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*A publicly traded company on the American Stock Exchange ("AMEX") under the symbol MDH



2006
 Annual Report

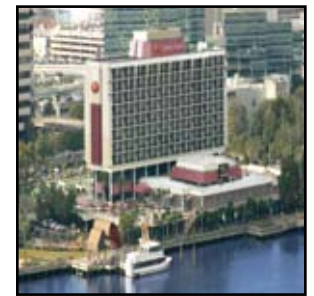
Celebrating 50 Years of Hospitality Excellence



PORTFOLIO



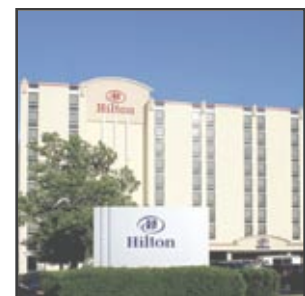
Hilton Savannah DeSoto, Savannah, GA



Crowne Plaza Riverfront, Jacksonville, FL



Holiday Inn Brownstone, Raleigh, NC



Hilton Philadelphia Airport, Philadelphia, PA



Shell Island Resort, Wrightsville Beach, NC



Holiday Inn Laurel, Laurel, MD



Hilton Wilmington Riverside, Wilmington, NC



Crowne Plaza SIAN Resort, Hollywood Beach, FL



Sheraton Louisville Riverside, Jeffersonville, IN



SHAREHOLDER LETTER

Building Blocks to Growth

To Our Shareholders:



Turning to other 2006 portfolio initiatives:

- We reflagged and completed \$3.0 million in renovations at our Crowne Plaza Jacksonville Riverfront Hotel. While performance for the year reflected the stress of extensive renovations coupled with a brand change we are enthusiastic about prospects for this repositioned asset going forward.
- Planning for the Hilton Wilmington Riverside's 2007 renovation actually began in late 2006. The hotel experienced sound top line growth for the year. And we have extended our franchise with Hilton until 2018.
- The Hilton Philadelphia Airport profited from an ambitious 2005 renovation, achieving a significant increase in ADR in 2006, and remains our top-performing asset.
- The Hilton Savannah DeSoto continued to perform at a high level for the year, albeit with slightly slowing top line growth due to additional Hilton branded product in the market.
- Following thorough renovations and a rebranding in 2005, the Holiday Inn Laurel completed its first full year of operations in 2006 and performance is well in line with our expectations.
- With strong improvements in RevPAR and operating margins, the Holiday Inn Brownstone Hotel & Conference Center in Raleigh performed at its highest level ever in 2006.

Building Momentum

We continue to source attractive lodging acquisition opportunities, although cap rates remain low and prices very high in this overheated market. We believe the industry has reached a plateau. The pace of growth is slowing, and demand and supply are nearly in balance, although there is sufficient new building planning activity to expect a continued increase in mid-term supply. Within this environment we are maintaining a disciplined and highly selective investment strategy while we await more attractive pricing. We continue to consider alternative noncore investments and other opportunities that meet our return criteria.

Looking ahead we have established the following goals to drive continued growth and to build value for shareholders.

- In terms of performance we have raised FFO guidance targets for 2007. We also reaffirm our commitment to pay an above market dividend.
- Regarding portfolio initiatives, we will continue to source well-located underperforming hotel assets, while maintaining a disciplined investment approach. In 2007 we plan to acquire two or more hotel properties. And we will continue repositioning our core assets.
- In order to further enhance our financial capacity and to create a fee income stream, we intend to complete a joint venture with a private equity partner. We also will refinance the company's fixed rate debt to lower interest expense.

In 2006 we put important building blocks in place for future growth. We bolstered management and financial resources, and we continued to implement creative repositioning strategies at our assets. In our second full year as a public company we delivered solid performance results. And since our IPO in December 2004 we have achieved significant growth. Room sales and total sales were over 40% greater in 2006 than 2004. RevPAR has increased over 19% during that time frame. And since 2004 the market value of our assets has doubled and the equity in the company has grown by 80%.

We believe we are well-positioned for continued and accelerating growth. And as managers of our shareholders' capital we remain committed to building long-term value. We pursue this endeavor being mindful of the original cornerstones of our company: hospitality, value and opportunity. On behalf of our senior management team, I want to thank our shareholders, Board of Directors, and employees for their continued support. We look forward to another successful year in 2007.

Sincerely,

Andrew M. Sims
Chairman and CEO
MHI Hospitality Corporation

CORPORATE PROFILE

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



Kim E. Sims, Director



James P. O'Hanlon, Director

OFFICERS



Andrew M. Sims,
President, CEO



William J. Zaiser,
Executive Vice President, CFO



David R. Folsom,
Executive Vice President, COO



Julia F. Connolly,
Vice President
Chief Compliance Officer



Anthony E. Domabki,
Vice President
Chief Accounting Officer

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Independent Auditors
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Phone: 757-229-7180
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EXECUTIVE STAFF



Diana D. Johnson,
Director of Investor Relations



Scott M. Kucinski,
Development Analyst



Rhonda L. Smith,
Executive Assistant

Glossary

ADR: Average daily room rate.

FFO: Funds from Operations. Commonly reported measure of REIT operating performance equal to net income, excluding gains or losses from sales of property, and adding back real estate depreciation.

Hospitality: The friendly reception and treatment of guests.

Hotel: An establishment that provides lodging and usually meals and other services for travelers and other paying guests. An inn of the better sort (1765).

Key: Hotel room.

Lodging REIT: Company dedicated to investing in and owning hotel properties. Investing in a lodging REIT such as MHI Hospitality Corporation is a liquid, dividend-paying means of participating in the commercial real estate market.

RevPAR: Revenue per available room. Performance metric typically calculated by multiplying hotel's average daily room rate (ADR) by occupancy rate.

Upscale Hotel: Full service lodging with room rates in the highest 25%-30% of all hotels within market.

Upper Upscale Hotel: Branded or independent full service property realizing top 10%-15% room rates within local market.