Franchise	2,418	2,266
Corporate	(5,578)	(4,844)
Gain on property and equipment, net	758	1,234
Pension cost (benefit) included in reporting segments	470	(56)
Total	$ 7,449	$ 8,024
Interest expense, net-Corporate	$ 5,420	$ 5,286
Depreciation and amortization:		
Restaurant	$ 4,143	$ 4,470
Foodservice	736	823
Franchise	68	40
Corporate	833	818
Total	$ 5,780	$ 6,151
Other non-cash expenses (income):		
Net periodic pension cost (benefit)	$ 470	$ (56)
Write-downs of property and equipment	215	
Total	$ 685	$ (56)
Income (loss) from continuing operations before benefit from income taxes:		
Restaurant	$ 2,691	$ 2,806
Foodservice	1,811	1,325
Franchise	2,350	2,226
Corporate	(11,831)	(10,948)
Gain on property and equipment, net	543	1,234
Total	$ (4,436)	$ (3,357)

15

	For the Three Months Ended April 2, 2006		For the Year Ended January 1, 2006	
	(in thousands)			
Capital expenditures, including assets acquired under capital leases:				
Restaurant	$	2,215	$	14,674
Foodservice		68		1,516
Corporate		121		968
Total	$	2,404	$	17,158

	April 2, 2006		January 1, 2006	
	(in thousands)			
Total assets:				
Restaurant	$	128,276	$	131,810
Foodservice		34,214		38,609
Franchise		11,909		7,634
Corporate		43,232		40,189
Total	$	217,631	$	218,242

7. RELATED PARTY TRANSACTIONS

The Ice Cream Company (TICC) operates three Friendly s restaurants under franchise agreements with Friendly s Restaurants Franchise, Inc. (FRFI), a subsidiary of Friendly s. The owners of TICC are family members of the Company s Chairman of the Board of Directors. The franchise agreement terms with TICC are identical in all material respects to the terms generally offered to unrelated franchisees of FRFI in the ordinary course of Friendly s business. TICC purchases certain food products used in the normal course of its franchise business from Friendly s. For the year ended January 1, 2006, TICC paid Friendly s approximately $2,110,122 for franchise royalty fees, marketing fees, food purchases and miscellaneous other products and services.

On March 20, 2006, Friendly s and TICC entered into a preliminary agreement whereby TICC would purchase three existing Company-operated restaurants and develop six new restaurants, all in the Lancaster and York, Pennsylvania areas. The transaction is dependent on approval by the Company s Board of Directors, which is conducting a transaction value appraisal through an independent appraiser.

8. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

FICC s obligation related to its $175,000,000 8.375% senior notes (the Senior Notes) issued in March 2004 is guaranteed fully and unconditionally by one of FICC s wholly owned subsidiaries. There are no restrictions on FICC s ability to obtain dividends or other distributions of funds from this subsidiary, except those imposed by applicable law. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for FICC (the Parent Company), Friendly s Restaurants Franchise, Inc. (the Guarantor Subsidiary) and Friendly s International, Inc., Restaurant Insurance Corporation, Friendly s Realty I, LLC, Friendly s Realty II, LLC and Friendly s Realty III, LLC (collectively, the Non-guarantor Subsidiaries). All of the LLCs assets were owned by the LLCs, which are separate entities with separate creditors which will be entitled to be satisfied out of the LLCs assets. Separate complete financial statements and other disclosures of the Guarantor Subsidiary as of April 2, 2006 and January 1, 2006 and for the three months ended April 2, 2006 and April 3, 2005 were not presented because management has determined that such information is not material to investors.

Investments in subsidiaries are accounted for by the Parent Company on the equity method for purposes of the supplemental consolidating presentation. Earnings of the subsidiaries are, therefore, reflected in the Parent Company s investment accounts and earnings. The principal elimination entries eliminate the Parent Company s investments in subsidiaries and intercompany balances and transactions.

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Balance Sheet

As of April 2, 2006

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 16,625	$ 790	$ 2,356	$	$ 19,771
Restricted cash			1,927		1,927
Accounts receivable, net	9,774	2,014			11,788
Inventories	15,974				15,974
Assets held for sale	1,554				1,554
Deferred income taxes		26		(26)	
Prepaid expenses and other current assets	5,374	656	7,785	(9,075)	4,740
Total current assets	49,301	3,486	12,068	(9,101)	55,754
Deferred income taxes		381		(381)	
Property and equipment, net	95,606		42,025		137,631
Intangibles and deferred costs, net	16,584		2,197		18,781
Investments in subsidiaries	5,795			(5,795)	
Other assets	4,550	5,856	915	(5,856)	5,465
Total assets	$ 171,836	$ 9,723	$ 57,205	$ (21,133)	$ 217,631
Liabilities and Stockholders (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations	$ 9,229	$	$ 1,429	$ (7,776)	$ 2,882
Accounts payable	22,171				22,171
Deferred income taxes	131			(131)	
Accrued expenses	40,111	2,488	1,560	(1,064)	43,095
Total current liabilities	71,642	2,488	2,989	(8,971)	68,148
Deferred income taxes	276			(276)	
Long-term obligations, less current maturities	181,841		48,460		230,301
Other long-term liabilities	61,637	970	6,226	(6,091)	62,742
Stockholders (deficit) equity	(143,560)	6,265	(470)	(5,795)	(143,560)
	$ 171,836	$ 9,723	$ 57,205	$ (21,133)	$ 217,631

Total liabilities and stockholders (deficit) equity	

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Statement of Operations

For the Three Months Ended April 2, 2006

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 123,097	$ 2,618	$	$	$ 125,715
Costs and expenses:					
Cost of sales	48,385				48,385
Labor and benefits	36,012				36,012
Operating expenses and write- downs of property and equipment	25,920		(1,706)		24,214
General and administrative expenses	9,942	1,155			11,097
Depreciation and amortization	5,237		543		5,780
Gain on franchise sales of restaurant operations and properties	(866)				(866)
Loss on disposals of other property and equipment, net	109				109
Interest expense, net	4,337		1,083		5,420
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(5,979)	1,463	80		(4,436)
Benefit from (provision for) income taxes	654	(600)	(54)		
(Loss) income from continuing operations	(5,325)	863	26		(4,436)
Income from discontinued operations	2,616				2,616
(Loss) income before equity in net income of consolidated subsidiaries	(2,709)	863	26		(1,820)
Equity in net income of consolidated subsidiaries	889			(889)	
Net (loss) income	$ (1,820)	$ 863	$ 26	$ (889)	$ (1,820)

19

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Statement of Cash Flows

For the Three Months Ended April 2, 2006

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	$ 1,998	$ 10	$ 926	$ (235)	$ 2,699
Cash flows from investing activities:					
Purchases of property and equipment	(2,404)				(2,404)
Proceeds from sales of property and equipment	5,794				5,794
Return of investment in subsidiary	282			(282)	
Net cash provided by investing activities	3,672			(282)	3,390
Cash flows from financing activities:					
Proceeds from revolving credit facility	8,000				8,000
Repayments of obligations	(8,405)		(324)		(8,729)
Payments of deferred financing costs	(205)				(205)
Stock options exercised	19				19
Reinsurance payments made from deposits			(235)	235	
Dividends paid			(282)	282	
Net cash used in financing activities	(591)		(841)	517	(915)
Net increase in cash and cash equivalents	5,079	10	85		5,174
Cash and cash equivalents, beginning of year	11,546	780	2,271		14,597
Cash and cash equivalents, end of year	$ 16,625	$ 790	$ 2,356	$	$ 19,771
Supplemental disclosures:					
Interest paid	$ 505	$	$ 1,023	$	$ 1,528
Income taxes (refunded) paid	(3,094)	2,534	57		(503)

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Balance Sheet

As of January 1, 2006

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 11,546	$ 780	$ 2,271	$	$ 14,597
Restricted cash			2,549		2,549
Accounts receivable, net	9,036	1,721			10,757
Inventories	15,775				15,775
Assets held for sale	1,628				1,628
Deferred income taxes	(131)	26		105	
Prepaid expenses and other current assets	7,571	2,565	7,785	(12,877)	5,044
Total current assets	45,425	5,092	12,605	(12,772)	50,350
Deferred income taxes	(276)	381		(105)	
Property and equipment, net	100,309		42,510		142,819
Intangibles and deferred costs, net	16,808		2,255		19,063
Investments in subsidiaries	5,188			(5,188)	
Other assets	5,095	5,118	915	(5,118)	6,010
Total assets	$ 172,549	$ 10,591	$ 58,285	$ (23,183)	$ 218,242
Liabilities and Stockholders (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations	$ 9,253	$	$ 1,368	$ (7,776)	$ 2,845
Accounts payable	24,968				24,968
Accrued expenses	37,237	4,258	1,825	(4,844)	38,476
Total current liabilities	71,458	4,258	3,193	(12,620)	66,289
Long-term obligations, less current maturities	182,221		48,846		231,067
Other long-term liabilities	60,708	930	6,461	(5,375)	62,724
Stockholders (deficit) equity	(141,838)	5,403	(215)	(5,188)	(141,838)
Total liabilities and stockholders (deficit) equity	$ 172,549	$ 10,591	$ 58,285	$ (23,183)	$ 218,242

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Statement of Operations

For the Three Months Ended April 3, 2005

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 119,191	$ 2,472	$	$	$ 121,663
Costs and expenses:					
Cost of sales	46,889				46,889
Labor and benefits	35,084				35,084
Operating expenses	25,140		(1,739)		23,401
General and administrative expenses	8,293	1,156			9,449
Depreciation and amortization	5,593		558		6,151
Gain on franchise sales of restaurant operations and properties	(1,309)				(1,309)
Loss on disposals of other property and equipment, net	69				69
Interest expense, net	4,167		1,119		5,286
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(4,735)	1,316	62		(3,357)
Benefit from (provision for) income taxes	1,330	(540)	(51)		739
(Loss) income from continuing operations	(3,405)	776	11		(2,618)
Loss from discontinued operations, net of income taxes	(368)				(368)
(Loss) income before equity in net income of consolidated subsidiaries	(3,773)	776	11		(2,986)
Equity in net income of consolidated subsidiaries	787			(787)	
Net (loss) income	$ (2,986)	$ 776	$ 11	$ (787)	$ (2,986)

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Supplemental Condensed Consolidating Statement of Cash Flows

For the Three Months Ended April 3, 2005

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	$ 3,638	$ (534)	$ 383	$ (241)	$ 3,246
Cash flows from investing activities:					
Purchases of property and equipment	(2,408)				(2,408)
Proceeds from sales of property and equipment	1,706				1,706
Purchases of marketable securities	(183)				(183)
Proceeds from sales of marketable securities	42				42
Return of investment in subsidiary	162			(162)	
Net cash used in investing activities	(681)			(162)	(843)
Cash flows from financing activities:					
Proceeds from revolving credit facility	15,250				15,250
Repayments of obligations	(19,627)		(406)		(20,033)
Payments related to deferred financing costs	(11)				(11)
Stock options exercised	136				136
Reinsurance payments made from deposits			(241)	241	
Dividends paid			(162)	162	
Net cash used in financing activities	(4,252)		(809)	403	(4,658)
Net decrease in cash and cash equivalents	(1,295)	(534)	(426)		(2,255)
Cash and cash equivalents, beginning of period	9,873	1,360	2,172		13,405
Cash and cash equivalents, end of period	$ 8,578	$ 826	$ 1,746	$	$ 11,150
Supplemental disclosures:					
Interest paid	$ 198	$	$ 1,557	$	$ 1,755
Income taxes (refunded) paid	(2,552)	2,495	52		(5)

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements of the Company and the notes thereto included elsewhere herein.

Forward Looking Statements

Statements contained herein that are not historical facts constitute forward looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Words such as believes, plans, anticipates, expects, will and similar expressions are intended to identify forw looking statements. Forward looking statements include, but are not limited to, statements relating to the sufficiency of our capital resources, changes in commodity prices, anticipated capital expenditures and our plans with respect to restaurant openings, closings, re-imagings and re-franchisings. All forward looking statements are subject to known and unknown risks, uncertainties and other factors which could cause actual results to differ materially from those anticipated. These factors include: our highly competitive business environment; exposure to fluctuating commodity prices; risks associated with the foodservice industry, such as changes in consumer tastes and adverse publicity resulting from food quality, illness, injury or other health concerns; the ability to retain and attract new employees; government regulations; high geographic concentration in the Northeast and its attendant weather patterns; conditions needed to meet restaurant re-imaging and new opening targets; risks and uncertainties arising out of accounting adjustments; our ability to service our debt and other obligations; our ability to meet ongoing financial covenants contained in our debt instruments, loan agreements, leases and other long-term commitments; and costs associated with improved service and other initiatives. Other factors that may cause actual results to differ from the forward looking statements contained herein and that may affect our prospects in general are included in our other filings with the Securities and Exchange Commission. We are not obligated to update any forward looking statements, whether as a result of new information, future events or otherwise.

Overview

Our revenues are derived primarily from the operation of full-service restaurants, the distribution and sale of premium ice cream desserts through retail locations and franchising. As of April 2, 2006, we operated 312 full-service restaurants, franchised 207 full-service restaurants and seven non-traditional units and manufactured a full line of premium ice cream desserts distributed through more than 4,500 supermarkets and other retail locations in 13 states.

Following is a summary of the Company-operated and franchised units:

	For the Three Months Ended	
	April 2, 2006	April 3, 2005
Company Units:		
Beginning of period	314	347
Openings	1	
Refranchised closings	(1)	(7)
Closings	(2)	(3)
End of period	312	337
Franchised Units:		
Beginning of period	213	195
Refranchised openings	1	7
Closings		(1)
End of period	214	201

Discontinued Operations

During December 2005, we closed seven restaurants and committed to a plan to sell the seven restaurants as well as four restaurants that were closed in 2004. During the three months ended April 2, 2006, we sold five of these restaurants. At April 2, 2006, the remaining six properties and one additional property closed during the three months ended April 2, 2006 met the criteria for held for sale as defined in SFAS No. 144.

In accordance with SFAS No. 144, the results of operations of the five properties that were disposed of during the three months ended April 2, 2006 and the related net gain on the disposals, as well as the results of operations of the properties held for sale at April 2, 2006, were reported separately as discontinued operations.

Three Months Ended April 2, 2006 Compared With Three Months Ended April 3, 2005

Revenues:

Total revenues - Total revenues increased $4.0 million, or 3.3%, to $125.7 million for the first quarter ended April 2, 2006 from $121.7 million for the same quarter in 2005.

Restaurant revenues - Restaurant revenues increased $2.2 million, or 2.3%, to $95.3 million for the three months ended April 2, 2006 from $93.1 million for the same period in 2005. Comparable Company-operated restaurant revenues increased 4.8% from the 2005 quarter to the 2006 quarter as increases occurred in all dayparts with the largest occurring during the dinner and afternoon snack periods. Operating days lost due to weather closings were lower in 2006 when compared to 2005 as most markets in New England recorded higher than normal snowfall during 2005. Additionally, the opening of three new restaurants over the past 15 months increased revenues by $1.1 million. These increases were partially offset by the closing of two locations and the re-franchising of 16 locations over the past 15 months resulting in declines of $0.2 million and $3.2 million, respectively, in restaurant revenues in the first quarter of 2006 as compared to the same period in 2005.

There was one new restaurant opened during the first three months of 2006. There were no new restaurants opened during the first three months of 2005; however, two mall restaurants were remodeled during the quarter.

Foodservice revenues - Foodservice (product sales to franchisees and retail customers) revenues increased $1.6 million, or 6.3%, to $26.9 million for the three months ended April 2, 2006 from $25.3 million for the three months ended April 3, 2005. This increase was primarily due to a $1.3 million increase in franchised restaurant product revenue resulting from the increased number of franchised restaurants in the first quarter of 2006 compared to the same period in 2005. Sales to foodservice retail supermarket customers increased $0.3 million in the three months ended April 2, 2006 compared to the same period in 2005 as case volume in our retail supermarket business increased 8.0% for the three months ended April 2, 2006 when compared to the three months ended April 3, 2005. Discounting and sales allowances were 3.2% greater as a percentage of gross revenues in the 2006 period when compared to the same period in 2005.

Franchise revenues - Franchise royalty and fee revenues increased $0.2 million, or 9.1%, to $3.5 million for the three months ended April 2, 2006 compared to $3.3 million for the same period in 2005.

Royalties on franchised sales increased $0.2 million in the first quarter of 2006 as compared to the same period in 2005 due primarily to the opening of six new franchise restaurants and 16 re-franchised restaurants during the last 15 months. The closing of three under-performing locations during the same period had little impact. Comparable franchised revenues grew 0.6% from the three months ended April 3, 2005 to the three months ended April 2, 2006.

Initial franchise fees declined by $0.1 million during the three months ended April 2, 2006 when compared to the same period in 2005 due to the refranchising of seven Company-operated locations during the quarter ended April 3, 2005 versus one re-franchise opening during the quarter ended April 2, 2006.

An increase in rental income for leased and subleased franchise locations of $0.1 million contributed to the higher revenues. There were 214 and 201 franchise units open at April 2, 2006 and April 3, 2005, respectively.

Cost of sales:

Cost of sales increased $1.5 million, or 3.2%, to $48.4 million for the three months ended April 2, 2006 from $46.9 million for the same period in 2005. Cost of sales as a percentage of total revenues was 38.5% for both three month periods. A shift in sales mix from Company-operated restaurant sales to foodservice sales had an unfavorable impact on the overall cost of sales as a percentage of total revenues. Foodservice sales to franchisees and retail supermarket customers (21.4% and 20.8% of total revenues for the three months ended April 2, 2006 and April 3, 2005, respectively) have a higher food cost as a percentage of revenue, at 92.6%, than sales in Company-operated restaurants to restaurant patrons. Foodservice retail sales promotional allowances, recorded as offsets to revenues, increased by 3.2% in the 2006 quarter as a percentage of gross retail sales when compared to the 2005 quarter as a result of a competitive climate in the northeast. This increase also had an unfavorable impact on the overall cost of sales as a percentage of total revenues. These increases were mostly offset by lower cream costs and growth in franchise revenues.

The cost of cream was approximately $0.7 million lower in the three month period ended April 2, 2006 when compared to the same period in 2005; however, market losses on cash-settled butter futures contracts were $0.2 greater than the losses experienced on butter future contracts during the first quarter of 2005. We enter into commodity option contracts from time to time to manage dairy cost pressures. Our commodity option contracts do not meet hedge accounting criteria as defined by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related amendment, SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities , and, accordingly, are marked to market each period with the resulting gains or losses recognized in cost of sales.

Restaurant cost of sales as a percentage of restaurant revenues decreased to 26.8% in the first quarter of 2006 from 27.4% in the first quarter of 2005. The decrease in the 2006 quarter when compared to the 2005 quarter was in part due to lower cream costs, re-formulation of certain products and menu price increases.

Increases in franchise revenues, which have no associated product cost, reduced cost of sales as a percentage of total revenues by 0.1% for the three months ended April 2, 2006 when compared to the 2005 quarter. Manufacturing efficiencies improved in the current period when compared to the same period a year ago.

For the remainder of 2006, we expect that cream prices will be lower than the prices experienced in 2005. Additionally, the results derived from options for butter futures contracts are more likely to be unfavorable in 2006 when compared to 2005.

The table below shows the average monthly price of a pound of AA butter. Futures and options on AA butter are traded on the Chicago Mercantile Exchange and AA butter is the commodity used to derive the price of cream. The prices shown were obtained from market quotes provided by the United States Department of Agriculture s (USDA) Agricultural Marketing Service.

Month:	2006	2005	2004	2003	2002	2001
January	$ 1.3368	$ 1.5775	$ 1.4320	$ 1.0815	$ 1.3454	$ 1.2531
February	1.1930	1.6145	1.7132	1.0405	1.2427	1.3852
March	1.1663	1.5527	2.1350	1.0915	1.2473	1.5708
April		1.4933	2.2204	1.0906	1.1712	1.8217
May		1.4044	2.0363	1.0919	1.0590	1.8713
June		1.5313	1.9300	1.1142	1.0427	1.9783
July		1.6210	1.7458	1.1985	1.0302	1.8971
August		1.6861	1.5408	1.1708	0.9752	2.0880
September		1.6988	1.7656	1.1731	0.9635	2.0563
October		1.6204	1.6475	1.1846	1.0315	1.4070
November		1.4260	1.9238	1.2057	1.0425	1.3481
December		1.3552	1.7083	1.2969	1.1198	1.2793
Mathematical Avg	$ 1.2320	$ 1.5484	$ 1.8166	$ 1.1450	$ 1.1059	$ 1.6630

The cost of cream, the principal ingredient used in making ice cream, affects cost of sales as a percentage of total revenues, especially in foodservice s retail business. A $0.10 increase in the cost of a pound of AA butter adversely affects our annual cost of sales by approximately $0.9 million. This adverse impact may be offset by price increases or other factors. However, no assurance can be given that we will be able to offset any cost increases in the future and future increases in cream prices could have a material adverse effect on our results of operations. To minimize risk, alternative supply sources continue to be pursued.

On September 19, 2005, the Chicago Mercantile Exchange launched the first electronically traded, cash-settled butter futures contract. This new futures contract is designed to meet the needs of food and dairy companies that have exposure to butterfat price risk but do not want to expose themselves to the possibility of being compelled to take physical delivery of butter. The size of the contract is 20,000 pounds of AA butter, versus the traditional butter futures contract, which is 40,000 pounds. The contract is cash settled based upon the USDA monthly weighted average price for butter in the United States. With this new type of futures contract, there is no risk of delivery of butter; therefore it offers us the ability to hedge the price risk of cream (on a butter basis) without having to take delivery of commodity butter. We have evaluated this new hedging instrument and believe it is an attractive way to hedge the price risk related to cream. At April 2, 2006, we held 83 contracts spread over the remaining months of the year. These contracts correspond to approximately 20% of our anticipated cream purchases for the remainder of the year.

Labor and benefits:

Labor and benefits increased $0.9 million, or 2.6%, to $36.0 million for the three months ended April 2, 2006 from $35.1 million for the three months ended April 3, 2005. Labor and benefits as a percentage of total revenues decreased to 28.6% in the 2006 quarter from 28.8% in the 2005 quarter. As a percentage of restaurant revenues, labor and benefits increased to 37.8% in the 2006 quarter from 37.7% in the 2005 quarter. The increase in labor dollars was primarily a result of higher general manager bonus and restaurant pension expense. Revenue increases derived from franchised locations and retail customers, which do not have any associated restaurant labor and benefits, contributed to the lower restaurant labor and benefits as a percentage of total revenues.

Operating expenses:

Operating expenses increased $0.6 million, or 2.6%, to $24.0 million for the three months ended April 2, 2006 from $23.4 million for the three months ended April 3, 2005. Operating expenses as a percentage of total revenues were 19.1% and 19.2% in the 2006 and 2005 periods, respectively. The dollar increase resulted from higher advertising and restaurant utility costs of $0.5 million and $0.4 million, respectively. These increases were partially offset by lower costs for snow removal and maintenance as a result of better weather in the 2006 period when compared to the 2005 period.

General and administrative expenses:

General and administrative expenses were $11.1 million and $9.4 million for the three months ended April 2, 2006 and April 3, 2005, respectively. General and administrative expenses as a percentage of total revenues increased to 8.8% in the 2006 period from 7.8% in the 2005 period. The $1.7 million increase is primarily the result of increases in bonuses ($0.5 million), severance costs ($0.3 million), salaries ($0.4 million), pension costs ($0.1 million) and legal fees ($0.1 million).

Write-downs of property and equipment:

During the three months ended April 2, 2006, we determined that the carrying value of one restaurant property exceeded its estimated fair values less costs to sell and the carrying value was reduced by $0.2 million accordingly.

Stock-based compensation expense:

On January 2, 2006, we adopted the Financial Accounting Standards Board s Statement of Financial Accounting Standard No. 123 (revised 2004), *Share-Based Payment, (* SFAS No. 123R), using the modified prospective application method. Compensation cost is calculated on the date of grant using the fair value of the options as determined by the Black-Scholes valuation model. The Black-Scholes valuation model requires us to make several assumptions including volatility. We have considered the guidance in SFAS No. 123R and believe that our historical estimated volatility is materially indicative of expectations about future volatility.

During the three months ended April 2, 2006, we recognized $0.1 million of total stock-based compensation expense as a result of the adoption of SFAS No. 123R, which was included in general and administrative expenses. We expect to recognize an additional $0.4 million of stock compensation expense during the remainder of 2006 related to the awards outstanding at April 2, 2006.

Prior to the adoption of SFAS No. 123R, we accounted for share-based payments to employees using APB Opinion No. 25 s, *Accounting for Stock Issued to Employees*, intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. The adoption of SFAS No. 123R under the modified prospective application method allowed us to recognize compensation cost (a) based on the requirement of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. Under the modified prospective application method, prior periods were not restated for the effect of SFAS No. 123R. We used the straight-line attribution method to recognize expense for all grants made.

On December 20, 2004, our Board of Directors approved the vesting of all outstanding and unvested options for our 1997 Plan and our 2003 Incentive Plan. This action was taken to reduce, or eliminate to the extent permitted, the transition expense related to outstanding stock option awards under SFAS No. 123R. The 259,850 options that were vested included 145,239 options with exercise prices greater than our closing stock price on the modification date. Under the accounting guidance of APB Opinion No. 25, the accelerated vesting resulted in stock-based compensation cost of $9,400 (net of related income tax benefit of $6,600), which was included in net loss for the year ended January 2, 2005. Additionally, the effect of the accelerated vesting in the Company s pro-forma disclosure was incremental stock-based compensation of approximately $0.7 million (net of related income tax benefit of $0.5 million). Stock-based compensation expense of $0.4 million and $0.1 million would otherwise have been recognized in accordance with SFAS No. 123R in our consolidated statements of operations during the 2006 and 2007 fiscal years, respectively.

As of April 2, 2006, there was $1.1 million of total unrecognized compensation cost related to unvested share-based awards. That cost is expected to be recognized over a weighted-average period of 2.7 years.

See Note 3 of Notes to Condensed Consolidated Financial Statements contained in Item 1 of this Quarterly Report on Form 10-Q for further information regarding our adoption of SFAS No. 123R.

Depreciation and amortization:

Depreciation and amortization was $5.8 million and $6.2 million for the three months ended April 2, 2006 and April 3, 2005, respectively. Depreciation and amortization as a percentage of total revenues was 4.6% and 5.1% in the 2006 and 2005 quarters, respectively. The 2005 quarter was higher primarily due to a reduction of the lives of leasehold improvement assets as a result of management decisions to close certain leased properties sooner than previously anticipated.

Gain on franchise sales of restaurant operations and properties:

Gain on franchise sales of restaurant operations and properties was $0.9 million and $1.3 million in the three months ended April 2, 2006 and April 3, 2005, respectively. During the three months ended April 2, 2006, we recognized a gain of $0.9 million associated with the sale of certain equipment assets, lease and sublease rights and franchise rights in one existing Friendly s restaurant. During the three months ended April 3, 2005, we recognized a gain of $1.3 million associated with the sale of certain equipment assets, lease and sublease rights and franchise rights in one existing Friendly s restaurant.

Loss on disposals of other property and equipment, net:

The loss on disposals of other property and equipment net was $0.1 million for both three month periods ended April 2, 2006 and April 3, 2005. The table below identifies the components of the loss on disposals of other property and equipment, net as shown on the accompanying condensed consolidated statements of operations (in thousands):

	For the Three Months Ended	
	April 2, 2006	April 3, 2005
Restaurant equipment assets retired due to replacement	$ 75	$ 52
Loss due to restaurant fire	30	
All other	4	17
Loss on disposals of other property and equipment, net	$ 109	$ 69

Interest expense, net:

Interest expense, net of capitalized interest and interest income was $5.4 million and $5.3 million for the three months ended April 2, 2006 and April 3, 2005, respectively. The increase in interest expense in the first quarter of 2006 compared to the same period in 2005 is primarily due to a fee of $0.2 million associated with the assignment our Credit Facility from Bank of America and certain other lenders to Wells Fargo Foothill. This fee was partially offset by reduced amounts of interest on capital leases and lower interest rates on our mortgage financing. Total outstanding debt, including capital lease and finance obligations, decreased from $235.1 million at April 3, 2005 to $233.2 million at April 2, 2006.

Benefit from income taxes:

As a result of the loss for the period ended April 2, 2006 and our intent to record a full valuation allowance on tax benefits until we can sustain an appropriate level of profitability, the benefit from income taxes was zero, an effective tax rate of 0%, for the three months ended April 2, 2006. The benefit from income taxes was $0.7 million, an effective tax rate of 25.0%, for the three months ended April 3, 2005.

Loss from continuing operations:

Loss from continuing operations was $4.4 million and $2.6 million for the three months ended April 2, 2006 and April 3, 2005, respectively, for the reasons discussed above.

Income (loss) from discontinued operations:

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations of a component of an entity that either has been disposed of or is classified as held for sale and any related gain (loss) on the sales are reported in discontinued operations if both of the following conditions are met: (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

Income (loss) from the discontinued operations of properties that were disposed of during the three months ended April 2, 2006 or classified as held for sale at April 2, 2006 consisted of the following (in thousands):

	For the Three Months Ended	
	April 2, 2006	**April 3, 2005**
Net sales	$	$ 2,985
Operating loss	$ (248)	$ (623)
Gain on disposals of property and equipment	2,864	
Income tax benefit		255
Income (loss) from discontinued operations	$ 2,616	$ (368)

Liquidity and Capital Resources

General:

Our primary sources of liquidity and capital resources are cash generated from operations and, if needed, borrowings under our $35 million revolving credit facility (the Credit Facility). Additional sources of liquidity consist of capital and operating leases for financing leased restaurant locations (in malls and shopping centers and land or building leases), restaurant equipment, manufacturing equipment, distribution vehicles and computer equipment. Other sources of cash are sales of under-performing existing restaurant properties and other assets and re-franchising (to the extent FICC s and its subsidiaries debt instruments permit). The amount of debt financing that FICC is able to incur is limited by the terms of our Credit Facility and 8.375% senior notes indenture. Below was the financing status of our operating restaurants as of April 2, 2006:

Owned land and building, mortgaged	61
Leased land, owned building, mortgaged	1
Sold and leased back	59
Owned land and building	17
Leased land, owned building	69
Leased land and building	105
Total Company-operated restaurants	312

The restaurants above not identified as owned land and building, mortgaged or sold and leased back secure our obligations under the Credit Facility. Of the 17 restaurant properties identified as owned land and building, six were available to be sold.

In addition to the 61 properties identified as owned land and building, mortgaged, we own and mortgage an additional 11 properties in this category that are operated by franchisees.

In addition to our 312 operating restaurants, we have seven closed properties that are classified as held for sale in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Operating Cash Flows:

Net cash provided by operating activities was $2.7 million and $3.2 million for the three months ended April 2, 2006 and April 3, 2005, respectively. Net loss excluding the gains on sales of fixed assets and other non-cash expenses contributed $0.3 million to the $0.5 million decline in cash provided by operating activities. Changes in working capital reduced cash by an additional $0.2 million as favorable changes in accounts receivable and notes receivable were more than offset by unfavorable changes in inventory and accounts payable. We increased our inventory of ice cream as cream prices steadily declined during the quarter.

We had a working capital deficit of $12.4 million and $15.9 million as of April 2, 2006 and January 1, 2006, respectively. Our working capital deficit includes assets classified as held for sale in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The working capital needs of companies engaged in the restaurant industry are generally low and as a result, restaurants are frequently able to operate with a working capital deficit because: (i) restaurant operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable; (ii) rapid turnover allows a limited investment in inventories; and (iii) cash from sales is usually received before related expenses for food, supplies and payroll are paid.

Investing Cash Flows:

Net cash provided by investing activities was $3.4 million for the first quarter ended April 2, 2006 as compared to net cash used in investing activities of $0.8 million for the first quarter ended April 3, 2005.

During both three month periods ended April 2, 2006 and April 3, 2005, we spent $2.4 million on capital expenditures, of which $2.2 million and $2.0 million, respectively, was spent on restaurant operations. Capital expenditures were offset by net proceeds from the sales of property and equipment of $5.8 million and $1.7 million for the quarters ended April 2, 2006 and April 3, 2005, respectively.

As of January 1, 2006, we had 11 restaurants that were reported as held for sale in accordance with SFAS No. 144. During the three months ended April 2, 2006, we sold five of these restaurants. In accordance with SFAS No. 144, the results of operations of the five properties that were disposed of during the three months ended April 2, 2006 and the related net gain on the disposals, as well as the results of operations of the properties held for sale at April 2, 2006, were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for all periods presented. Operating losses before depreciation from these properties were $0.2 million and $0.4 million during the three months ended April 2, 2006 and April 3, 2005, respectively. Gross proceeds on the disposals of the five properties sold during the 2006 quarter were $5.1 million. There were no properties sold during the 2005 quarter.

During the first quarter of 2006, we completed one re-franchising transaction in which an existing franchisee purchased one existing Company-operated restaurant and agreed to develop a total of two new restaurants in future years. Gross proceeds from this transaction were $1.2 million, of which $0.1 million was for franchise fees and $1.1 million was for the sale of certain assets and leasehold rights.

During the first quarter of 2005, we completed one re-franchising transaction in which an existing franchisee purchased one existing Company-operated restaurant and agreed to develop a total of three new restaurants in future years. Gross proceeds from this transaction were $1.8 million, of which $0.1 million was for franchise fees and $1.7 million was for the sale of certain assets and leasehold rights. In addition, we completed three transactions in which three former employees received franchises to operate six existing restaurants with options to purchase the restaurants within two years. If the options are exercised, one franchisee will also agree to develop two new restaurants in future years. Proceeds from option transactions will be recognized upon purchase.

Financing Cash Flows:

Net cash used in financing activities was $0.9 million and $4.7 million for the first quarters ended April 2, 2006 and April 3, 2005, respectively. There were $4.0 million of revolving credit loans outstanding at the end of 2004 that were repaid in the first quarter of 2005. There were no revolving credit loans outstanding at the end of 2005.

Outstanding Debt:

Sale/Leaseback and Mortgage Financings. In December 2001, we completed a financial restructuring plan which included the repayment of all amounts outstanding under our then existing credit facility and the purchase of approximately $21.3 million of our 10.5% senior notes with the proceeds from $55.0 million in long-term mortgage financing (the Mortgage Financing) and a $33.7 million sale and leaseback transaction (the Sale/Leaseback Financing).

In connection with the Sale/Leaseback Financing, we sold 44 properties operating as Friendly s restaurants and entered into a master lease with the buyer to lease the 44 properties for an initial term of 20 years under a triple net lease. There are four five-year renewal options and lease payments are subject to escalator provisions every five years based upon increases in the Consumer Price Index.

Interest on $10.0 million of the original $55.0 million from the Mortgage Financing is variable (Variable Mortgages) and the remaining $45.0 million of the original $55.0 million from the Mortgage Financing bears interest at a fixed annual rate of 10.16% (Fixed Mortgages). The Fixed Mortgages have a maturity date of January 1, 2022 and are amortized over 20 years.

On December 30, 2005, we completed a refinancing of the Variable Mortgages (the Variable Refinancing). Under the terms of the loan agreement for the Variable Refinancing, we borrowed an aggregate sum of $8.5 million. The interest rate is variable and is the sum of the 90-day LIBOR rate in effect (5.0% at April 2, 2006) plus 4% on an annual basis. Changes in the interest rate are calculated monthly and recognized annually when the monthly payment amount is adjusted. Changes in the monthly payment amounts owed due to interest rate changes are reflected in the principal balances, which are re-amortized over the remaining life of the mortgages. The loans under the Variable Refinancing have a maturity date of January 1, 2020 and are being amortized over 14 years.

The primary purposes of the Variable Refinancing were to (i) reduce the variable interest rate on the Variable Mortgages from LIBOR plus 6% on an annual basis to LIBOR plus 4% on an annual basis, (ii) enable the partial prepayment of the loans, subject to applicable prepayment premiums during the first three years and an agreed upon release value for properties released in connection with partial prepayments, and (iii) permit partial lien releases on the properties subject to the loans upon partial prepayments. In addition, in connection with this transaction, we prepaid two mortgage loans from the lender in the aggregate amount of $1.0 million from existing cash.

Pursuant to the terms of the Mortgage Financing, we may sell properties securing our obligations provided that other properties are substituted in place of the sold properties. The substituted properties must meet certain requirements under the terms of the Mortgage Financing. In August 2005, proceeds of $0.4 million and $2.7 million were received in connection with the sale of two mortgaged properties and $0.4 million and $1.3 million was placed in escrow. As of January 1, 2006, these balances were held as collateral and were included in restricted cash on the accompanying condensed consolidated balance sheet as of January 1, 2006. In connection with the Variable Refinancing, the mortgage on one of these properties was released and the $0.4 million was released from escrow during the first quarter of 2006. A substitution property for the second property must be in place to secure our obligations no later than May 31, 2006. As of April 2, 2006, the balance of $1.3 million that was held as collateral pending property substitution was included in restricted cash on the accompanying condensed consolidated balance sheet as of April 2, 2006.

In September 2005, we acquired additional financing secured by our newly constructed Milford, MA restaurant (the Milford Mortgage). The financing provided for a real estate improvement and equipment loan. The real estate improvement loan has a principal balance of $0.8 million and is amortized over 15 years with a balloon payment due on October 1, 2010. The equipment loan has a principal balance of $0.3 million and is amortized over seven years with a balloon payment due on October 1, 2010. The interest rate is variable and is the sum of the 90-day LIBOR rate in effect (5.0% at April 2, 2006) plus 4% on an annual basis. Changes in the interest rate are calculated monthly and recognized annually when the monthly payment amount is adjusted. Changes in the monthly payment amounts owed due to interest rate changes are reflected in the principal balances, which are re-amortized over the remaining life of the mortgages. The variable rate notes are subject to prepayment penalties during the first three years.

All mortgage financings are subject to annual covenants, including various minimum fixed charge coverage ratios. We were in compliance with the covenants for the Variable Mortgages and the Fixed Mortgages as of January 1, 2006. As of January 1, 2006, we were not in compliance with the fixed charge coverage ratio related to the Milford Mortgage. We obtained a waiver from the Milford Mortgage lender on March 7, 2006 waiving this covenant requirement for the year ended January 1, 2006.

8.375% Senior Notes. In 2003 and 2004, we purchased or redeemed all of the remaining outstanding 10.5% senior notes in a series of transactions. In February 2004, we announced a cash tender offer and consent solicitation for $176 million of our 10.5% senior notes to be financed with the proceeds from a $175 million private offering of new 8.375% senior notes (the Senior Notes), available cash and our Credit Facility. In March 2004, $127.4 million of aggregate principal amount of 10.5% senior notes were purchased at the tender offer and consent solicitation price of 104% of the principal amount and $0.5 million of aggregate principal amount of 10.5% senior notes were purchased at the tender offer price of 102% of the principal amount. In April 2004, the remaining $48.1 million of 10.5% senior notes were redeemed in accordance with the 10.5% senior notes indenture at 103.5% of the principal amount.

The $175 million of Senior Notes issued in March 2004 are unsecured senior obligations of FICC, guaranteed on an unsecured senior basis by FICC s Friendly s Restaurants Franchise, Inc. subsidiary, but are effectively subordinated to all secured indebtedness of FICC, including the indebtedness incurred under our Credit Facility. The Senior Notes mature on June 15, 2012. Interest on the Senior Notes is payable at 8.375% per annum semi-annually on June 15 and December 15 of each year. The Senior Notes are redeemable, in whole or in part, at any time on or after June 15, 2008 at FICC s option at redemption prices from 104.188% to 100.00%, based on the redemption date. In addition, at any time prior to June 15, 2007, FICC may redeem, subject to certain conditions, up to 35% of the aggregate principal amount of the Senior Notes with the proceeds of one or more qualified equity offerings, as defined, at a redemption price of 108.375% of the principal amount, plus accrued interest.

Revolving Credit Facility. We have a $35.0 million Credit Facility which is available for borrowings to provide working capital, for letters of credit and for other corporate needs. As of April 2, 2006 and January 1, 2006, total letters of credit outstanding were $17.1 million and $16.0 million, respectively. During 2006 and 2005, there were no drawings against the letters of credit. The revolving credit loans bear interest at our option at either (a) the base rate plus the applicable margin as in effect from time to time (the Base Rate) (10.25% at April 2, 2006) or (b) the Eurodollar rate plus the applicable margin as in effect from time to time (the Eurodollar Rate) (9.32% at April 2, 2006). As of April 2, 2006 and January 1, 2006, there were no revolving credit loans outstanding. As of April 2, 2006 and January 1, 2006, $17.9 million and $19.0 million, respectively, was available for borrowing.

The Credit Facility has an annual clean-up provision which obligates us to repay in full any and all outstanding revolving credit loans for a period of not less than 15 consecutive days during the period beginning on or after May 1 and ending on or before June 15 (or the next business day, if, in any year, June 15 is not a business day) of each calendar year, such that immediately following the date of such repayment, the amount of all outstanding revolving credit loans shall be zero.

The Credit Facility matures on June 30, 2007. The Credit Facility includes certain restrictive covenants including limitations on indebtedness, restricted payments such as dividends and stock repurchases, liens, mergers, investments and sales of assets and of subsidiary stock. Additionally, the Credit Facility limits the amount which we may spend on capital expenditures, restricts the use of proceeds, as defined, from asset sales and requires that we comply with certain financial covenants. On March 15, 2006, we amended and restated the Credit Facility as of December 30, 2005 to, among other things, (i) revise certain financial covenants beginning with the fourth quarter of 2005 and extending through the Credit Facility maturity date of June 30, 2007 (including leverage, interest coverage, minimum EBITDA and the deletion of the tangible net worth covenant) and (ii) permit certain transactions to be excluded from our annual capital expenditures limit. We were in compliance with the covenants in the Credit Facility as of April 2, 2006.

We anticipate requiring capital in the future principally to maintain existing restaurant and plant facilities and to continue to renovate and re-image existing restaurants. We anticipate that capital expenditures for 2006 will be between $18.0 million and $26.0 million in the aggregate, of which we expect to spend between $14.0 million and $18.0 million on restaurants. Our actual 2006 capital expenditures may vary from these estimated amounts. We believe that the combination of the funds generated from operating activities and borrowing availability under our Credit Facility will be sufficient to meet our anticipated operating requirements, debt service requirements, lease obligations, capital requirements and obligations associated with the corporate restructurings.

There have been no material changes to our contractual obligations and commitments from those disclosed in our 2005 Annual Report on Form 10-K.

Seasonality

Due to the seasonality of ice cream consumption, and the effect from time to time of weather on patronage of the restaurants, our revenues and operating income are typically higher in our second and third quarters.

Geographic Concentration

Approximately 97% of the Company-operated restaurants are located, and substantially all of its retail sales are generated, in the Northeast. As a result, a severe or prolonged economic recession or changes in demographic mix, employment levels, population density, weather, real estate market conditions or other factors specific to this geographic region may adversely affect us more than certain of our competitors which are more geographically diverse.

Critical Accounting Estimates

The discussion and analysis of our consolidated financial condition and results of operations are based upon our interim condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, insurance reserves, recoverability of accounts receivable, stock compensation expense, income tax valuation allowances and pension and other post-retirement benefits expense. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

The critical accounting estimates that we believe affect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements presented in this report are described in our Management s Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2006. The only material change to our critical accounting estimates relates to stock-based compensation and is described below.

Actual results may differ from these estimates under different assumptions or conditions. Any differences may have a material impact on our financial condition and results of operations. For a discussion of how these and other factors may affect our business, see the Forward Looking Statement above and other factors included in our other filings with the Securities and Exchange Commission.

Stock-Based Compensation

The adoption of SFAS No. 123R in the first quarter of fiscal 2006 requires that stock-based compensation expense associated with stock options be recognized in the statement of operations, rather than being disclosed in a pro forma footnote to the consolidated financial statements. Determining the amount of stock-based compensation to be recorded requires us to develop estimates to be used in calculating the grant-date fair value of stock options. We calculate the grant-date fair values using the Black-Scholes valuation model. The use of valuation models requires us to make estimates of the following assumptions:

Expected volatility - we are responsible for estimating volatility and have used historical volatility to estimate the grant-date fair value of stock options. Management considered the guidance in SFAS No. 123R and believes that the historical estimated volatility is materially indicative of expectations about future volatility. In general, the higher the expected volatility used in the Black-Scholes valuation model, the higher the grant-date fair value of the option.

Expected term - we use historical employee exercise and option expiration data to estimate the expected term assumption for the Black-Scholes grant-date valuation. We believe that this historical data is currently the best estimate of the expected term of a new option. Currently stock options are only issued to corporate officers and directors. In general, the longer the expected term used in the Black-Scholes valuation model, the higher the grant-date fair value of the option.

Risk-free interest rate - the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption is used as the risk-free interest rate.

Expected dividend yield - we have not paid any dividends in the last five years and currently intend to retain any earnings to finance future growth and, therefore, do not anticipate paying any cash dividends on our common stock in the foreseeable future.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered option. We currently expect, based on an analysis of our historical forfeitures, that approximately 97% of our options will actually vest, and therefore have applied an annual forfeiture rate of 3% to all unvested options as of April 2, 2006. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our market risk exposure since the filing of the 2005 Annual Report on Form 10-K.

Item 4. Controls and Procedures

As of April 2, 2006, an evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of April 2, 2006.

There were no significant changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to our risk factors from those disclosed in our 2005 Annual Report on Form 10-K.

Item 6. Exhibits

(a) Exhibits

The exhibit index is incorporated by reference herein.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Friendly Ice Cream Corporation	
By:	/s/PAUL V. HOAGLAND Name: Paul V. Hoagland Title: Executive Vice President of Administration and Chief Financial Officer (Principal Financial Officer)
Date:	May 4, 2006

37

EXHIBIT INDEX

4.9	Amended and Restated Revolving Credit Agreement dated as of March 15, 2006 (Incorporated by reference to Exhibit 4.9 to the Company s Annual Report on Form 10-K for the fiscal year ended January 1, 2006, File No. 001-13579).
10.1	Memorandum of Agreement Between Allan J. Okscin and Friendly Ice Cream Corporation effective January 23, 2006 (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed with the Commission on January 26, 2006).*
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by John L. Cutter.
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Paul V. Hoagland.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by John L. Cutter and Paul V. Hoagland.

* - Management Contract or Compensatory Plan or Arrangement