

Acquisitions & Renovations



Hilton Jacksonville Riverfront
Jacksonville, FL



Hilton Philadelphia Airport
Philadelphia, PA



Holiday Inn Laurel West
Laurel, MD

Hilton Philadelphia Airport
Philadelphia, PA

Holiday Inn Laurel West
Laurel, MD

Holiday Inn Downtown Williamsburg
Williamsburg, VA

Holiday Inn Brownstone
Raleigh, NC

Shell Island Resort
Wrightsville Beach, NC

Hilton Wilmington Riverside
Wilmington, NC

Hilton Savannah DeSoto
Savannah, GA

Hilton Jacksonville Riverfront
Jacksonville, FL



Holiday Inn Downtown Williamsburg



Holiday Inn Brownstone



Shell Island Resort



Hilton Savannah DeSoto



Hilton Wilmington Riverside

A well-located hotel sits shuttered and desolate. To many it represents a better past; to MHI Hospitality Corporation ("MHI") it represents potential for a better future.

The Company, together with affiliated entities, has a long and successful history of instituting growth strategies focused on renovating and upbranding underperforming hotels, while at the same time improving the operating results of our initial portfolio.

Our experience has proven that many troubled properties have outstanding inherent value. Unlocking it requires vision, acumen, and diligence - qualities that we bring to every opportunity. At MHI we create value through a singular focus: excellence in product and performance.

We believe that investments in the hospitality industry can be made with confidence, with prudence and with outstanding results. Opportunities are developed, not discovered. Execution is the critical factor.

Edgar Sims, Jr. - attorney, community leader, dedicated father - started MHI almost 50 years ago, on a foundation of quality, integrity and hospitality. Those values still guide us today. For now, and for the future, they remain the hallmarks that ensure satisfaction for our quests, our employees and our business partners.

Andrew M. Sims
CEO & Chairman
MHI Hospitality Corporation



2005

Annual Report



Creating
value and opportunity through
hospitality



Corporate Headquarters
814 Capitol Landing Road
Williamsburg, VA 21385
Phone: 757-229-5648
Fax: 757-564-8801

Finance & Administrative Offices
6411 Ivy Lane
Suite 510
Greenbelt, MD 20770
Phone: 301-220-5400
Fax: 301-474-0807



Hilton Savannah DeSoto
Savannah, GA



Shell Island Resort
Wrightsville Beach, NC



Holiday Inn Downtown Williamsburg
Williamsburg, VA



Dear Shareholder:

Although we are a relatively new public company, our predecessor entities and management team have long been involved in the hospitality business dating to the acquisition of our predecessor's first hotel in 1957. We made the decision to go public in 2004, gaining access to the capital markets, which were receptive to the signs of a recovery in the lodging industry. Our management team has a wealth of knowledge in nearly every aspect of the business, including hotel construction and renovation, financing, operations and asset management.

We seek to create value by acquiring under-performing assets at a discount and applying our asset management skills and branding relationships to unlock the property's potential. Often times we bring in new management and rebrand the property, which leads to an improved guest mix and an increase in occupancy, as well as the average room rate. The goal is an investment in branded lodging with total invested capital below replacement cost. As a rule, we strive to achieve average cash on cash return of 10% to 14%, and an internal rate of return of 20% on our investments. Realizing that turning around an under-performing property involves risk, we manage that by seeking properties with an attractive purchase price and location in the markets in which we operate. Today our market focus is on the mid-Atlantic and Southeastern states.

As managers of our shareholders' capital, we work to create strong operating results and enhanced market value for every property we own. Our goal is to generate increasing cash flows from each of our properties, to build equity value, and to return a portion of our profits to shareholders in the form of dividends. Our operating strategy includes both internal growth from the improving performance of our original hotels, and external growth from accretive acquisitions.

We are very pleased with our first full year as a public company. Our initial public offering occurred in December of 2004; we priced six million shares at \$10 with an additional over allotment of 700,000 shares. We put our money to work, funding the acquisition of our portfolio of six initial hotels, as well as repaying some of our outstanding debt. In addition, we made an investment during the year in our seventh hotel -the Jacksonville Hilton - and are under contract to acquire an interest in a hotel condominium conversion in Hollywood, Florida. We successfully repositioned our Philadelphia and Laurel properties and generated solid operating results from our portfolio,

with full year RevPAR growth of 7.4% over the prior year driven by an increase of 12.1% in the average daily rate. Our dividend yield of 7% based upon our initial public offering price compares favorably to the equity and lodging sector REIT averages of 5.5%.

As the lodging industry continues its recovery and industry reports indicate that demand continues to outpace supply, the sector has seen increased competition for attractive acquisition opportunities - - in short it's a seller's market. As a result, we have seen the compression of cap rates over the last year across the entire real estate sector. We believe that MHI Hospitality Corporation has a competitive advantage, given our successful track record of buying and repositioning underperforming hotels. In this defined niche, growth is focused on assets that can generate high returns, but may take longer to reap accretive benefits. Many public or institutional buyers are unwilling to commit to a lengthy timeframe.



For 2006, we intend to remain disciplined in our growth strategy and investment underwriting, and continue to seek distressed properties in recovering lodging markets. We will also consider alternative non-core investments that meet our return hurdles as we wait for more attractive pricing in the market. The pipeline remains active and our relationships developed over the years create many opportunities before they are available publicly. Be assured, we will not grow simply for growth's sake. In many cases, we bid on properties only to see them sold to others for what we consider too high a price for the corresponding returns. Notwithstanding the overheated market, we believe that this year's investment and repositioning transactions will produce solid growth for the upcoming year.

This has been a good beginning to what we consider a great company. I extend my gratitude to our employees who truly made this year a success, and our knowledgeable board of directors, who helped guide us during our first year as a public entity. On behalf of all of us here, I would also like to thank our shareholders for their support.

Sincerely,

Andrew M. Sims
Chairman of the Board and Chief Executive Officer
MHI Hospitality Corporation



Holiday Inn Laurel West
Laurel, MD



Hilton Philadelphia Airport
Philadelphia, PA



Hilton Jacksonville Riverfront
Jacksonville, FL

BOARD OF DIRECTORS



Andrew M. Sims, President
CEO, Chairman of the Board



General Anthony C. Zinni
(USMC Ret.), Director



J. Paul Carey, Director



Edward S. Stein, Director



Christopher L. Sims, Director



David J. Beatty, Director



Kim E. Sims, Director

OFFICERS



Andrew M. Sims, President, CEO



William J. Zaiser, CFO



David R. Folsom, Executive Vice
President, COO

EXECUTIVE STAFF



Anthony E. Domalski, Chief
Accounting Officer



Julie F. Connolly,
Compliance Officer



Diana D. Johnson, Director
of Investor Relations



Scott M. Kuchinski,
Development Analyst



Rhonda L. Smith, Executive
Assistant

CORPORATE OFFICES

Corporate Headquarters
814 Capital Landing Road
Williamsburg, VA 21385
Phone: 757-229-5648
Fax: 757-564-8801

Finance & Administrative Offices
6411 Ivy Lane
Suite 510
Greenbelt, MD 20770
Phone: 301-220-5400
Fax: 301-474-0807

Independent Auditors
PKF Witt Mares
4801 Courthouse Street
Suite 200
Williamsburg, VA 23188
Phone: 757-229-7180
Fax: 757-229-5452

