

MOODY NATIONAL REIT II, INC.
SUPPLEMENT NO. 5 DATED AUGUST 18, 2017
TO THE PROSPECTUS DATED JUNE 12, 2017

This document supplements, and should be read in conjunction with, our prospectus dated June 12, 2017, as supplemented by Supplement No. 3, dated June 12, 2017 and Supplement No. 4 dated August 10, 2017 relating to our offering of up to \$1,100,000,000 in shares of our common stock. Terms used and not otherwise defined in this Supplement No. 5 shall have the same meanings as set forth in our prospectus. The purpose of this Supplement No. 5 is to disclose an agreement with and loan to our affiliate Moody National REIT I, Inc, or Moody I, and our Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2017.

Loan to Moody I

On April 15, 2017, Moody National Operating Partnership II, LP, or our operating partnership, made a loan in the amount of \$7,106,505.60, or the loan, to Moody National International-Fort Worth Holding, LLC, a Delaware limited liability company, or Moody Holding, and an indirect subsidiary of Moody National Operating Partnership I, L.P., or Moody I operating partnership, the operating partnership of Moody I, and Moody Holding executed a promissory note, or the note, evidencing the loan in favor of our operating partnership. The note bears interest at a rate of 6.50% per annum and is secured by a TownePlace Suites hotel property owned by Moody I and located in Ft. Worth, Texas, or the Fort Worth property. The loan will mature upon the earlier of (i) the consummation of the mergers (defined below) or (ii) September 30, 2017. Moody Holding will use the proceeds of the loan to repay an existing loan secured by the Fort Worth property that has matured and become due. We expect the loan to be refinanced with the proceeds of a new loan that we intend to obtain in connection with the consummation of the mergers. In the event the mergers are not consummated, Moody I intends to refinance the loan with proceeds of a new loan.

Moody National REIT Sponsor, LLC, or Moody National Sponsor, sponsored us and Moody I. Moody National Sponsor and its affiliates provide investment advisory services to us and Moody I pursuant to written advisory agreements. We are party to that certain Agreement and Plan of Merger dated as of November 16, 2016, or the merger agreement, as amended by Amendment No. 1 to the merger agreement on August 9, 2017, by and among Moody I, Moody I operating partnership, us, our operating partnership, Moody Merger Sub, LLC, our wholly owned subsidiary, or merger sub, Moody National Advisor I, LLC and Moody National Advisor II, LLC pursuant to which (i) Moody I will merge with and into merger sub, with merger sub continuing as the surviving entity and (ii) Moody I operating partnership will merge with and into our operating partnership, with our operating partnership surviving as the surviving partnership, together, the mergers.

Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2017

On August 14, 2017, we filed with the SEC our Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, a copy of which is attached hereto as Appendix A (without exhibits).

APPENDIX A

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2017

OR

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 000-55778

MOODY NATIONAL REIT II, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of Incorporation or Organization)
6363 Woodway Drive, Suite 110
Houston, Texas
(Address of Principal Executive Offices)

47-1436295
(I.R.S. Employer Identification No.)

77057
(Zip Code)

(713) 977-7500
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No []

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No []

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

Large accelerated filer [] Accelerated filer []
Non-accelerated filer [] Smaller reporting company [X]
(Do not check if a smaller reporting company) Emerging Growth Company [X]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

[X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [] No [X]

As of August 10, 2017, there were 4,822,621 shares of the Registrant's common stock issued and outstanding.

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**MOODY NATIONAL REIT II, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)**

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
ASSETS		
Investments in hotel properties, net	\$ 98,962,546	\$ 99,989,740
Cash and cash equivalents	49,762,453	19,577,312
Restricted cash	2,240,922	1,870,304
Accounts receivable, net of allowance for doubtful accounts of \$3,000 at June 30, 2017 and December 31, 2016	369,579	278,796
Mortgage note receivable from related party	11,200,000	11,200,000
Prepaid expenses and other assets	1,074,647	209,535
Earnest money	—	2,000,000
Deferred franchise costs, net of accumulated amortization of \$24,516 and \$15,656 at June 30, 2017 and December 31, 2016, respectively ...	225,484	234,344
Due from related parties	3,293,310	398,743
Total Assets	<u>\$ 167,128,941</u>	<u>\$ 135,758,774</u>
LIABILITIES AND EQUITY		
Liabilities:		
Notes payable, net of unamortized debt issuance costs of \$776,346 and \$931,498 as of June 30, 2017 and December 31, 2016, respectively ...	\$ 69,198,654	\$ 69,043,502
Accounts payable and accrued expenses	2,059,167	1,431,535
Dividends payable	676,447	451,631
Operating partnership distributions payable	2,589	2,668
Total Liabilities	71,936,857	70,929,336
Special Limited Partnership Interests	1,000	1,000
Commitments and Contingencies		
Equity:		
Stockholders' equity:		
Preferred stock, \$0.01 par value per share; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.01 par value per share; 1,000,000,000 shares authorized, 4,750,286 and 3,173,348 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	47,503	31,733
Additional paid-in capital	103,520,485	68,571,270
Accumulated deficit	(8,736,665)	(4,154,395)
Total stockholders' equity	94,831,323	64,448,608
Noncontrolling interests in Operating Partnership	359,761	379,830
Total Equity	<u>95,191,084</u>	<u>64,828,438</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 167,128,941</u>	<u>\$ 135,758,774</u>

See accompanying notes to consolidated financial statements.

MOODY NATIONAL REIT II, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Revenue				
Room revenue.....	\$ 5,002,614	\$ 3,324,190	\$ 8,738,806	\$ 4,638,627
Other hotel revenue.....	369,572	131,113	753,506	167,028
Total hotel revenue.....	<u>5,372,186</u>	<u>3,455,303</u>	<u>9,492,312</u>	<u>4,805,655</u>
Interest income from mortgage note receivable...	156,139	—	312,278	—
Total revenue.....	<u>5,528,325</u>	<u>3,455,303</u>	<u>9,804,590</u>	<u>4,805,655</u>
Expenses				
Hotel operating expenses.....	2,905,687	1,613,266	5,417,674	2,212,527
Property taxes, insurance and other.....	293,326	150,146	548,626	202,756
Depreciation and amortization.....	585,516	376,054	1,169,987	555,605
Acquisition expenses.....	423,601	1,238,122	1,048,328	1,238,122
Corporate general and administrative.....	573,848	528,703	1,152,486	674,701
Total expenses.....	<u>4,781,978</u>	<u>3,906,291</u>	<u>9,337,101</u>	<u>4,883,711</u>
Operating income (loss)	746,347	(450,988)	467,489	(78,056)
Interest expense and amortization of debt issuance costs.....	<u>819,327</u>	<u>668,079</u>	<u>1,599,269</u>	<u>868,058</u>
Loss before income tax expense	(72,980)	(1,119,067)	(1,131,780)	(946,114)
Income tax expense (benefit).....	<u>33,000</u>	<u>156,000</u>	<u>(112,000)</u>	<u>170,000</u>
Net loss	(105,980)	(1,275,067)	(1,019,780)	(1,116,114)
(Income) loss attributable to noncontrolling interests in Operating Partnership.....	<u>(70)</u>	<u>7,727</u>	<u>4,448</u>	<u>7,727</u>
Net loss attributable to common stockholders ...	<u>\$ (106,050)</u>	<u>\$ (1,267,340)</u>	<u>\$ (1,015,332)</u>	<u>\$ (1,108,387)</u>
Per-share information – basic and diluted:				
Net loss attributable to common stockholders ...	<u>\$ (0.02)</u>	<u>\$ (0.94)</u>	<u>\$ (0.25)</u>	<u>\$ (1.03)</u>
Dividends declared	<u>\$ 0.44</u>	<u>\$ 0.44</u>	<u>\$ 0.87</u>	<u>\$ 0.87</u>
Weighted average common shares outstanding	<u>4,588,010</u>	<u>1,354,525</u>	<u>4,107,945</u>	<u>1,072,200</u>

See accompanying notes to consolidated financial statements.

MOODY NATIONAL REIT II, INC.
CONSOLIDATED STATEMENT OF EQUITY
Six months ended June 30, 2017
(unaudited)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Noncontrolling Interests in Operating Partnership</u>		<u>Total Equity</u>
	<u>Number of Shares</u>	<u>Par Value</u>	<u>Number of Shares</u>	<u>Par Value</u>			<u>Number of Units</u>	<u>Value</u>	
Balance at December 31, 2016	—	\$ —	3,173,348	\$ 31,733	\$ 68,571,270	\$ (4,154,395)	18,000	\$ 379,830	\$ 64,828,438
Issuance of common stock, net of offering costs	—	—	1,536,102	15,362	33,879,607	—	—	—	33,894,969
Issuance of common stock pursuant to dividend reinvestment plan . . .	—	—	40,836	408	999,808	—	—	—	1,000,216
Stock-based compensation	—	—	—	—	69,800	—	—	—	69,800
Net loss	—	—	—	—	—	(1,015,332)	—	(4,448)	(1,019,780)
Dividends and distributions declared	—	—	—	—	—	(3,566,938)	—	(15,621)	(3,582,559)
Balance at June 30, 2017	—	\$ —	4,750,286	\$ 47,503	\$ 103,520,485	\$ (8,736,665)	18,000	\$ 359,761	\$ 95,191,084

See accompanying notes to consolidated financial statements.

MOODY NATIONAL REIT II, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six months ended June 30,	
	2017	2016
Cash flows from operating activities		
Net loss.....	\$ (1,019,780)	\$ (1,116,114)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization.....	1,169,987	555,605
Amortization of debt issuance costs.....	155,152	175,523
Deferred income tax.....	(112,000)	6,000
Stock-based compensation.....	69,800	191,059
Changes in operating assets and liabilities:		
Restricted cash.....	(162,625)	105,055
Accounts receivable.....	(90,783)	(471,615)
Prepaid expenses and other assets.....	(753,112)	(406,347)
Accounts payable and accrued expenses.....	627,632	1,776,699
Due from related parties.....	(1,133,777)	340,500
Net cash provided by (used in) operating activities.....	(1,249,506)	1,156,365
Cash flows from investing activities		
Increase in restricted cash.....	(207,993)	(170,554)
Payment of deferred franchise costs.....	—	(100,000)
Improvements and additions to hotel properties.....	(133,933)	(29,001)
Acquisition of hotel property.....	—	(73,649,460)
Net cash used in investing activities.....	(341,926)	(73,949,015)
Cash flows from financing activities		
Proceeds from issuance of common stock.....	38,936,780	31,240,539
Offering costs paid.....	(4,802,601)	(4,392,752)
Dividends paid.....	(2,341,906)	(537,121)
Operating partnership distributions paid.....	(15,700)	(688)
Proceeds from note payable.....	—	56,250,000
Payment of debt issuance costs.....	—	(1,157,379)
Net cash provided by financing activities.....	31,776,573	81,402,599
Net change in cash and cash equivalents.....	30,185,141	8,609,949
Cash and cash equivalents at beginning of period.....	19,577,312	1,580,967
Cash and cash equivalents at end of period.....	\$ 49,762,453	\$ 10,190,916
Supplemental Disclosure of Cash Flow Activity		
Interest paid.....	\$ 1,546,368	\$ 385,894
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Assignment of purchase contract to related party.....	\$ 2,000,000	—
Increase in accrued offering costs due to related party.....	\$ 239,210	\$ 329,669
Issuance of common stock from dividend reinvestment plan.....	\$ 1,000,216	\$ 242,265
Issuance of operating partnership units for hotel property.....	\$ —	\$ 450,540
Dividends payable.....	\$ 676,447	\$ 172,275
Operating partnership distributions payable.....	\$ 2,589	\$ 2,582

See accompanying notes to consolidated financial statements.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

1. Organization

Moody National REIT II, Inc. (the “Company”) was formed on July 25, 2014, as a Maryland corporation and intends to elect to be taxed as a real estate investment trust (“REIT”) beginning with the year ended December 31, 2016. The Company has used, and expects to use, the proceeds from its initial public offering (as described below) to invest in a portfolio of hospitality properties focusing primarily on the premier-brand, select-service segment of the hospitality sector. To a lesser extent, the Company may also invest in hospitality-related real estate securities and debt investments. As discussed in Note 6, “Equity,” the Company was initially capitalized by Moody National REIT Sponsor, LLC (the “Sponsor”). The Company’s fiscal year end is December 31.

As of June 30, 2017, the Company owned a 112-room hotel property located in Austin, Texas (the “Residence Inn Austin”), a 234-room hotel property located in Seattle, Washington (the “Springhill Suites Seattle”) and a mortgage note receivable from a related party (the “MN TX II Note”). For more information on the Company’s real estate investments see Note 3, “Investment in Hotel Properties” and Note 4, “Mortgage Note Receivable from Related Party.”

On January 20, 2015, the Securities and Exchange Commission (the “SEC”) declared the Company’s registration statement on Form S-11 effective, and the Company commenced its initial public offering (the “Offering”), of up to \$1,100,000,000 in shares of common stock consisting of up to \$1,000,000,000 in shares of the Company’s common stock offered to the public (the “Primary Offering”), at an initial offering price of \$25.00 per share, and up to \$100,000,000 in shares offered to the Company’s stockholders pursuant to its distribution reinvestment plan (the “DRP”), at an initial offering price of \$23.75 per share. On March 16, 2017, the Company’s board of directors determined an estimated value per share of the Company’s common stock of \$25.04 as of December 31, 2016.

On June 12, 2017, the Company filed Articles of Amendment with the State Department of Assessments and Taxation of Maryland (the “SDAT”), which changed the name and designation of the Company’s common stock to Class A common stock (the “Class A Shares”). The Articles of Amendment became effective immediately upon filing with the SDAT. Immediately following the filing of the Articles of Amendment, the Company filed Articles Supplementary with the SDAT. The Articles Supplementary (1) reclassified 250,000,000 authorized but unissued Class A Shares as Class D common stock (the “Class D Shares”), (2) reclassified 250,000,000 authorized but unissued Class A Shares as Class I common stock (the “Class I Shares”), (3) reclassified 250,000,000 authorized but unissued Class A Shares as Class T common stock (the “Class T Shares”), and (4) revised the preferences, rights, powers, restrictions, limitations, qualifications, terms and conditions of the newly designated shares. The Articles Supplementary became effective immediately upon filing with the SDAT.

The Class T Shares contain a conversion feature whereby upon the occurrence of a specified event (generally related to a Class T stockholder’s account having incurred a maximum of 8.5% in underwriting compensation), Class T Shares owned in a stockholder’s Class T account for a given offering will automatically convert to Class A Shares.

On June 26, 2017, the SEC declared effective the Company’s post-effective amendment to its registration statement for the Offering which added the additional share classes described above. Accordingly, the Company is currently offering its shares of common stock (i) to the public in the Primary Offering at a purchase price equal to the estimated value per Class A Share of \$25.04 as of December 31, 2016, plus applicable selling commissions and dealer manager fees, subject to any applicable discounts, all as described in the prospectus for the Offering and (ii) to the Company’s stockholders pursuant to the DRP at a purchase price of \$25.04, which is equal to the estimated value per Class A Share of \$25.04 as of December 31, 2016.

As of June 30, 2017, the Company had received and accepted investors’ subscriptions for and issued 4,722,286 Class A Shares in the Offering, including 75,901 Class A Shares pursuant to the DRP, resulting in gross offering proceeds of \$116,693,855.

The Company’s advisor is Moody National Advisor II, LLC (the “Advisor”), a Delaware limited liability company and an affiliate of the Sponsor. Pursuant to an advisory agreement among the Company, the OP (defined below) and the Advisor (the “Advisory Agreement”), and subject to certain restrictions and limitations therein, the Advisor is responsible for managing the Company’s affairs on a day-to-day basis and for identifying and making acquisitions and investments on behalf of the Company.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Substantially all of the Company's business is conducted through Moody National Operating Partnership II, LP, a Delaware limited partnership (the "OP"). The Company is the sole general partner of the OP. The initial limited partners of the OP were Moody OP Holdings II, LLC, a Delaware limited liability company and a wholly owned subsidiary of the Company ("Moody Holdings II"), and Moody National LPOP II, LLC ("Moody LPOP II"), an affiliate of the Advisor. Moody Holdings II initially invested \$1,000 in the OP in exchange for limited partnership interests, and Moody LPOP II has invested \$1,000 in the OP in exchange for a separate class of limited partnership interests (the "Special Limited Partnership Interests"). As the Company accepts subscriptions for shares of common stock, it transfers substantially all of the net proceeds from such sales to the OP as a capital contribution. The limited partnership agreement of the OP provides that the OP will be operated in a manner that will enable the Company to (1) satisfy the requirements for being classified as a REIT for tax purposes, (2) avoid any federal income or excise tax liability and (3) ensure that the OP will not be classified as a "publicly traded partnership" for purposes of Section 7704 of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"), which classification could result in the OP being taxed as a corporation, rather than as a partnership. In addition to the administrative and operating costs and expenses incurred by the OP in acquiring and operating real properties, the OP will pay all of the Company's administrative costs and expenses, and such expenses will be treated as expenses of the OP.

Pending Merger with Moody National REIT I, Inc.

On September 27, 2016, the Company jointly announced with Moody National REIT I, Inc. ("Moody I"), a Maryland corporation and a related party of the Company, that the Company had entered into a non-binding Letter of Intent (the "LOI") that set forth the terms and conditions upon which the Company would acquire Moody I and its subsidiaries. Moody I is a public, non-listed REIT formed in January 2008 to invest primarily in hotel properties. As of June 30, 2017, Moody I's portfolio included 14 total investments, comprised of (i) interests in 12 hotel properties with a total of 1,595 rooms, and (ii) two promissory notes issued to related parties with an aggregate initial principal amount of \$13,500,000. Moody I is managed by Moody National Advisor I, LLC ("Moody I Advisor"), which is indirectly owned and controlled by the Sponsor.

On November 16, 2016, the Company along with the OP, the Advisor, Moody I, Moody National Operating Partnership I, LP, the operating partnership of Moody I ("Moody I OP"), Moody I Advisor, and Moody Merger Sub, LLC, the Company's wholly owned subsidiary ("Merger Sub"), entered into an agreement and plan of merger (the "Merger Agreement"). Pursuant to the Merger Agreement, Moody I will merge with and into Merger Sub, with Merger Sub continuing as the "Surviving Entity" and the Company's wholly owned subsidiary (the foregoing transaction, the "Merger"). In addition, the Merger Agreement originally provided that the OP would merge with and into Moody I OP (the "Partnership Merger"). On August 9, 2017, the parties to the Merger Agreement entered into Amendment No. 1 to the Merger Agreement, which provides that Moody I OP will merge with and into the OP, with the OP continuing as the surviving partnership (the "Surviving Partnership") following the Partnership Merger. Unless context suggests otherwise, the Merger and the Partnership Merger together shall be the "Mergers." The Merger Agreement was the product of a negotiation between a special committee of the Company's board of directors and a special committee of the board of directors of Moody I (both consisting solely of independent directors), each of which was represented by its own counsel and financial advisor. Entry into the Merger Agreement was unanimously approved by the Company's board of directors upon the recommendation of the special committee of the Company's board of directors.

Subject to the terms and conditions of the Merger Agreement, the Company will pay gross consideration of \$11.00 per share of Moody I common stock, which amount will be reduced by certain disposition fees and profit sharing amounts to Moody I's sponsor, financial advisory and legal fees payable by Moody I, and other transaction and closing costs incurred by Moody I to arrive at the net merger consideration payable to the holders of Moody I's common stock (the "Net Per Share Price.") Pursuant to the terms of the Merger Agreement, the Net Per Share Price was calculated as (i) the gross per share price of \$11.00, minus (ii) all fees and expenses that Moody I incurred as a result of or in connection with the Mergers and other transactions contemplated by the Merger Agreement (the "Moody I Transaction Fees and Expenses") provided that in no event could the Net Per Share Price be less than \$10.25. Subsequent to the execution of the Merger Agreement, the parties thereto have determined the final amount of the Moody I transaction fees and expenses. Based on such determination, the Net Per Share Price was determined to be \$10.25.

At the effective time of the Merger, each outstanding share of Moody I common stock will be automatically cancelled and retired, and converted into the right to receive, at the election of each holder of such share of Moody I's common stock, but subject to the limitations discussed below, either:

- (i) an amount in cash equal to the Net Per Share Price (the "Cash Consideration"); or

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

(ii) a number of Class A Shares (the “Stock Consideration” and, together with the Cash Consideration, the “Merger Consideration”) equal to the Net Per Share Price divided by \$25.00 (such quotient, as adjusted pursuant to the Merger Agreement, the “Exchange Ratio”).

Pursuant to the Merger Agreement, the maximum number of shares of Moody I common stock that may be converted into the right to receive the Cash Consideration may not exceed 50% of the aggregate number of shares of Moody I common stock entitled to receive Merger Consideration. Based on elections of Moody I’s stockholders and pursuant to the terms of the Merger Agreement, approximately 8.90 million shares, or approximately 67%, of Moody I’s common stock, will be converted into the right to receive the Stock Consideration and approximately 4.36 million shares, or approximately 33%, of Moody I’s common stock will be converted into the right to receive the Cash Consideration. Accordingly, if the Mergers are consummated, based on the foregoing amounts, the Company anticipates that it will issue approximately 3.65 million Class A Shares to former Moody I stockholders and pay approximately \$44.7 million in aggregate cash consideration to former Moody I stockholders.

Subject to the terms and conditions of the Merger Agreement, at the effective time of the Partnership Merger, each outstanding unit of limited partnership interest in Moody I OP will be automatically cancelled and retired, and converted into the right to receive a number of units of limited partnership interests in the Surviving Partnership equal to the Exchange Ratio. Each unit of limited partnership interest in Moody I OP designated as a special partnership unit pursuant to Moody I OP’s limited partnership agreement will be automatically cancelled and retired and shall cease to exist, and no consideration shall be paid, nor, except as expressly provided in the termination agreement (described below), shall any other payment or right inure or be made with respect thereto in connection with or as a consequence of the Partnership Merger. Each outstanding unit of limited partnership interest in the OP will remain outstanding as one unit of equity ownership in the Surviving Partnership, and each unit designated as a special partnership unit pursuant to the limited partnership agreement of the OP will remain outstanding as one special unit in the Surviving Partnership.

The Merger Agreement contains customary covenants, including covenants prohibiting Moody I and its subsidiaries and representatives from soliciting, providing information with respect to or entering into discussions concerning proposals relating to alternative business combination transactions, subject to certain limited exceptions. However, under the terms of the Merger Agreement, during the period beginning on November 16, 2016 and continuing until 11:59 p.m. New York City time on December 31, 2016 (the “Go Shop Period End Time”) Moody I had the right to initiate, solicit, provide information and enter into discussions concerning proposals relating to alternative business combination transactions. Additionally, for up to five business days after the Go Shop Period End Time, Moody I had the right to continue to participate in such discussions with certain other parties (each, a “Go Shop Bidder”) and could, subject to certain conditions set forth in the Merger Agreement regarding the proposal made by such Go Shop Bidder, terminate the Merger Agreement and enter into an agreement with a Go Shop Bidder with respect to the proposal made by such Go Shop Bidder. None of the parties contacted during the Go Shop Process submitted a proposal that was deemed an “acquisition proposal” under the Merger Agreement to Moody I prior to the Go Shop Period End Time.

Concurrently with the entry into the Merger Agreement, the Company, Moody I, Moody I OP, Moody I Advisor, Moody National Realty Company, LP (“Moody National”) and Moody OP Holdings I, LLC (“OP Holdings”), the holder of all outstanding special partnership units in Moody I OP, entered into a termination agreement (the “Termination Agreement”). Pursuant to the Termination Agreement, at the effective time of the Mergers, the amended and restated advisory agreement, dated August 14, 2009, among Moody I, Moody I OP, Moody I Advisor and Moody National (the “Moody I Advisory Agreement”) will be terminated, and Moody I will pay Moody I Advisor a payment of \$5,580,685 (the “Moody I Advisor Payment”). The Moody I Advisor Payment is a negotiated amount that represents a reduction in the disposition fee to which the Moody I Advisor could have been entitled and a waiver of any other fees that Moody I Advisor would have been due under the Moody I Advisory Agreement between Moody I and Moody I Advisor in connection with the Mergers. In addition, the Termination Agreement provides that at the effective time of the Partnership Merger and in accordance with the terms of the limited partnership agreement of Moody I OP, Moody I OP will pay to OP Holdings an amount not to exceed \$613,751 (the “Promote Payment”). In the event that the Merger Agreement is terminated prior to the consummation of the Mergers, the Termination Agreement will automatically terminate and be of no further effect and no Moody I Advisor Payment or Promote Payment will be owed and payable.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Pursuant to certain provisions of the Advisory Agreement that will only become effective if the Mergers are consummated, the Company will be obligated to pay the Advisor an acquisition fee of 1.5% of the aggregate Cash Consideration paid in the Merger. However, during the first year following the consummation of the Mergers, if the Company sells a property that was previously owned by Moody I, then any disposition fee to which the Advisor would be entitled under the Advisory Agreement will be reduced by an amount equal to the portion of the Moody I Advisor Payment attributable to such property.

The Merger Agreement may be terminated under certain circumstances by both Moody I and the Company. If such termination occurs under certain circumstances, then Moody I would be obligated to pay the Company a termination fee of either \$1,000,000 or \$2,000,000, depending on the occurrence of certain conditions, plus an expense reimbursement fee of up to \$500,000. The Merger Agreement also provides that one party may be required to reimburse the other party's expenses, up to \$500,000, if the Merger Agreement is terminated under certain circumstances.

On May 24, 2017, Moody I's stockholders approved the Merger. The obligation of each party to consummate the Mergers is subject to a number of additional conditions, including receipt of any regulatory approvals, delivery of certain documents and consents, the truth and correctness of the representations and warranties of the parties, subject to the materiality standards contained in the Merger Agreement, and the absence of a material adverse effect with respect to either the Company or Moody I. There is no guarantee that the Mergers will close. The Company's management has, and will continue to, expend time and resources to consummate the Mergers, which time and resources may otherwise have been allocated to the Company's other operational needs.

In connection with the Mergers, on February 2, 2017, the Company entered into a stockholder servicing coordination agreement with Moody Securities, LLC ("Moody Securities"), the dealer manager of the Offering and an affiliate of Advisor. Pursuant to the stockholder servicing coordination agreement, the Company will pay to Moody Securities certain stockholder servicing fees of up to \$2.125 per share of the Company's common stock issued as Stock Consideration. All stockholder servicing fees will be re-allowed to broker-dealers that provide ongoing financial advisory services to Moody I stockholders following the Mergers and that enter into participating broker-dealer agreements with Moody Securities. The aggregate amount of stockholder servicing fees is based on the number of shares of the Company's common stock issued as consideration in the Merger, and will be approximately \$7.0 million. No stockholder servicing fees will be paid with respect to any cash paid by the Company as Cash Consideration in the Merger.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The Company's consolidated financial statements include its accounts and the accounts of its subsidiaries over which it has control. All intercompany balances and transactions are eliminated in consolidation.

The Company prepares its consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Regulation S-X promulgated under Securities and Exchange Act of 1934, as amended (the "Exchange Act"). Accordingly, the consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation in accordance with GAAP have been included. Results for the three months ended June 30, 2017 may not be indicative of the results that may be expected for the full year of 2017. For further information, please read the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

The Company includes the accounts of certain entities in its consolidated financial statements when the Company is the primary beneficiary for entities deemed to be variable interest entities (each, a "VIE") through which the Company has a controlling interest. Interests in entities acquired are evaluated based on GAAP, which require the consolidation of VIEs in which the Company is deemed to have the controlling financial interest. The Company has the controlling financial interest if the Company has the power to direct the activities of the VIE that most significantly impact its economic performance and the obligation to absorb losses or receive benefits from the VIE that could be significant to the Company. If the interest in the entity is determined not to be a VIE, then the entity is evaluated for consolidation based on legal form, economic substance, and the extent to which the Company has control and/or substantive participating rights under the respective ownership agreement. There are judgments and estimates involved in determining if an entity in which the Company has an investment is a VIE. The entity is evaluated to determine if it is a VIE by, among other things, determining if the equity investors as a group have a controlling financial interest in the entity and if the entity has sufficient equity at risk to finance its activities without additional subordinated financial support. The Company did not have a VIE interest as of June 30, 2017.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Organization and Offering Costs

Organization and offering costs of the Company are paid directly by the Company or may be incurred by the Advisor on behalf of the Company. Pursuant to the Advisory Agreement between the Company and the Advisor, the Company is obligated to reimburse the Advisor or its affiliates, as applicable, for organization and offering costs incurred by the Advisor associated with each of the Company's public offerings, provided that within 60 days of the last day of the month in which a public offering ends, the Advisor is obligated to reimburse the Company to the extent organization and offering costs incurred by the Company in connection with the completed public offering exceed 15.0% of the gross offering proceeds from the sale of the Company's shares of common stock in the completed public offering. Such organization and offering costs include selling commissions and dealer manager fees paid to a dealer manager, legal, accounting, printing and other offering expenses, including marketing, salaries and direct expenses of the Advisor's employees and employees of the Advisor's affiliates and others. Any reimbursement of the Advisor or its affiliates for organization and offering costs will not exceed actual expenses incurred by the Advisor.

All offering costs, including selling commissions and dealer manager fees, are recorded as an offset to additional paid-in-capital, and all organization costs are recorded as an expense when the Company has an obligation to reimburse the Advisor.

As of June 30, 2017, total offering costs for the Offering were \$15,658,503, comprised of \$11,726,007 of offering costs incurred directly by the Company and \$3,932,496 in offering costs incurred by and reimbursable to the Advisor. As of June 30, 2017, the Company had \$88,568 due from the Advisor for reimbursable offering costs.

Income Taxes

The Company intends to make an election to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code commencing with the taxable year ended December 31, 2016. The Company did not meet all of the qualifications to be a REIT under the Internal Revenue Code for the years ended December 31, 2015 and 2014, including not having 100 shareholders for a sufficient number of days in 2015. Prior to qualifying to be taxed as a REIT, the Company is subject to normal federal and state corporation income taxes.

Provided that the Company qualifies as a REIT, it generally will not be subject to federal corporate income tax to the extent it distributes its REIT taxable income to its stockholders, so long as it distributes at least 90% of its REIT taxable income (which is computed without regard to the dividends paid deduction or net capital gain and which does not necessarily equal net income as calculated in accordance with GAAP) and satisfies the other organizational and operational requirements for qualification as a REIT. Even if the Company qualifies for taxation as a REIT, it may be subject to certain state and local taxes on its income and property, and federal income and excise taxes on its undistributed income. The Company leases the hotels it acquires to a wholly-owned taxable REIT subsidiary ("TRS") that is subject to federal, state and local income taxes.

The Company accounts for income taxes of its TRS using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The Company records a valuation allowance for net deferred tax assets that are not expected to be realized.

The Company has reviewed tax positions under GAAP guidance that clarify the relevant criteria and approach for the recognition and measurement of uncertain tax positions. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition of a tax position taken, or expected to be taken, in a tax return. A tax position may only be recognized in the consolidated financial statements if it is more likely than not that the tax position will be sustained upon examination. The Company had no material uncertain tax positions as of June 30, 2017.

The preparation of the Company's various tax returns requires the use of estimates for federal and state income tax purposes. These estimates may be subjected to review by the respective taxing authorities. A revision to an estimate may result in an assessment of additional taxes, penalties and interest. At this time, a range in which the Company's estimates may change is not expected to be material. The Company will account for interest and penalties relating to uncertain tax positions in the current period results of operations, if necessary. The Company has tax years 2014, 2015 and 2016 remaining subject to examination by various federal and state tax jurisdictions. For more information, see Note 11, "Income Taxes."

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Fair Value Measurement

Fair value measures are classified into a three-tiered fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1: Observable inputs such as quoted prices in active markets.
- Level 2: Directly or indirectly observable inputs, other than quoted prices in active markets.
- Level 3: Unobservable inputs in which there is little or no market data, which require a reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of the following valuation techniques:

- Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- Cost approach: Amount required to replace the service capacity of an asset (replacement cost).
- Income approach: Techniques used to convert future income amounts to a single amount based on market expectations (including present-value, option-pricing, and excess-earnings models).

The Company's estimates of fair value were determined using available market information and appropriate valuation methods. Considerable judgment is necessary to interpret market data and develop estimated fair value. The use of different market assumptions or estimation methods may have a material effect on the estimated fair value amounts. The Company classifies assets and liabilities in the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement.

The Company elected not to use the fair value option in recording its financial instruments, which include cash and cash equivalents, restricted cash, accounts receivable, mortgage note receivable, notes payable, and accounts payable and accrued expenses. With the exception of the Company's fixed-rate mortgage note receivable from a related party and notes payable, the carrying amounts of these financial instruments approximate their fair values due to their short-term nature. For the fair value of the Company's mortgage note receivable and notes payable, see Note 4, "Mortgage Note Receivable from Related Party" and Note 5, "Debt," respectively.

Concentration of Credit Risk

As of June 30, 2017, the Company had cash and cash equivalents and restricted cash deposited in certain financial institutions in excess of federally insured levels. The Company diversifies its cash and cash equivalents with several banking institutions in an attempt to minimize exposure to any one of these institutions. The Company regularly monitors the financial stability of these financial institutions and believes that it is not exposed to any significant credit risk in cash and cash equivalents or restricted cash.

The Company is also exposed to credit risk with respect to its mortgage note receivable from related party. The failure of the borrower on the mortgage note receivable from related party to make payments of interest and principal when due, or any other event of default under the mortgage note receivable from related party, would have an adverse impact on the Company's results of operations.

Valuation and Allocation of Hotel Properties — Acquisition

Upon acquisition, the purchase price of hotel properties is allocated to the tangible assets acquired, consisting of land, buildings and furniture, fixtures and equipment, any assumed debt, identified intangible assets and asset retirement obligations, if any, based on their fair values. Acquisition costs are charged to expense as incurred. Initial valuations are subject to change during the measurement period, but the measurement period ends as soon as the information is available. The measurement period shall not exceed one year from the acquisition date.

Land values are derived from appraisals and building values are calculated as replacement cost less depreciation or estimates of the relative fair value of these assets using discounted cash flow analyses or similar methods. The value of furniture, fixtures and equipment is based on their fair value using replacement costs less depreciation. Any difference between the fair value of the hotel property acquired and the purchase price of the hotel property is recorded as goodwill or gain on acquisition of hotel property.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

The Company determines the fair value of any assumed debt by calculating the net present value of the scheduled mortgage payments using interest rates for debt with similar terms and remaining maturities that the Company believes it could obtain at the date of acquisition. Any difference between the fair value and stated value of the assumed debt is recorded as a discount or premium and amortized over the remaining life of the loan as interest expense.

In allocating the purchase price of each of the Company's properties, the Company makes assumptions and uses various estimates, including, but not limited to, the estimated useful lives of the assets, the cost of replacing certain assets and discount rates used to determine present values. The Company uses Level 3 inputs to value acquired properties. Many of these estimates are obtained from independent third party appraisals. However, the Company is responsible for the source and use of these estimates. These estimates require judgment and are subject to being imprecise; accordingly, if different estimates and assumptions were derived, the valuation of the various categories of the Company's hotel properties or related intangibles could in turn result in a difference in the depreciation or amortization expense recorded in the Company's consolidated financial statements. These variances could be material to the Company's results of operations and financial condition.

Valuation and Allocation of Hotel Properties — Ownership

Investment in hotel properties is recorded at cost less accumulated depreciation. Major improvements that extend the life of an asset are capitalized and depreciated over a period equal to the shorter of the life of the improvement or the remaining useful life of the asset. The costs of ordinary repairs and maintenance are charged to expense when incurred.

Depreciation expense is computed using the straight-line method based upon the following estimated useful lives:

	Estimated Useful Lives (years)
Buildings and improvements.....	39-40
Exterior improvements.....	10-20
Furniture, fixtures and equipment.....	5-10

Impairment

The Company monitors events and changes in circumstances indicating that the carrying amount of a hotel property may not be recoverable. When such events or changes in circumstances are present, the Company assesses potential impairment by comparing estimated future undiscounted cash flows expected to be generated over the life of the asset from operating activities and from its eventual disposition, to the carrying amount of the asset. In the event that the carrying amount exceeds the estimated future undiscounted cash flows, the Company recognizes an impairment loss to adjust the carrying amount of the asset to estimated fair value for assets held for use and fair value less costs to sell for assets held for sale. There were no such impairment losses for the three or six months ended June 30, 2017.

In evaluating a hotel property for impairment, the Company makes several estimates and assumptions, including, but not limited to, the projected date of disposition of the property, the estimated future cash flows of the property during the Company's ownership and the projected sales price of the property. A change in these estimates and assumptions could result in a change in the estimated undiscounted cash flows or fair value of the Company's hotel property which could then result in different conclusions regarding impairment and material changes to the Company's consolidated financial statements.

Revenue Recognition

Hotel revenues, including room, food, beverage and other ancillary revenues, are recognized as the related services are delivered. Revenue is recorded net of any sales and other taxes collected from customers. Interest income is recognized when earned. Amounts received prior to guest arrival are recorded as advances from the customer and are recognized at the time of occupancy.

Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand or held in banks and short-term investments with an initial maturity of three months or less at the date of purchase.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Restricted Cash

Restricted cash includes reserves for property taxes, as well as reserves for property improvements and replacement of furniture, fixtures, and equipment, as required by certain management or mortgage debt agreement restrictions and provisions.

Accounts Receivable

The Company takes into consideration certain factors that require judgments to be made as to the collectability of receivables. Collectability factors taken into consideration are the amounts outstanding, payment history and financial strength of the customer, which, taken as a whole, determines the valuation. Ongoing credit evaluations are performed and an allowance for potential credit losses is provided against the portion of accounts receivable that is estimated to be uncollectible.

Impairment of Mortgage Note Receivable from Related Party

The Company reviews the mortgage note receivable from related party for impairment in each reporting period pursuant to the applicable authoritative accounting guidance. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts recorded as assets on the consolidated balance sheets. The Company applies normal loan review and underwriting procedures (as may be implemented or modified from time to time) in making that judgment.

When a loan is impaired, the Company measures impairment based on the present value of expected cash flows discounted at the loan's effective interest rate against the value of the asset recorded on the consolidated balance sheets. The Company may also measure impairment based on a loan's observable market price or the fair value of collateral, if the loan is collateral dependent. If a loan is deemed to be impaired, the Company records a valuation allowance through a charge to earnings for any shortfall. The Company's assessment of impairment is based on considerable judgment and estimates. The Company did not record a valuation allowance during the six months ended June 30, 2017.

Prepaid Expenses and Other Assets

Prepaid expenses include prepaid property insurance and hotel operating expenses. Other assets include the Company's deferred income tax asset.

Deferred Franchise Costs

Deferred franchise costs are recorded at cost and amortized over the term of the respective franchise contract on a straight-line basis. Accumulated amortization of deferred franchise costs was \$24,516 and \$15,656 as of June 30, 2017 and December 31, 2016, respectively. Expected future amortization of deferred franchise costs as of June 30, 2017 is as follows:

<u>Years Ending December 31,</u>	
2017	\$ 8,860
2018	17,720
2019	17,720
2020	17,720
2021	17,720
Thereafter	145,744
Total	<u>\$ 225,484</u>

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Debt Issuance Costs

Debt issuance costs are presented as a direct deduction from the carrying value of the notes payable on the consolidated balance sheets. Debt issuance costs are amortized as a component of interest expense over the term of the related debt using the straight-line method, which approximates the interest method. Accumulated amortization of debt issuance costs was \$391,056 and \$325,904 as of June 30, 2017 and December 31, 2016, respectively. Expected future amortization of debt issuance costs as of June 30, 2017 is as follows:

<u>Years Ending December 31,</u>	
2017	\$ 66,865
2018	119,818
2019	80,054
2020	80,274
2021	80,054
Thereafter	349,281
Total	<u>\$ 776,346</u>

Earnings (Loss) per Share

Earnings (loss) per share (“EPS”) is calculated based on the weighted average number of shares outstanding during each period. Basic and diluted EPS are the same for all periods presented. Non-vested shares of restricted common stock totaling 1,250 and 6,250 shares as of June 30, 2017 and 2016, respectively, held by the Company’s independent directors are included in the calculation of basic EPS because such shares have been issued and participate in dividends.

Comprehensive Income

For the periods presented, there were no differences between reported net loss attributable to common stockholders and comprehensive loss.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers,” which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. The standard permits the use of either the full retrospective or modified retrospective adoption. In July 2015, the FASB voted to defer the effective date to January 1, 2018 with early adoption beginning January 1, 2017. The Company has begun to evaluate each of its revenue streams under the new model. Based on preliminary assessments, the Company does not expect the adoption of ASU No. 2014-09 to have a material effect on the Company’s consolidated financial position or the Company’s consolidated results of operations.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Liabilities,” which enhances the reporting requirements surrounding the measurement of financial instruments and requires equity securities to be measured at fair value with changes in the fair value recognized through net income for the period. ASU No. 2016-01 is effective for the Company’s fiscal year commencing on January 1, 2018. The Company does not anticipate that the adoption of ASU No. 2016-01 will have a material effect on the Company’s consolidated financial position or the Company’s consolidated results of operations.

In February 2016, the FASB issued ASU No. 2016-02, “Leases,” which changes lessee accounting to reflect the financial liability and right-of-use assets that are inherent to leasing an asset on the balance sheet. ASU No. 2016-02 is effective for the Company’s fiscal year commencing on January 1, 2019, but early adoption is permitted. The effect that the adoption of ASU No. 2016-02 will have on the Company’s consolidated financial position or the Company’s consolidated results of operations is not currently reasonably estimable.

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments,” which addresses the Statement of Cash Flow classification and presentation of certain cash transactions. ASU No. 2016-15 is effective for the Company’s fiscal year commencing on January 1, 2018. The effect of this amendment is to be applied retrospectively where practical and early adoption is permitted. The Company expects to adopt ASU No. 2016-15 for the Company’s fiscal year commencing on January 1, 2018. The Company does not believe that the adoption of ASU No. 2016-15 will have a material effect on the Company’s consolidated financial position or the Company’s consolidated results of operations.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

In November 2016, the FASB issued ASU No. 2016-18, “Classification of Restricted Cash,” which addresses the Statement of Cash Flow classification and presentation of restricted cash transactions. ASU No. 2016-18 is effective for the Company’s fiscal year commencing on January 1, 2018. The effect of this amendment is to be applied retrospectively and early adoption is permitted. The Company expects to adopt ASU No. 2016-18 for its fiscal year commencing on January 1, 2018. The Company does not believe that the adoption of ASU No. 2016-18 will have a material effect on the Company’s consolidated financial position or the Company’s consolidated results of operations.

In January 2017, the FASB issued ASU No. 2017-01, “Clarifying the Definition of a Business,” with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as an acquisition of assets or a business. ASU No. 2017-01 is effective for the Company’s fiscal year commencing on January 1, 2018. The effect of this guidance is to be applied prospectively and early adoption is permitted. The Company does not believe that the adoption of ASU No. 2017-01 will have a material effect on the Company’s consolidated financial position or the Company’s consolidated results of operations.

3. Investment in Hotel Properties

The following table sets forth summary information regarding the Company’s investment in hotel properties as of June 30, 2017:

<u>Property Name</u>	<u>Date Acquired</u>	<u>Location</u>	<u>Ownership Interest</u>	<u>Purchase Price⁽¹⁾</u>	<u>Rooms</u>	<u>Mortgage Debt Outstanding</u>
Residence Inn Austin	October 15, 2015	Austin, Texas	100%	\$ 27,500,000	112	\$ 16,575,000
Springhill Suites Seattle	May 24, 2016	Seattle, Washington	100%	74,100,000	234	45,000,000
Totals				<u>\$ 101,600,000</u>	346	<u>\$ 61,575,000</u>

(1) Excludes closing costs and includes gain on acquisition.

Investments in hotel properties consisted of the following at June 30, 2017 and December 31, 2016:

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
Land	\$ 18,350,000	\$ 18,350,000
Buildings and improvements	80,810,000	80,810,000
Furniture, fixtures and equipment	2,794,702	2,660,769
Total cost	101,954,702	101,820,769
Accumulated depreciation	(2,992,156)	(1,831,029)
Investment in hotel properties, net	<u>\$ 98,962,546</u>	<u>\$ 99,989,740</u>

On May 24, 2016, Moody National Yale-Seattle Holding, LLC, a wholly owned subsidiary of the OP (“Moody Seattle Holding”), acquired fee simple title to the Springhill Suites Seattle from the then current tenant-in-common owners of the Springhill Suites Seattle for an aggregate purchase price of \$74,100,000, excluding acquisition costs.

The following unaudited pro forma consolidated financial information for the three and six months ended June 30, 2017 and 2016 is presented as if the Company acquired the Springhill Suites Seattle on January 1, 2016. This information is not necessarily indicative of what the actual results of operations would have been had the Company completed the acquisition of the Springhill Suites Seattle on January 1, 2016, nor does it purport to represent the Company’s future operations:

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Revenue	\$ 5,528,325	\$ 5,549,171	\$ 9,804,590	\$ 10,368,926
Net loss	(105,980)	(42,665)	(1,019,780)	(504,859)
Net loss attributable to common shareholders	(106,050)	(34,824)	(1,015,332)	(497,132)
Net loss per common share - basic and diluted	\$ (0.02)	\$ (0.01)	\$ (0.25)	\$ (0.39)

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

4. Mortgage Note Receivable from Related Party

On October 6, 2016, the Company originated a secured loan in the aggregate principal amount of \$11,200,000 (the “MN TX II Note”) to MN TX II, LLC, a Texas limited liability company and a related party (“MN TX II”). Proceeds from the MN TX II Note were used by MN TX II solely to acquire a commercial real property located in Houston, Texas. The Company financed the MN TX II Note in part with the proceeds of a loan from a bank secured by the MN TX II Note, with an initial principal balance of \$8,400,000.

The entire unpaid principal balance of the MN TX II Note and all accrued and unpaid interest thereon and all other amounts due under the MN TX II Note are due and payable on October 6, 2018. Interest on the outstanding principal balance of the MN TX II Note accrues at a fixed per annum rate equal to 5.50%, provided that in no event will the interest rate exceed the maximum rate permitted by applicable law. The MN TX II Note may be prepaid in whole or part by MN TX II without penalty at any time upon prior written notice to the Company. Interest income for the three and six months ended June 30, 2017 was \$156,139 and \$312,278, respectively, and interest receivable as of June 30, 2017 and December 31, 2016 was \$459,743 and \$147,465, respectively, and is included in Due from Related Parties in the consolidated balance sheets.

5. Debt

The Company’s aggregate borrowings are reviewed by the Company’s board of directors at least quarterly. Under the Company’s Articles of Amendment and Restatement (as amended, the “Charter”), the Company is prohibited from borrowing in excess of 300% of the value of the Company’s net assets. “Net assets” for purposes of this calculation is defined to be the Company’s total assets (other than intangibles), valued at cost prior to deducting depreciation, reserves for bad debts and other non-cash reserves, less total liabilities. However, the Company may temporarily borrow in excess of these amounts if such excess is approved by a majority of the Company’s independent directors and disclosed to stockholders in the Company’s next quarterly report, along with an explanation for such excess. As of June 30, 2017, the Company’s debt levels did not exceed 300% of the value of the Company’s net assets, as defined above.

As of June 30, 2017 and December 31, 2016, the Company’s mortgage notes payable, secured by the respective real properties and mortgage note receivable, consisted of the following:

Mortgage Loan	Principal as of June 30, 2017	Principal as of December 31, 2016	Interest Rate at June 30, 2017	Maturity Date
Residence Inn Austin ⁽¹⁾	\$ 16,575,000	\$ 16,575,000	4.580%	November 1, 2025
Springhill Suites Seattle ⁽²⁾	45,000,000	45,000,000	4.380%	October 1, 2026
MN TX II Note ⁽³⁾	8,400,000	8,400,000	3.750%	October 6, 2018
Total notes payable	69,975,000	69,975,000		
Less unamortized debt issuance costs	(776,346)	(931,498)		
Total notes payable, net of unamortized debt issuance costs	<u>\$ 69,198,654</u>	<u>\$ 69,043,502</u>		

- (1) Monthly payments of interest are due and payable until the maturity date. Monthly payments of principal are due and payable beginning in December 2017 until the maturity date.
- (2) Monthly payments of interest only are due and payable in calendar years 2016 and 2017, after which monthly payments of principal and interest are due and payable until the maturity date.
- (3) Monthly payments of interest only are due until the maturity date.

Maturities of the notes payable as of June 30, 2017 are as follows:

Years ending December 31,	
2017	\$ 21,511
2018	8,769,830
2019	985,124
2020	1,022,688
2021	1,077,272
Thereafter	58,098,575
Total	<u>\$ 69,975,000</u>

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

The estimated fair value of the Company's notes payable as of both June 30, 2017 and December 31, 2016 was \$70,000,000. The fair value of the notes payable was estimated based on discounted cash flow analyses using the current incremental borrowing rates for similar types of borrowing arrangements as of the respective reporting dates. The discounted cash flow method of assessing fair value results in a general approximation of value, and such value may never actually be realized.

In addition to the foregoing, the Company may re-finance or extend loans that are currently secured by properties held by Moody I that the Company would acquire if the Mergers are consummated.

6. Equity

Capitalization

Under its Charter, the Company has the authority to issue 1,000,000,000 shares of common stock and 100,000,000 shares of preferred stock. All shares of such stock have a par value of \$0.01 per share. On August 15, 2014, the Company sold 8,000 shares of common stock to the Sponsor at a purchase price of \$25.00 per share for an aggregate purchase price of \$200,000, which was paid in cash. As of June 30, 2017, there were a total of 4,750,286 shares of the Company's common stock issued and outstanding, including the 8,000 shares sold to Sponsor and 20,000 shares of restricted stock, as discussed in Note 8, "Incentive Award Plan."

The Company's board of directors is authorized to amend its Charter without the approval of the stockholders to increase the aggregate number of authorized shares of capital stock or the number of shares of any class or series that the Company has authority to issue.

Distributions

The Company's board of directors has authorized and declared a distribution to its stockholders that (1) accrues daily to the Company's stockholders of record as of the close of business on each day; (2) is payable in cumulative amounts on or before the 15th day of each calendar month; and (3) is calculated at a rate of \$1.75 per share of the Company's common stock per year, or approximately \$0.00479 per share per day, before any class-specific expenses. The Company first paid distributions on September 15, 2015.

The following table summarizes distributions paid in cash and pursuant to the DRP for the six months ended June 30, 2017 and 2016.

Period	Cash Distribution	Distribution Paid Pursuant to DRP⁽¹⁾	Total Amount of Distribution
First Quarter 2017	\$ 1,016,749	\$ 410,733	\$ 1,427,482
Second Quarter 2017	1,325,157	589,483	1,914,640
Total	<u>\$ 2,341,906</u>	<u>\$ 1,000,216</u>	<u>\$ 3,342,122</u>
First Quarter 2016	\$ 185,952	\$ 84,466	\$ 270,418
Second Quarter 2016	351,169	157,799	508,968
Total	<u>\$ 537,121</u>	<u>\$ 242,265</u>	<u>\$ 779,386</u>

(1) Amount of distributions paid in shares of common stock pursuant to the Company's distribution reinvestment plan.

Noncontrolling Interests in Operating Partnership

Noncontrolling interests in the OP at June 30, 2017 was \$359,761, which represented 18,000 common units in the OP issued in connection with the acquisition of the Springhill Suites Seattle, and is reported in equity in the consolidated balance sheets. Income (loss) from the OP attributable to these noncontrolling interests was \$70 and \$(7,727) for the three months ended June 30, 2017 and 2016, respectively, and was \$(4,448) and \$(7,727) for the six months ended June 30, 2017 and 2016, respectively.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

7. Related Party Arrangements

Pursuant to the Advisory Agreement, Advisor and certain affiliates of Advisor receive fees and compensation in connection with the Offering and the acquisition, management and sale of the Company's real estate investments. In addition, in exchange for \$1,000 and in consideration of services to be provided by Advisor, the OP has issued an affiliate of the Advisor, Moody LPOP II, a separate, special limited partnership interest, in the form of Special Limited Partnership Interests. For further detail, please see Note 9, "Subordinated Participation Interest."

Sales Commissions, Dealer Manager Fees and Stockholder Servicing Fees

Subject to volume discounts and other special circumstances described in the prospectus for the Offering, the Company will pay Moody Securities up-front selling commissions of up to (i) 7.0% of the gross proceeds of the Class A Shares sold in the Primary Offering and (ii) 3.0% of the gross proceeds of the Class T Shares sold in the Primary Offering. The Company will also pay Moody Securities up-front dealer manager fees of up to (i) 3.0% of the gross proceeds of the Class A Shares sold in the Primary Offering and (ii) 2.5% of the gross proceeds of the Class T Shares sold in the Primary Offering. The Sponsor may also pay Moody Securities (i) up-front dealer manager fees of up to 1.0% of the total amount of Class I Shares purchased in the Primary Offering and (ii) up-front selling commissions of up to 3.0% on purchases of \$5,000,000 or more of our Class D Shares purchased in the Primary Offering, which will not be reimbursed by the Company. The Company does not pay Moody Securities any selling commissions or dealer manager fees with respect to DRP shares. Subject to certain limitations set forth in the Dealer Manager Agreement with Moody Securities, the Company will also pay Moody Securities a trailing stockholder servicing fee of (i) 1.0% per annum of the net asset value ("NAV") of Class T Shares sold in the Primary Offering and (ii) 0.5% per annum of the NAV of Class D Shares sold in the Primary Offering. Moody Securities may reallocate all or a portion of the foregoing selling commissions, dealer manager fees or stockholder servicing fees to participating broker-dealers.

As of June 30, 2017, the Company had paid Moody Securities \$8,928,421 in selling commissions related to the Offering and \$2,001,206 in dealer manager fees related to the Offering, which amounts have been recorded as a reduction to additional paid-in capital in the consolidated balance sheets.

Organization and Offering Expenses

Advisor will receive reimbursement for organizational and offering expenses incurred on the Company's behalf, but only to the extent that such reimbursements do not exceed actual expenses incurred by Advisor and do not cause the cumulative selling commissions, dealer manager fees, stockholder servicing fees and other organization and offering expenses borne by the Company to exceed 15.0% of gross offering proceeds from the sale of shares in the Offering as of the date of reimbursement.

As of June 30, 2017, total offering costs were \$15,658,503, comprised of \$11,726,007 of offering costs incurred directly by the Company and \$3,932,496 in offering costs incurred by and reimbursable to Advisor. As of June 30, 2017, the Company had \$88,568 due from Advisor for reimbursable offering costs.

Acquisition Fees

Advisor, or its affiliates, will also receive an acquisition fee equal to 1.5% of (1) the cost of all investments the Company acquires (including the Company's pro rata share of any indebtedness assumed or incurred in respect of the investment and exclusive of acquisition and financing coordination fees), (2) the Company's allocable cost of investments acquired in a joint venture (including the Company's pro rata share of the purchase price and the Company's pro rata share of any indebtedness assumed or incurred in respect of that investment and exclusive of acquisition fees and financing coordination fees) or (3) the amount funded by the Company to acquire or originate a loan or other investment, including mortgage, mezzanine or bridge loans (including any third-party expenses related to such investment and exclusive of acquisition fees and financing coordination fees). Once the proceeds from the Offering have been fully invested, the aggregate amount of acquisition fees and financing coordination fees shall not exceed 1.9% of the contract purchase price and the amount advanced for a loan or other investment, as applicable, for all the assets acquired. For the three and six months ended June 30, 2017, the Company did not pay Advisor any acquisition fees. For the three and six months ended June 30, 2016, the Company paid Advisor acquisition fees of \$1,111,500 in connection with the acquisition of the Springhill Suites Seattle.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Reimbursement of Acquisition Expenses

Advisor may also be reimbursed by the Company for actual expenses related to the evaluation, selection and acquisition of real estate investments, regardless of whether the Company actually acquires the related assets. The Company did not reimburse Advisor for any acquisition expenses during the three and six months ended June 30, 2017 and 2016.

Financing Coordination Fee

Advisor will also receive financing coordination fees of 1% of the amount available under any loan or line of credit made available to the Company and 0.75% of the amount available or outstanding under any refinanced loan or line of credit. Advisor will pay some or all of these fees to third parties with whom it subcontracts to coordinate financing for the Company. For the three and six months ended June 30, 2017, the Company did not pay any debt financing fees to Advisor. For the six months ended June 30, 2016, the Company paid \$562,500 in financing coordination fees to Advisor incurred in connection with the acquisition of the Springhill Suites Seattle.

Property Management Fee

The Company will pay Moody National Hospitality Management, LLC (“Property Manager”) a monthly hotel management fee equal to 4.0% of the monthly gross operating revenues from the properties managed by Property Manager for services it provides in connection with operating and managing properties. The hotel management agreements between the Company and the Property Manager generally have initial terms of ten years. Property Manager may pay some or all of the compensation it receives from the Company to a third-party property manager for management or leasing services. In the event that the Company contracts directly with a non-affiliated third-party property manager, the Company will pay Property Manager a market-based oversight fee. The Company will reimburse the costs and expenses incurred by Property Manager on the Company’s behalf, including legal, travel and other out-of-pocket expenses that are directly related to the management of specific properties, but the Company will not reimburse Property Manager for general overhead costs or personnel costs other than employees or subcontractors who are engaged in the on-site operation, management, maintenance or access control of the properties. For the three months ended June 30, 2017 and 2016, the Company paid the Property Manager property management fees of \$214,887 and \$138,212, respectively, and accounting fees of \$15,000 and \$10,000. For the six months ended June 30, 2017 and 2016, the Company paid the Property Manager property management fees of \$379,692 and \$192,190, respectively, and accounting fees of \$30,000 and \$17,500, respectively, which are included in hotel operating expenses in the accompanying consolidated statements of operations.

Asset Management Fee

The Company will pay Advisor a monthly asset management fee of one-twelfth of 1.0% of the cost of investment of all real estate investments the Company acquires. For the three months ended June 30, 2017 and 2016, the Company incurred asset management fees of \$283,000 and \$130,000, respectively, and for the six months ended June 30, 2017 and 2016, the Company incurred asset management fees of \$566,000 and \$198,751, respectively, payable to Advisor, which are recorded in corporate general and administrative expenses in the accompanying consolidated statements of operations.

Disposition Fee

Advisor or its affiliates will also receive a disposition fee in an amount of up to one-half of the brokerage commission paid on the sale of an asset, but in no event greater than 3% of the contract sales price of each property or other investment sold; provided, however, in no event may the aggregate disposition fees paid to the Advisor and any real estate commissions paid to unaffiliated third parties exceed 6% of the contract sales price. As of June 30, 2017, the Company had not paid any disposition fees to Advisor.

Operating Expense Reimbursement

The Company will reimburse Advisor for all expenses paid or incurred by Advisor in connection with the services provided to the Company, subject to the limitation that the Company will not reimburse Advisor for any amount by which its operating expenses (including the asset management fee) at the end of the four preceding fiscal quarters exceeds the greater of: (1) 2% of its average invested assets, or (2) 25% of its net income determined without reduction for any additions to reserves for depreciation, bad debts or other similar non-cash reserves and excluding any gain from the sale of the Company’s assets for that period (the “2%/25% Limitation”). Notwithstanding the above, the Company may reimburse Advisor for expenses in excess of this limitation if a majority of the independent directors determines that such excess expenses are justified based on unusual and non-recurring factors. For the four fiscal quarters ended June 30, 2017, total operating expenses of the Company were \$1,968,440, which included \$1,359,472 in operating expenses incurred directly by the Company and \$608,968 incurred by Advisor on behalf of the Company. Of the \$1,968,440 in total operating expenses incurred during the four fiscal quarters ended June 30, 2017, \$0 exceeded the 2%/25% Limitation. The Company reimbursed Advisor \$709,000 during four fiscal quarters ended June 30, 2017, which includes reimbursements for quarters prior to the four quarters ended June 30, 2017.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

Merger Agreement with Moody I

On November 16, 2016, the Company entered into the Merger Agreement. See Note 1, “Organization—Pending Merger with Moody National REIT I, Inc.”

Earnest Money

The Company assigned its earnest money contract in the amount of \$2,000,000 to a related party for consideration to the Company of \$2,000,000 during the six months ended June 30, 2017.

8. Incentive Award Plan

The Company has adopted an incentive plan (the “Incentive Award Plan”) that provides for the grant of equity awards to its employees, directors and consultants and those of the Company’s affiliates. The Incentive Award Plan authorizes the grant of non-qualified and incentive stock options, restricted stock awards, restricted stock units, stock appreciation rights, dividend equivalents and other stock-based awards or cash-based awards. Shares of common stock will be authorized and reserved for issuance under the Incentive Award Plan. The Company has also adopted an independent directors compensation plan (the “Independent Directors Compensation Plan”) pursuant to which each of the Company’s independent directors was entitled, subject to the Independent Directors Compensation Plan’s conditions and restrictions, to receive an initial grant of 5,000 shares of restricted stock when the Company raised the minimum offering amount of \$2,000,000 in the Offering. Each new independent director who subsequently joins the Company’s board of directors will receive a grant of 5,000 shares of restricted stock upon his or her election to the Company’s board of directors. In addition, on the date of each of the first four annual meetings of the Company’s stockholders at which an independent director is re-elected to the Company’s board of directors, he or she will receive an additional grant of 2,500 shares of restricted stock. Subject to certain conditions, the non-vested shares of restricted stock granted pursuant to the Independent Directors Compensation Plan will vest and become non-forfeitable in four equal quarterly installments beginning on the first day of the first quarter following the date of grant; provided, however, that the restricted stock will become fully vested on the earlier to occur of (1) the termination of the independent director’s service as a director due to his or her death or disability or (2) a change in control of the Company. As of June 30, 2017, there were 1,980,000 common shares remaining available for future issuance under the Incentive Award Plan and the Independent Directors Compensation Plan.

The Company recorded compensation expense related to such shares of restricted stock of \$34,893 and \$133,047 for the three months ended June 30, 2017 and 2016, respectively, and \$69,800 and \$191,059 for the six months ended June 30, 2017 and 2016, respectively. As of June 30, 2017, there were 1,250 non-vested shares of restricted common stock granted pursuant to the Independent Directors Compensation Plan. The remaining unrecognized compensation expense associated with those 1,250 non-vested shares of \$383 will be recognized during the third quarter of 2017.

The following is a summary of activity under the Independent Directors Compensation Plan for the six months ended June 30, 2017 and year ended December 31, 2016:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance of non-vested shares as of December 31, 2015	7,500	\$ 25.00
Shares granted on February 23, 2016	5,000	25.00
Shares granted on August 10, 2016	5,000	25.00
Shares vested	(12,500)	25.00
Balance of non-vested shares as of December 31, 2016	5,000	25.00
Shares vested	(3,750)	25.00
Balance of non-vested shares as of June 30, 2017	1,250	\$ 25.00

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

9. Subordinated Participation Interest

Pursuant to the limited partnership agreement for the OP, Moody LPOP II, the holder of the Special Limited Partnership Interests, is entitled to receive distributions equal to 15.0% of the OP's net cash flows, whether from continuing operations, the repayment of loans, the disposition of assets or otherwise, but only after the Company's stockholders have received, in the aggregate, cumulative distributions equal to their total invested capital plus a 6.0% cumulative, non-compounded annual pre-tax return on such aggregated invested capital. In addition, Moody LPOP II is entitled to a separate payment if it redeems its Special Limited Partnership Interests. The Special Limited Partnership Interests may be redeemed upon: (1) the listing of the Company's common stock on a national securities exchange or (2) the occurrence of certain events that result in the termination or non-renewal of the Advisory Agreement, in each case for an amount that Moody LPOP II would have been entitled to receive had the OP disposed of all of its assets at the enterprise valuation as of the date of the event triggering the redemption.

10. Commitments and Contingencies

Restricted Cash

Under certain management and debt agreements existing at June 30, 2017, the Company escrows payments required for property improvement plans, real estate taxes, replacement of hotel furniture and fixtures and rent holdback.

The composition of the Company's restricted cash as of June 30, 2017 and December 31, 2016 are as follows:

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
Property improvement plan.....	\$ 1,200,000	\$ 1,200,000
Real estate taxes.....	255,059	92,434
Hotel furniture and fixtures.....	537,143	329,150
Seasonality.....	234,000	234,000
Rent holdback.....	14,720	14,720
Total restricted cash.....	<u>\$ 2,240,922</u>	<u>\$ 1,870,304</u>

Franchise Agreements

The Residence Inn Austin and the Springhill Suites Seattle are operated under franchise agreements with initial terms of 20 years. The franchise agreements allow the properties to operate under the franchisor's brand. Pursuant to the franchise agreements, the Company pays a royalty fee of 5.5% to 6.0% of room revenue, plus additional fees for marketing, central reservation systems and other franchisor costs of 2.5% of room revenue. The Company incurred franchise fee expense of approximately \$406,835 and \$270,131 for the three months ended June 30, 2017 and 2016, respectively, and \$712,263 and \$382,704 for the six months ended June 30, 2017 and 2016, respectively, which amounts are included in hotel operating expenses in the accompanying consolidated statements of operations.

11. Income Taxes

The Company has formed a TRS that is a C-corporation for federal income tax purposes and uses the asset and liability method of accounting for income taxes. Tax return positions are recognized in the consolidated financial statements when they are "more-likely-than-not" to be sustained upon examination by the taxing authority. Deferred income tax assets and liabilities result from temporary differences. Temporary differences are differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future periods. A valuation allowance may be placed on deferred income tax assets, if it is determined that it is more likely than not that a deferred tax asset may not be realized.

As of June 30, 2017, the Company had operating loss carry-forwards of \$34,000.

The Company had deferred tax assets of \$122,000 and \$10,000 as of June 30, 2017 and December 31, 2016, respectively, related to net operating loss carry forwards of the TRS. As of June 30, 2017, the TRS had a net operating loss carry-forward of \$382,000.

MOODY NATIONAL REIT II, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017
(unaudited)

The income tax expense (benefit) for the three months and six months ended June 30, 2017 and 2016 consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Current expense	\$ —	\$ 156,000	\$ —	\$ 164,000
Deferred expense (benefit)	33,000	—	(112,000)	6,000
Total expense (benefit), net	<u>\$ 33,000</u>	<u>\$ 156,000</u>	<u>\$ (112,000)</u>	<u>\$ 170,000</u>
Federal	\$ 33,000	\$ 156,000	\$ (112,000)	\$ 170,000
State	—	—	—	—
Total tax expense (benefit)	<u>\$ 33,000</u>	<u>\$ 156,000</u>	<u>\$ (112,000)</u>	<u>\$ 170,000</u>

12. Subsequent Events

Distributions Declared

On June 30, 2017, the Company declared a distribution in the aggregate amount of \$676,447, of which \$466,609 was paid in cash on July 15, 2017 and \$209,838 was paid pursuant to the DRP in the form of additional shares of the Company's common stock. On July 31, 2017, the Company declared a distribution in the aggregate amount of \$709,553, which is scheduled to be paid in cash and through the DRP in the form of additional shares of the Company's common stock on or about August 15, 2017.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis should be read in conjunction with the accompanying consolidated financial statements of Moody National REIT II, Inc. and the notes thereto. As used herein, the terms "we," "our," "us" and "our company" refer to Moody National REIT II, Inc. and, as required by context, Moody National Operating Partnership II, LP, a Delaware limited partnership, which we refer to as our "operating partnership," and to their respective subsidiaries. References to "shares" and "our common stock" refer to the shares of our common stock.

Forward-Looking Statements

Certain statements included in this quarterly report on Form 10-Q, or this Quarterly Report, that are not historical facts (including any statements concerning investment objectives, other plans and objectives of management for future operations or economic performance, or assumptions or forecasts related thereto) are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are only predictions. We caution that forward-looking statements are not guarantees. Actual events or our investments and results of operations could differ materially from those expressed or implied in any forward-looking statements. Forward-looking statements are typically identified by the use of terms such as "may," "should," "expect," "could," "intend," "plan," "anticipate," "estimate," "believe," "continue," "predict," "potential" or the negative of such terms and other comparable terms.

The forward-looking statements included herein are based upon our current expectations, plans, estimates, assumptions and beliefs, which involve numerous risks and uncertainties. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to:

- our ability to raise capital in our ongoing initial public offering;
- our ability to effectively deploy the proceeds raised in our initial public offering;
- the risk that the mergers (as defined below) will not be consummated within the expected time period or at all;
- the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement (as defined below);
- the failure to satisfy the conditions to completion of the mergers;
- risks related to disruption of management's attention from the ongoing business operations due to the pending mergers;
- the effect of the announcement of the mergers on our operating results and business generally;
- the outcome of any legal proceedings relating to the mergers;
- our ability to obtain financing on acceptable terms;
- our levels of debt and the terms and limitations imposed on us by our debt agreements;
- our ability to identify and acquire real estate and real estate-related assets on selling terms that are favorable to us;
- risks inherent in the real estate business, including the lack of liquidity for real estate and real estate-related assets on terms that are favorable to us;
- changes in demand for rooms at our hotel properties;
- our ability to compete in the hotel industry;
- adverse developments affecting our sponsor and its affiliates;
- the availability of cash flow from operating activities for distributions;
- changes in economic conditions generally and the real estate and debt markets specifically;

- conflicts of interest arising out of our relationship with our advisor and its affiliates;
- legislative or regulatory changes (including changes to the laws governing the taxation of REITs (as defined below));
- the availability of capital; and
- changes in interest rates.

Any of the assumptions underlying the forward-looking statements included herein could be inaccurate, and undue reliance should not be placed upon any forward-looking statements included herein. All forward-looking statements are made as of the date of this Quarterly Report and the risk that actual results will differ materially from the expectations expressed herein will increase with the passage of time. Except as otherwise required by the federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements made after the date of this Quarterly Report, whether as a result of new information, future events, changed circumstances or any other reason. In light of the significant uncertainties inherent in the forward-looking statements included in this Quarterly Report, including, without limitation, the risks described under “Risk Factors,” the inclusion of such forward-looking statements should not be regarded as a representation by us or any other person that the objectives and plans set forth in this Quarterly Report will be achieved.

Overview

We are a Maryland corporation formed on July 25, 2014 to invest in a portfolio of hospitality properties focusing primarily on the select-service segment of the hospitality sector with premier brands including, but not limited to, Marriott, Hilton and Hyatt. We intend to elect to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, beginning with our taxable year ended December 31, 2016. We own, and in the future intend to own, substantially all of our assets and conduct our operations through our operating partnership. We are the sole general partner of our operating partnership, and the initial limited partners of our operating partnership are our subsidiary, Moody OP Holdings II, LLC, or Moody Holdings II, and Moody National LPOP II, LLC, or Moody LPOP II, an affiliate of our advisor. Moody Holdings II invested \$1,000 in our operating partnership in exchange for limited partnership interests, and Moody LPOP II invested \$1,000 in our operating partnership in exchange for special limited partnership interests. As we accept subscriptions for sales of shares of our common stock, we transfer substantially all of the net proceeds from such sales to our operating partnership in exchange for limited partnership interests and our percentage ownership in our operating partnership increases proportionally.

We are externally managed by Moody National Advisor II, LLC, a related party, which we refer to as our “advisor,” pursuant to an advisory agreement among us, our operating partnership and our advisor, or the advisory agreement. Our advisor was formed in July 2014. Moody National REIT Sponsor, LLC, which we refer to as our “sponsor,” is owned and managed by Brett C. Moody, who also serves as our Chief Executive Officer and President and the Chief Executive Officer and President of our advisor.

On January 20, 2015, the Securities and Exchange Commission, or SEC, declared our registration statement on Form S-11 effective and we commenced our initial public offering, or our offering, of up to \$1,100,000,000 in shares of common stock, consisting of up to \$1,000,000,000 in shares of our common stock offered to the public, or our primary offering, at an initial offering price of \$25.00 per share, and up to \$100,000,000 in shares offered to our stockholders pursuant to our distribution reinvestment plan, or the DRP, at an initial offering price of \$23.75 per share. On March 16, 2017, our board of directors determined an estimated value per share of our common stock of \$25.04 as of December 31, 2016.

On June 12, 2017, we filed the Articles of Amendment with the State Department of Assessments and Taxation of Maryland, or the SDAT. The Articles of Amendment changed the name and designation of our common stock to Class A common stock, or the Class A shares. The Articles of Amendment became effective immediately upon filing with the SDAT. Immediately following the filing of the Articles of Amendment, we filed the Articles Supplementary with the SDAT. The Articles Supplementary (1) reclassified 250,000,000 authorized but unissued Class A shares as Class D common stock, or the Class D shares; (2) reclassified 250,000,000 authorized but unissued Class A shares as Class I common stock, or the Class I shares; and (3) reclassified 250,000,000 authorized but unissued Class A shares as Class T common stock, or the Class T shares; and (4) revised the preferences, rights, powers, restrictions, limitations, qualifications, terms and conditions of the newly designated shares. The Articles Supplementary became effective immediately upon filing with the SDAT.

Our Class T shares contain a conversion feature whereby upon the occurrence of a specified event (generally related to a Class T stockholder’s account having incurred a maximum of 8.5% of underwriting compensation), Class T shares owned in a shareholder’s Class T account for a given offering will automatically convert to Class A shares.

On June 26, 2017, the SEC declared effective our post-effective amendment to the registration statement for our offering which added the additional share classes described above. Accordingly, we are currently offering shares of our common stock (i) to the public in the primary offering at a purchase price equal to the estimated value per Class A share of \$25.04 as of December 31, 2016, plus applicable selling commissions and dealer manager fees, subject to any applicable discounts, all as described in the prospectus for our offering and (ii) to our stockholders pursuant to the DRP at a purchase price of \$25.04, which is equal to the estimated value per Class A share of \$25.04 as of December 31, 2016.

Moody Securities, LLC, an affiliate of our advisor, which we refer to as the “dealer manager” or “Moody Securities,” is the dealer manager for our offering and is responsible for the distribution of our common stock in our offering.

As of June 30, 2017, we had received and accepted investors’ subscriptions for and issued 4,722,286 Class A shares in our offering, including 75,901 shares of common stock pursuant to our DRP, resulting in gross offering proceeds of \$116,693,855. We will continue to offer shares of our common stock on a continuous basis until January 20, 2018, pursuant to an extension of our offering by our board of directors. However, in certain states our offering may continue for only one year unless we renew the offering period for an additional year. As of July 27, 2017, we had received and accepted investors’ subscriptions for and issued 4,793,070 shares of our common stock in our offering, including 84,281 shares pursuant to our DRP, resulting in gross offering proceeds of \$117,642,596. As of July 27, 2017, 35,123,032 shares remained to be sold in our offering. We reserve the right to terminate our offering at any time.

We intend to use the net proceeds from our offering to acquire hotel properties located in the East Coast, the West Coast and the Sunbelt regions of the United States, including pursuant to the pending mergers described below. To a lesser extent, we may also invest in other hospitality properties located within other markets and regions, as well as real estate securities and debt-related investments related to the hospitality sector.

As of June 30, 2017, our portfolio consisted of two hotel properties and a note receivable: (1) the Residence Inn Austin, a 112-room hotel property located in Austin, Texas, (2) the Springhill Suites Seattle, a 234-room hotel property located in Seattle, Washington and (3) a mortgage note receivable from a related party, or the MN TX II note, with an initial aggregate principal balance of \$11,200,000.

Our principle executive offices are located at 6363 Woodway Drive, Suite 110, Houston, Texas 77057, and our main telephone number is (713) 977-7500.

Pending Merger with Moody National REIT I, Inc.

On September 27, 2016, we jointly announced with Moody National REIT I, Inc., or Moody I, a Maryland corporation and a related party, that we had entered into a non-binding letter of intent that set forth the terms and conditions upon which we would acquire Moody I and its subsidiaries. Moody I is a public, non-listed REIT formed in January 2008 to invest primarily in hotel properties. As of June 30, 2017, Moody I’s portfolio included 14 total investments, comprised of (i) interests in 12 hotel properties with a total of 1,595 rooms, and (ii) two promissory notes issued to related parties with an aggregate initial principal amount of \$13,500,000. Moody I is managed by Moody National Advisor I, LLC, or Moody I Advisor, which is indirectly owned and controlled by our sponsor.

On November 16, 2016, we, along with our operating partnership, our advisor, Moody I, Moody National Operating Partnership I, LP, the operating partnership of Moody I, or Moody I OP, Moody I Advisor, and Moody Merger Sub, LLC, our wholly-owned subsidiary, or merger sub, entered into an agreement and plan of merger, or the merger agreement. Pursuant to the merger agreement, Moody I will merge with and into merger sub, with merger sub continuing as the surviving entity and our wholly-owned subsidiary. We refer to the foregoing transaction as the “merger.” In addition the merger agreement originally provided that our operating partnership would merge with and into Moody I OP, with Moody I OP continuing as the surviving partnership, and which transaction we refer to as the “partnership merger.” On August 9, 2017, the parties to the merger agreement entered into amendment no. 1 to the merger agreement, which provides that Moody I OP will merge with and into our operating partnership, with our operating partnership continuing as the “surviving partnership” following the partnership merger. Unless context suggests otherwise, we refer to the merger and the partnership merger together as the “mergers.” The merger agreement was the product of a negotiation between a special committee of our board of directors and a special committee of the board of directors of Moody I (both consisting solely of independent directors), each of which was represented by its own counsel and financial advisor. Entry into the merger agreement was unanimously approved by our board of directors upon the recommendation of the special committee of our board of directors.

Subject to the terms and conditions of the merger agreement, we will pay gross consideration of \$11.00 per share of Moody I common stock, which amount will be reduced by certain disposition fees and profit sharing amounts to Moody I's sponsor, financial advisory and legal fees payable by Moody I, and other transaction and closing costs incurred by Moody I to arrive at the net merger consideration payable to the holders of Moody I's common stock, which price we refer to as the "net per share price." Pursuant to the terms of the merger agreement, the net per share price was calculated as (i) the gross per share price of \$11.00, minus (ii) all fees and expenses that Moody I incurred as a result of or in connection with the mergers and other transactions contemplated by the merger agreement, or the Moody I transaction fees and expenses, provided that in no event could the net per share price be less than \$10.25. Subsequent to the execution of the merger agreement, the parties thereto determined the final amount of the Moody I transaction fees and expenses. Based on such determination, the net per share price was determined to be \$10.25.

At the effective time of the merger, each outstanding share of Moody I common stock will be automatically cancelled and retired, and converted into the right to receive, at the election of each holder of such share of Moody I's common stock, but subject to the limitations discussed below, either:

- (i) an amount in cash equal to the net per share price, which we refer to as the "cash consideration;" or
- (ii) a number of Class A Shares, which we refer to as the "stock consideration," equal to the net per share price divided by \$25.00, which quotient, as adjusted pursuant to the merger agreement, is referred to as the "exchange ratio."

We refer to the stock consideration together with the cash consideration as the "merger consideration." Pursuant to the merger agreement, the maximum number of shares of Moody I common stock that may be converted into the right to receive the cash consideration may not exceed 50% of the aggregate number of shares of Moody I common stock entitled to receive merger consideration. Based on elections of Moody I's stockholders and pursuant to the terms of the merger agreement, approximately 8.90 million shares, or approximately 67%, of Moody I's common stock, will be converted into the right to receive the stock consideration and approximately 4.36 million shares, or approximately 33%, of Moody I's common stock will be converted into the right to receive the cash consideration. Accordingly, if the mergers are consummated based on the foregoing amounts, we anticipate that we will issue approximately 3.65 million Class A shares to former Moody I stockholders and pay approximately \$44.7 million in aggregate cash consideration to former Moody I stockholders.

Subject to the terms and conditions of the merger agreement, at the effective time of the partnership merger, each outstanding unit of limited partnership interest in Moody I OP will be automatically cancelled and retired, and converted into the right to receive a number of units of limited partnership interests in the surviving partnership equal to the exchange ratio. Each unit of limited partnership interest in Moody I OP designated as a special partnership unit pursuant to Moody I OP's limited partnership agreement will be automatically cancelled and retired and shall cease to exist, and no consideration shall be paid, nor, except as expressly provided in the termination agreement (described below), shall any other payment or right inure or be made with respect thereto in connection with or as a consequence of the partnership merger. Each outstanding unit of limited partnership interest in our operating partnership will remain outstanding as one unit of equity ownership in the surviving partnership, and each unit designated as a special partnership unit pursuant to the limited partnership agreement of our operating partnership will remain outstanding as one special unit in the surviving partnership.

The merger agreement contains customary covenants, including covenants prohibiting Moody I and its subsidiaries and representatives from soliciting, providing information with respect to or entering into discussions concerning proposals relating to alternative business combination transactions, subject to certain limited exceptions. However, under the terms of the merger agreement, during the period beginning on November 16, 2016 and continuing until 11:59 p.m. New York City time on December 31, 2016, or the go shop period end time, Moody I had the right to initiate, solicit, provide information and enter into discussions concerning proposals relating to alternative business combination transactions. Additionally, for up to five business days after the go shop period end time, Moody I had the right to continue to participate in such discussions with certain other parties, each referred to as a "go shop bidder," and could, subject to certain conditions set forth in the merger agreement regarding the proposal made by such go shop bidder, terminate the merger agreement and enter into an agreement with a go shop bidder with respect to the proposal made by such go shop bidder. None of the parties contacted during the go shop process submitted a proposal that was deemed an "acquisition proposal" under the merger agreement to Moody I prior to the go shop period end time.

Concurrently with the entry into the merger agreement, we, Moody I, Moody I OP, Moody I advisor, Moody National Realty Company, LP, or Moody National, and Moody OP Holdings I, LLC, or OP Holdings, the holder of all of the outstanding special partnership units in Moody I OP, entered into a termination agreement, or the termination agreement. Pursuant to the termination agreement, at the effective time of the mergers, the amended and restated advisory agreement, dated August 14, 2009, among Moody I, Moody I OP, Moody I advisor and Moody National will be terminated and Moody I will pay Moody I advisor a payment of \$5,580,685, or the Moody I advisor payment. The Moody I advisor payment is a negotiated amount that represents a reduction in the disposition fee to which the Moody I advisor could have been entitled and a waiver of any other fees that the Moody I advisor would have been due under the advisory agreement between Moody I and Moody I advisor in connection with the merger. In addition, the termination agreement provides that at the effective time of the partnership merger and in accordance with the terms of the limited partnership agreement of Moody I OP, Moody I OP will pay to OP Holdings an amount not to exceed \$613,751, or the promote payment. In the event that the merger agreement is terminated prior to the consummation of the mergers, the termination agreement will automatically terminate and be of no further effect and no Moody I advisor payment or promote payment will be owed and payable.

Pursuant to certain provisions of our advisory agreement that will only become effective if the mergers are consummated, we will be obligated to pay our advisor an acquisition fee of 1.5% of the aggregate cash consideration paid in the merger. However, during the first year following the consummation of the mergers, if we sell a property that was previously owned by Moody I, then any disposition fee to which our advisor would be entitled under the advisory agreement will be reduced by an amount equal to the portion of the Moody I advisor payment attributable to such property.

The merger agreement may be terminated under certain circumstances by both Moody I and us. If such termination occurs under certain circumstances, then Moody I would be obligated to pay us a termination fee of either \$1,000,000 or \$2,000,000, depending on the occurrence of certain conditions, plus an expense reimbursement fee of up to \$500,000. The merger agreement also provides that one party may be required to reimburse the other party's expenses, up to \$500,000, if the merger agreement is terminated under certain circumstances.

On May 24, 2017, Moody I's stockholders approved the merger. The obligation of each party to consummate the mergers is subject to a number of additional conditions, including receipt of any regulatory approvals, delivery of certain documents and consents, the truth and correctness of the representations and warranties of the parties, subject to the materiality standards contained in the merger agreement and the absence of a material adverse effect with respect to either us or Moody I. There is no guarantee that the mergers will close. Our management has, and will continue to, expend time and resources to consummate the mergers, which time and resources may otherwise have been allocated to our other operational needs.

In connection with the mergers, on February 2, 2017, we entered into a stockholder servicing coordination agreement, or the stockholder servicing coordination agreement, with Moody Securities. Pursuant to the stockholder servicing coordination agreement, we will pay to Moody Securities certain stockholder servicing fees, or the stockholder servicing fees, of up to \$2.125 per share of our common stock issued as stock consideration. All stockholder servicing fees will be re-allowed to broker-dealers that provide ongoing financial advisory services to Moody I stockholders following the mergers and that enter into participating broker-dealer agreements with Moody Securities. The aggregate amount of stockholder servicing fees is based on the number of shares of our common stock issued as consideration in the merger, and will be approximately \$7.0 million. No stockholder servicing fees will be paid with respect to any cash paid by us as cash consideration in the merger.

Factors Which May Influence Results of Operations

Economic Conditions Affecting Our Target Portfolio

Adverse economic conditions affecting the hospitality sector, the geographic regions in which we plan to invest or the real estate market generally may have a material impact on our capital resources and the revenue or income to be derived from the operation of our hospitality investments.

Offering Proceeds

Our ability to make investments depends upon the net proceeds raised in our offering and our ability to finance the acquisition of our investments. If we raise substantially less than the maximum offering amount of \$1,100,000,000, we will make fewer investments resulting in less diversification in terms of the number of investments owned and fewer sources of income. In such event, the likelihood of our profitability being affected by the performance of any one of our investments will increase. In addition, if we are unable to raise substantial funds, our fixed operating expenses as a percentage of gross income would be higher, which could affect our net income and results of operations.

Results of Operations

We were formed on July 25, 2014. As of June 30, 2016, we owned the Residence Inn Austin, a 112-room hotel property located in Austin, Texas and the Springhill Suites Seattle, a 234-room hotel property located in Seattle, Washington. As of June 30, 2017, we owned the Residence Inn Austin, the Springhill Suites Seattle, and the MN TX II note. Because we owned one investment for the entire six months ended June 30, 2016, our results of operations for the three and six months ended June 30, 2016 are not directly comparable to those for the three and six months ended June 30, 2017. In general, we expect that our income and expenses related to our investment portfolio will increase in future periods as a result of anticipated future acquisitions of real estate and real estate-related investments. In addition, we expect that our income and expenses related to our investment portfolio will differ significantly if the mergers are consummated.

Comparison of the three months ended June 30, 2017 versus the three months ended June 30, 2016

Revenue

Total revenue increased to \$5,528,325 for the three months ended June 30, 2017 from \$3,455,303 for the three months ended June 30, 2016. The increase in hotel revenue was primarily due to the fact that we owned the Springhill Suites Seattle for the entire three months ended June 30, 2017. Interest income from our related party mortgage note receivable increased to \$156,139 for the three months ended June 30, 2017 from \$0 for three months ended June 30, 2016. We expect that room revenue, other hotel revenue and total revenue will each increase in future periods as a result of having full periods of operations for properties owned and future acquisitions of real estate assets.

A comparison of hotel revenues for the hotel owned continuously for the three months ended June 30, 2017 and 2016 follows:

	<u>Three months ended June,</u>		
	<u>2017</u>	<u>2016</u>	<u>Decrease</u>
Residence Inn Austin	<u>\$ 1,292,169</u>	<u>\$ 1,378,370</u>	<u>\$ (86,201)</u>

Hotel Operating Expenses

Hotel operating expenses increased to \$2,905,687 for the three months ended June 30, 2017 from \$1,613,266 for the three months ended June 30, 2016 and were comprised of the hotel operating expenses of the Residence Inn Austin and the Springhill Suites Seattle. The increase in hotel operating expenses was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire three months ended June 30, 2017.

Property Taxes, Insurance and Other

Property taxes, insurance and other expenses increased to \$293,326 for the three months ended June 30, 2017 from \$150,146 for the three months ended June 30, 2016, all of which related to the operation of the Residence Inn Austin and the Springhill Suites Seattle. The increase in property taxes, insurance and other was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire three months ended June 30, 2017.

Depreciation and Amortization

Depreciation and amortization increased to \$585,516 for the three months ended June 30, 2017 from \$376,054 for the three months ended June 30, 2016, all of which related to the operation of the Residence Inn Austin and the Springhill Suites Seattle. The increase in depreciation and amortization was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire three months ended June 30, 2017.

Acquisition Expenses

Acquisition expenses decreased to \$423,601 for the three months ended June 30, 2017 from \$1,238,122 for the three months ended June 30, 2016. Acquisition expenses for the three months ended June 30, 2017 were related to the pending merger and acquisition expenses for the three months ended June 30, 2016 were related to the Springhill Suites Seattle acquisition.

Corporate General and Administrative Expenses

Corporate general and administrative expenses increased to \$573,848 for the three months ended June 30, 2017 from \$528,703 for the three months ended June 30, 2016. These general and administrative expenses consisted primarily of asset management fees, professional fees, restricted stock compensation and directors' fees. We expect corporate general and administrative expenses to increase in future periods as a result of anticipated future acquisitions, but to decrease as a percentage of total revenue.

Interest Expense and Amortization of Debt Issuance Costs

Interest expense and amortization of debt issuance costs increased to \$819,327 for the three months ended June 30, 2017 from \$668,079 for the three months ended June 30, 2016 due to the fact that we owned the Springhill Suites Seattle hotel and the MN TX II note for the entire three months ended June 30, 2017. In future periods, our interest expense will vary based on the amount of our borrowings, which will depend on the availability and cost of borrowings and our ability to identify and acquire real estate and real estate-related assets that meet our investment objectives.

Income Tax Expense

Our income tax expense decreased to \$33,000 for the three months ended June 30, 2017 from \$156,000 for the three months ended June 30, 2016 due to a decrease in taxable income of the TRS for the three months ended June 30, 2017 from the three months ended June 30, 2016.

Comparison of the six months ended June 30, 2017 versus the six months ended June 30, 2016

Revenue

Total revenue increased to \$9,804,590 for the six months ended June 30, 2017 from \$4,805,655 for the six months ended June 30, 2016. The increase in hotel revenue was primarily due to the fact that we owned the Springhill Suites Seattle for the entire six months ended June 30, 2017. Interest income from the MN TX II note increased to \$312,278 for the six months ended June 30, 2017 from \$0 for six months ended June 30, 2016. We expect that room revenue, other hotel revenue and total revenue will each increase in future periods as a result of having full periods of operations for properties currently owned and future acquisitions of real estate assets.

A comparison of hotel revenues for the hotel owned continuously for the six months ended June 30, 2017 and 2016 follows:

	<u>Six months ended June 30,</u>		
	<u>2017</u>	<u>2016</u>	<u>Decrease</u>
Residence Inn Austin	<u>\$ 2,588,401</u>	<u>\$ 2,728,721</u>	<u>\$ (140,320)</u>

Hotel Operating Expenses

Hotel operating expenses increased to \$5,417,674 for the six months ended June 30, 2017 from \$2,212,527 for the six months ended June 30, 2016 and were comprised of the hotel operating expenses of the Residence Inn Austin and the Springhill Suites Seattle. The increase in hotel operating expenses was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire six months ended June 30, 2017.

Property Taxes, Insurance and Other

Property taxes, insurance and other expenses increased to \$548,626 for the six months ended June 30, 2017 from \$202,756 for the six months ended June 30, 2016, all of which related to the operation of the Residence Inn Austin and the Springhill Suites Seattle. The increase in property taxes, insurance and other was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire six months ended June 30, 2017.

Depreciation and Amortization

Depreciation and amortization increased to \$1,169,987 for the six months ended June 30, 2017 from \$555,605 for the six months ended June 30, 2016, all of which related to the operation of the Residence Inn Austin and the Springhill Suites Seattle. The increase in depreciation and amortization was primarily due to the fact that we owned the Springhill Suites Seattle hotel for the entire six months ended June 30, 2017.

Acquisition Expenses

Acquisition expenses decreased to \$1,048,328 for the six months ended June 30, 2017 from \$1,238,122 for the six months ended June 30, 2016. Acquisition expenses for the six months ended June 30, 2017 were related to the pending merger and acquisition expenses for the six months ended June 30, 2016 were related to the Springhill Suites Seattle acquisition.

Corporate General and Administrative Expenses

Corporate general and administrative expenses increased to \$1,152,486 for the six months ended June 30, 2017 from \$674,701 for the six months ended June 30, 2016 due an increase in operating expenses reimbursable to our advisor. These general and administrative expenses consisted primarily of asset management fees, professional fees, restricted stock compensation and directors' fees. We expect corporate general and administrative expenses to increase in future periods as a result of anticipated future acquisitions, but to decrease as a percentage of total revenue.

Interest Expense and Amortization of Debt Issuance Costs

Interest expense and amortization of debt issuance costs increased to \$1,599,269 for the six months ended June 30, 2017 from \$868,058 for the six months ended June 30, 2016 due to the fact that we owned the Springhill Suites Seattle and the MN TX II note for the entire six months ended June 30, 2017. In future periods our interest expense will vary based on the amount of our borrowings, which will depend on the availability and cost of borrowings and our ability to identify and acquire real estate and real estate-related assets that meet our investment objectives.

Income Tax Expense (Benefit)

Our income tax expense (benefit) decreased to \$(112,000) for the six months ended June 30, 2017 from \$170,000 for the six months ended June 30, 2016 due to our taxable REIT subsidiary having a taxable loss for the six months ended June 30, 2017 and taxable income for the six months ended June 30, 2016.

Liquidity and Capital Resources

Our current principal demand for funds is the payment of the cash consideration in, and other costs related to, the mergers, including payment of the stockholder servicing fees described above. We intend to use proceeds from our offering and from a credit facility into which we intend to enter to supply the cash needed to cover such costs.

We intend to make a loan to Moody I in the amount of approximately \$7.1 million, or the Moody I Loan, secured by a hotel property owned by Moody I, on or about August 15, 2017. Moody I will use the Moody I Loan proceeds to repay a loan that has matured. We expect the Moody I Loan to be refinanced with the proceeds of a new loan that we will obtain in connection with the consummation of the merger.

Notwithstanding the mergers, our principal demand for funds will be for the acquisition of real estate assets, the payment of operating expenses, principal and interest payments on our outstanding indebtedness and the payment of distributions to our stockholders. Proceeds from our offering currently supply a significant portion of our cash. Over time, however, cash from operations will generally fund our cash needs for items other than asset acquisitions.

There may be a delay between the sale of shares of our common stock during our offering and our purchase of assets, which could result in a delay in the benefits to our stockholders, if any, of returns generated from our investment operations. Our advisor, subject to the oversight of our board, will evaluate potential acquisitions and will engage in negotiations with sellers and lenders on our behalf. If necessary, we may use financings or other sources of capital in the event of unforeseen significant capital expenditures.

We may, but are not required to, establish working capital reserves out of cash flow generated by our real estate assets or out of proceeds from the sale of our real estate assets. We do not anticipate establishing a general working capital reserve; however, we may establish working capital reserves with respect to particular investments. We also may, but are not required to, establish reserves out of cash flow generated by our real estate assets or out of net sale proceeds in non-liquidating sale transactions. Working capital reserves are typically used to fund tenant improvements, leasing commissions and major capital expenditures. Our lenders also may require working capital reserves.

To the extent that any working capital reserve we establish is insufficient to satisfy our cash requirements, additional funds may be provided from cash generated from operations, short-term borrowing, equity capital from joint venture partners, or the proceeds of public or private offerings of our shares or interests in our operating partnership. In addition, subject to certain limitations, we may incur indebtedness in connection with the acquisition of any real estate assets, refinance the debt thereon, arrange for the leveraging of any previously unfinanced property or reinvest the proceeds of financing or refinancing in additional properties. There can be no assurance that we will be able to obtain such capital or financing on favorable terms, if at all.

Net Cash Provided by (Used in) Operating Activities

As of June 30, 2017, we owned the Residence Inn Austin and the Springhill Suites Seattle hotel properties and the MN TX II note. Net cash provided by (used in) operating activities for the six months ended June 30, 2017 and 2016 was \$(1,249,506) and \$1,156,365, respectively.

Net Cash Used in Investing Activities

Our cash used in investing activities will vary based on how quickly we invest the net offering proceeds from our offering towards acquisitions of real estate and real-estate related investments. Net cash used in investing activities for the six months ended June 30, 2017 and 2016 was \$341,926 and \$73,949,015, respectively. The decrease in cash used in investing activities for the six months ended June 30, 2017 was due to the fact that we had no acquisitions during the six months ended June 30, 2017 and we acquired the Springhill Suites Seattle during the six months ended June 30, 2016.

Net Cash Provided by Financing Activities

For the six months ended June 30, 2017, our cash flows from financing activities consisted primarily of proceeds from our offering, net of offering costs, and distributions paid to our stockholders. Net cash provided by financing activities for the six months ended June 30, 2017 and 2016 was \$31,776,573 and \$81,402,599, respectively. The decrease in cash provided by financing activities was primarily due to proceeds of notes payable of \$0 for the six months ended June 30, 2017 compared to \$56,250,000 for the six months ended June 30, 2016.

Cash and Cash Equivalents

As of June 30, 2017, we had cash on hand of \$49,762,453.

Debt

We use, and intend to use in the future, secured and unsecured debt as a means of providing additional funds for the acquisition of real property, and potentially securities and debt-related investments. By operating on a leveraged basis, we expect that we will have more funds available for investments. This will generally allow us to make more investments than would otherwise be possible, potentially resulting in enhanced investment returns and a more diversified portfolio. However, our use of leverage increases the risk of default on loan payments and the resulting foreclosure on a particular asset. In addition, lenders may have recourse to assets other than those specifically securing the repayment of the indebtedness. When debt financing is unattractive due to high interest rates or other reasons, or when financing is otherwise unavailable on a timely basis, we may purchase certain assets for cash with the intention of obtaining debt financing at a later time.

As of June 30, 2017, our outstanding indebtedness totaled \$69,975,000. Our aggregate borrowings are reviewed by our board of directors at least quarterly. Under our Articles of Amendment and Restatement, or our charter, we are prohibited from borrowing in excess of 300% of the value of our net assets. "Net assets" for purposes of this calculation is defined to be our total assets (other than intangibles), valued at cost prior to deducting depreciation, reserves for bad debts and other non-cash reserves, less total liabilities. The preceding calculation is generally expected to approximate 75% of the aggregate cost of our assets before non-cash reserves and depreciation. However, we may temporarily borrow in excess of these amounts if such excess is approved by a majority of our independent directors and disclosed to our stockholders in our next quarterly report, along with an explanation for such excess. As of June 30, 2017 and December 31, 2016, our debt levels did not exceed 300% of the value of our net assets.

Contractual Commitments and Contingencies

The following is a summary of our contractual obligations as of June 30, 2017, other than the merger agreement (see "Pending Merger with Moody National REIT I, Inc." for more information about the obligations and commitments arising under the merger agreement):

Contractual Obligations	Payments Due By Period				
	Total	2017	2018-2019	2020-2021	Thereafter
Long-term debt obligations ⁽¹⁾	\$ 69,975,000	\$ 21,511	\$ 9,754,954	\$ 2,099,960	\$ 58,098,575
Interest payments on outstanding debt obligations ⁽²⁾	24,058,431	1,550,919	5,757,348	5,330,056	11,420,108
Total.....	<u>\$ 94,033,431</u>	<u>\$ 1,572,430</u>	<u>\$ 15,512,302</u>	<u>\$ 7,430,016</u>	<u>\$ 69,518,683</u>

(1) Amounts include principal payments only.

(2) Projected interest payments are based on the outstanding principal amounts and weighted-average interest rates at June 30, 2017.

Organization and Offering Costs

We pay our organization and offering costs that we directly incur or such costs may be incurred by our advisor on our behalf. Pursuant to the advisory agreement with our advisor, we are obligated to reimburse our advisor or its affiliates, as applicable, for organization and offering costs incurred by our advisor associated with our offering, provided that within 60 days of the last day of the month in which such offering ends, our advisor is obligated to reimburse us to the extent that organization and offering costs we may have incurred in connection with that offering exceed 15% of the gross offering proceeds from the sale of our shares of common stock in that offering. Such organization and offering costs include selling commissions and dealer manager fees paid to a dealer manager, legal, accounting, printing and other offering expenses, including marketing, salaries and direct expenses of our advisor's employees and employees of our advisor's affiliates and others. Any reimbursement to our advisor or its affiliates for organization and offering costs will not exceed actual expenses incurred by our advisor.

All offering costs, including selling commissions and dealer manager fees, are recorded as an offset to additional paid-in-capital, and all organization costs are recorded as an expense when we have an obligation to reimburse our advisor.

As of June 30, 2017, total offering costs were \$15,658,503, comprised of \$11,726,007 of offering costs incurred directly by us and \$3,932,496 in offering costs incurred by and reimbursable to our advisor. As of June 30, 2017, we had \$88,568 due from our advisor for reimbursable offering costs.

Operating Expenses

We will reimburse our advisor for all expenses paid or incurred by our advisor in connection with the services it provides to us, subject to the limitation that we will not reimburse our advisor for any amount by which our operating expenses (including the asset management fee we pay to our advisor) at the end of the four preceding fiscal quarters exceeds the greater of: (1) 2% of our average invested assets, or (2) 25% of our net income determined without reduction for any additions to reserves for depreciation, bad debts or other similar non-cash reserves and excluding any gain from the sale of our assets for that period, which we refer to as the “2%/25% Limitation.” Notwithstanding the above, we may reimburse our advisor for expenses in excess of this limitation if a majority of our independent directors determine that such excess expenses are justified based on unusual and non-recurring factors. For the four fiscal quarters ended June 30, 2017, our total operating expenses were \$1,968,440, which included \$1,359,472 in operating expenses incurred directly by us and \$608,968 incurred by our advisor on our behalf. Of that \$1,968,440 in total operating expenses, \$0 exceeded the 2%/25% Limitation. We reimbursed our advisor \$709,000 during four fiscal quarters ended June 30, 2017, which includes reimbursements for quarters prior to the four quarters ended June 30, 2017.

Critical Accounting Policies

General

We consider the accounting policies described below to be critical because they involve significant judgments and assumptions, require estimates about matters that are inherently uncertain and because they are important for understanding and evaluating our reported financial results. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If management’s judgment or interpretation of the facts and circumstances relating to various transactions is different, it is possible that different accounting policies will be applied or different amounts of assets, liabilities, revenues and expenses will be recorded, resulting in a different presentation of the consolidated financial statements or different amounts reported in the consolidated financial statements. Additionally, other companies may utilize different estimates that may impact the comparability of our results of operations to those of companies in similar businesses.

Income Taxes

We intend to make an election to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code commencing with the taxable year ended December 31, 2016. In order to elect to be taxed as a REIT for the year ended December 31, 2016, such election will be made by filing our 2016 federal income tax return as a REIT, which return should be filed, taking into account available extensions, by September 15, 2017. We did not meet all of the qualifications to be a REIT under the Internal Revenue Code for the year ended December 31, 2015 and for the period from July 25, 2014 (inception) to December 31, 2014, including not having enough shareholders for a sufficient number of days in those periods. Prior to qualifying to be taxed as a REIT we were subject to normal federal and state corporation income taxes.

Provided that we qualify as a REIT, we generally will not be subject to federal corporate income tax to the extent we distribute our REIT taxable income to our stockholders, so long as we distribute at least 90% of our REIT taxable income (which is computed without regard to the dividends-paid deduction or net capital gain and which does not necessarily equal net income as calculated in accordance with GAAP) and satisfy the other organizational and operational requirements for REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to certain state and local taxes on our income and property, and federal income and excise taxes on our undistributed income.

We account for income taxes of our TRS using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We record a valuation allowance for net deferred tax assets that are not expected to be realized.

We lease the hotels that we acquired to a wholly owned taxable REIT subsidiary, or TRS, that is subject to federal, state and local income taxes.

We have reviewed tax positions under GAAP guidance that clarify the relevant criteria and approach for the recognition and measurement of uncertain tax positions. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition of a tax position taken, or expected to be taken, in a tax return. A tax position may only be recognized in the consolidated financial statements if it is more likely than not that the tax position will be sustained upon examination. We had no material uncertain tax positions as of June 30, 2017.

The preparation of our various tax returns requires the use of estimates for federal and state income tax purposes. These estimates may be subjected to review by the respective taxing authorities. A revision to an estimate may result in an assessment of additional taxes, penalties and interest. At this time, a range in which our estimates may change is not expected to be material. We will account for interest and penalties relating to uncertain tax provisions in the current period’s results of operations, if necessary. Our tax years 2014, 2015 and 2016 remain subject to examination by various federal and state tax jurisdictions.

Valuation and Allocation of Hotel Properties — Acquisitions

Upon acquisition, the purchase price of hotel properties are allocated to the tangible assets acquired, consisting of land, buildings and furniture, fixtures and equipment, any assumed debt, identified intangible assets and asset retirement obligations, if any, based on their fair values. Acquisition costs are charged to expense as incurred. Initial valuations are subject to change during the measurement period, but the measurement period ends as soon as the information is available. The measurement period shall not exceed one year from the acquisition date.

Land fair values are derived from appraisals, and building fair values are calculated as replacement cost less depreciation or our estimates of the relative fair value of these assets using discounted cash flow analyses or similar methods. The fair value of furniture, fixtures and equipment is based on their fair value using replacement costs less depreciation.

We determine the fair value of any assumed debt by calculating the net present value of the scheduled mortgage payments using interest rates for debt with similar terms and remaining maturities that we believe we could obtain at the date of acquisition. Any difference between the fair value and stated value of the assumed debt is recorded as a discount or premium and amortized over the remaining life of the loan as interest expense.

In allocating the purchase price of each of our properties, we make assumptions and use various estimates, including, but not limited to, the estimated useful lives of the assets, the cost of replacing certain assets and discount rates used to determine present values. Many of these estimates are obtained from independent third party appraisals. However, we are responsible for the source and use of these estimates. These estimates are based on judgment and subject to being imprecise; accordingly, if different estimates and assumptions were derived, the valuation of the various categories of our hotel properties or related intangibles could, in turn, result in a difference in the depreciation or amortization expense recorded in our consolidated financial statements. These variances could be material to our results of operations and financial condition.

Valuation and Allocation of Hotel Properties — Ownership

Depreciation expense is computed using the straight-line method based upon the following estimated useful lives:

	Estimated Useful Lives (years)
Buildings and improvements	39-40
Exterior improvements	10-20
Furniture, fixtures and equipment	5-10

Impairment

We monitor events and changes in circumstances indicating that the carrying amounts of our hotel properties may not be recoverable. When such events or changes in circumstances are present, we assess potential impairment by comparing estimated future undiscounted cash flows expected to be generated over the life of the asset from operating activities and from its eventual disposition, to the carrying amount of the asset. In the event that the carrying amount exceeds the estimated future undiscounted cash flows, we recognize an impairment loss to adjust the carrying amount of the asset to estimated fair value for assets held for use and fair value less costs to sell for assets held for sale. There were no such impairment losses for the three or six month periods ended June 30, 2017 and 2016.

In evaluating our hotel properties for impairment, we make several estimates and assumptions, including, but not limited to, the projected date of disposition of the properties, the estimated future cash flows of the properties during our ownership and the projected sales price of each of the properties. A change in these estimates and assumptions could result in a change in the estimated undiscounted cash flows or fair value of our hotel properties which could then result in different conclusions regarding impairment and material changes to our consolidated financial statements.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or the FASB, issued Accounting Standards Update, or ASU, No. 2014-09, “Revenue from Contracts with Customers,” which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. The standard permits the use of either the full retrospective or modified retrospective adoption. In July 2015, the FASB voted to defer the effective date to January 1, 2018 with early adoption beginning January 1, 2017. We have begun to evaluate each of our revenue streams under the new model. Based on preliminary assessments, we do not expect the adoption of ASU No. 2014-09 to have a material effect on our consolidated financial position or our consolidated results of operations.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Liabilities,” which enhances the reporting requirements surrounding the measurement of financial instruments and requires equity securities to be measured at fair value with changes in the fair value recognized through net income for the period. ASU No. 2016-01 is effective for our fiscal year commencing on January 1, 2018. We do not anticipate that the adoption of ASU No. 2016-01 will have a material effect on our consolidated financial position or our consolidated results of operations.

In February 2016, the FASB issued ASU No. 2016-02, “Leases,” which changes lessee accounting to reflect the financial liability and right-of-use assets that are inherent to leasing an asset on the balance sheet. ASU No. 2016-02 is effective for our fiscal year commencing on January 1, 2019, but early adoption is permitted. The effect that the adoption of ASU No. 2016-02 will have on our consolidated financial position or our consolidated results of operations is not currently reasonably estimable.

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments,” which addresses the Statement of Cash Flow classification and presentation of certain cash transactions. ASU No. 2016-15 is effective for our fiscal year commencing on January 1, 2018. The effect of this amendment is to be applied retrospectively where practical and early adoption is permitted. We expect to adopt ASU No. 2016-15 for our fiscal year commencing on January 1, 2018. We do not anticipate that the adoption of ASU No. 2016-15 will have a material effect on our consolidated financial position or our consolidated results of operations.

In November 2016, the FASB issued ASU No. 2016-18, “Classification of Restricted Cash,” which addresses the Statement of Cash Flow classification and presentation of restricted cash transactions. ASU No. 2016-18 is effective for our fiscal year commencing on January 1, 2018. The effect of this amendment is to be applied retrospectively and early adoption is permitted. We expect to adopt ASU No. 2016-18 for our fiscal year commencing on January 1, 2018. We do not anticipate that the adoption of ASU No. 2016-18 will have a material effect on our consolidated financial position or our consolidated results of operations.

In January 2017, the FASB issued ASU No. 2017-01, “Clarifying the Definition of a Business,” with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as an acquisition of assets or a business. ASU No. 2017-01 is effective for our fiscal year commencing on January 1, 2018. The effect of this guidance is to be applied prospectively and early adoption is permitted. We do not anticipate that the adoption of ASU No. 2016-18 will have a material effect on our consolidated financial position or our consolidated results of operations.

Inflation

As of June 30, 2017, our investments consisted of our interests in the Residence Inn Austin, the Springhill Suites Seattle, and the MN TX II note. Operators of hotels, in general, possess the ability to adjust room rates daily to reflect the effects of inflation. Competitive pressures may, however, limit the operators’ ability to raise room rates. The MN TX II note bears interest at a fixed rate of interest and inflation could, therefore, have an impact on its fair value. As of June 30, 2017, we were not experiencing any material impact from inflation.

REIT Compliance

We intend to elect to be taxed as a REIT beginning with our taxable year ended December 31, 2016. To qualify as a REIT for tax purposes, we are required to distribute at least 90% of our REIT taxable income (determined for this purpose without regard to the dividends-paid deduction and excluding net capital gain) to our stockholders. We must also meet certain asset and income tests, as well as other requirements. We will monitor the business and transactions that may potentially impact our REIT status. If we fail to qualify as a REIT in any taxable year following the taxable year in which we initially elect to be taxed as a REIT, we will be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which our REIT qualification is lost unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. We did not meet all of the qualifications to be a REIT under the Internal Revenue Code for the year ended December 31, 2015 and the period from July 25, 2014 (inception) to December 31, 2014.

Distributions

Our board of directors has authorized distributions to our stockholders that (1) accrue daily to our stockholders of record on each day; (2) are payable in cumulative amounts on or before the 15th day of each calendar month and (3) are calculated at a rate of \$1.75 per share of our common stock per year, or approximately \$0.00479 per share per day, before any class-specific expenses.

The following table summarizes distributions paid in cash and pursuant to our DRP for the six months ended June 30, 2017 and 2016:

Period	Cash Distribution	Distribution Paid Pursuant to DRP⁽¹⁾	Total Amount of Distribution
First Quarter 2017	\$ 1,016,749	\$ 410,733	\$ 1,427,482
Second Quarter 2017	1,325,157	589,483	1,914,640
Total.....	<u>\$ 2,341,906</u>	<u>\$ 1,000,216</u>	<u>\$ 3,342,122</u>
First Quarter 2016	\$ 185,952	\$ 84,466	\$ 270,418
Second Quarter 2016	351,169	157,799	508,968
Total.....	<u>\$ 537,121</u>	<u>\$ 242,265</u>	<u>\$ 779,386</u>

(1) Amount of distributions paid in shares of common stock pursuant to our DRP.

Funds from Operations and Modified Funds from Operations

One of our objectives is to provide cash distributions to our stockholders from cash generated by our operations. Cash generated from operations is not equivalent to net income as determined under GAAP. Due to certain unique operating characteristics of real estate companies, the National Association of Real Estate Investment Trusts, or NAREIT, an industry trade group, has promulgated a standard known as Funds from Operations, or FFO, which it believes more accurately reflects the operating performance of a REIT. As defined by NAREIT, FFO means net income computed in accordance with GAAP, excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures in which the REIT holds an interest. We have adopted the NAREIT definition for computing FFO because, in our view, FFO is a meaningful supplemental performance measure in conjunction with net income.

Changes in the accounting and reporting rules under GAAP that have been put into effect since the establishment of NAREIT's definition of FFO have prompted a significant increase in the magnitude of non-cash and non-operating items included in FFO, as defined. As a result, in addition to FFO, we also calculate modified funds from operations, or MFFO, a non-GAAP supplemental financial performance measure that our management uses in evaluating our operating performance. Similar to FFO, MFFO excludes items such as depreciation and amortization. However, MFFO excludes non-cash and non-operating items included in FFO, such as amortization of certain in-place lease intangible assets and liabilities and the amortization of certain tenant incentives. Our calculation of MFFO will exclude these items, as well as the effects of straight-line rent revenue recognition, fair value adjustments to derivative instruments that do not qualify for hedge accounting treatment, non-cash impairment charges and certain other items, when applicable. Our calculation of MFFO will also include, when applicable, items such as master lease rental receipts, which are excluded from net income (loss) and FFO, but which we consider in the evaluation of the operating performance of our real estate investments.

We believe that MFFO reflects the overall impact on the performance of our real estate investments of occupancy rates, rental rates, property operating costs and development activities, as well as general and administrative expenses and interest costs, which is not immediately apparent from net income (loss). As such, we believe MFFO, in addition to net income (loss) as defined by GAAP, is a meaningful supplemental performance measure which is used by our management to evaluate our operating performance and determine our operating, financing and dividend policies.

Please see the limitations listed below associated with the use of MFFO as compared to net income (loss):

- Our calculation of MFFO will exclude any gains (losses) related to changes in estimated values of derivative instruments related to any interest rate swaps which we hold. Although we expect to hold these instruments to maturity, if we were to settle these instruments prior to maturity, it would have an impact on our operations. We do not currently hold any such derivative instruments and thus our calculation of MFFO set forth in the table below does not reflect any such exclusion.
- Our calculation of MFFO will exclude any impairment charges related to long-lived assets that have been written down to current market valuations. Although these losses will be included in the calculation of net income (loss), we will exclude them from MFFO because we believe doing so will more appropriately present the operating performance of our real estate investments on a comparative basis. We have not recognized any such impairment charges and thus our calculation of MFFO set forth in the table below does not reflect any such exclusion.
- Our calculation of MFFO will exclude organizational and offering expenses and acquisition expenses. Although organizational and acquisition expenses reduce net income, we fund such costs with proceeds from our offering and acquisition-related indebtedness, and do not consider these expenses in the evaluation of our operating performance and determining MFFO. Offering expenses do not affect net income. Our calculation of MFFO set forth in the table below reflects the exclusion of acquisition expenses.

We believe MFFO is useful to investors in evaluating how our portfolio might perform after our offering and acquisition stage has been completed and, as a result, may provide an indication of the sustainability of our distributions in the future. However, as described in greater detail below, MFFO should not be considered as an alternative to net income (loss) or as an indication of our liquidity. Many of the adjustments to MFFO are similar to adjustments required by SEC rules for the presentation of pro forma business combination disclosures, particularly acquisition expenses, gains or losses recognized in business combinations and other activity not representative of future activities. MFFO is also more comparable in evaluating our performance over time and as compared to other real estate companies, which may not be as involved in acquisition activities or as affected by impairments and other non-operating charges.

MFFO is useful in assisting management and investors in assessing the sustainability of operating performance in future operating periods, and in particular, after the offering and acquisition stages are complete and net asset value is disclosed. However, MFFO is not a useful measure in evaluating net asset value because impairments are taken into account in determining net asset value but not in determining MFFO. Investors are cautioned that, due to the fact that impairments are based on estimated future undiscounted cash flows and, given the relatively limited term of our operations, it could be difficult to recover any impairment charges.

The calculation of FFO and MFFO may vary from entity to entity because capitalization and expense policies tend to vary from entity to entity. Consequently, our presentation of FFO and MFFO may not be comparable to other similarly titled measures presented by other REITs. In addition, FFO and MFFO should not be considered as an alternative to net income (loss) or to cash flows from operating activities and are not intended to be used as a liquidity measure indicative of cash flow available to fund our cash needs. In particular, as we are currently in the acquisition phase of our life cycle, acquisition costs and other adjustments which are increases to MFFO are, and may continue to be, a significant use of cash. MFFO also excludes impairment charges, rental revenue adjustments and unrealized gains and losses related to certain other fair value adjustments. Accordingly, both FFO and MFFO should be reviewed in connection with other GAAP measurements.

The table below summarizes our calculation of FFO and MFFO for the three and six months ended June 30, 2017 and 2016 and a reconciliation of such non-GAAP financial performance measures to our net loss.

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net loss.....	\$ (105,980)	\$ (1,275,067)	\$ (1,019,780)	\$ (1,116,114)
Adjustments:				
Depreciation of real estate assets and amortization of deferred costs.....	585,516	376,054	1,169,987	555,605
Funds from Operations.....	479,536	(899,013)	150,207	(560,509)
Adjustments:				
Acquisition expenses	423,601	1,238,122	1,048,328	1,238,122
Modified Funds from Operations	<u>\$ 903,137</u>	<u>\$ 339,109</u>	<u>\$ 1,198,535</u>	<u>\$ 677,613</u>

Related Party Transactions and Agreements

We have entered into agreements with our advisor and its affiliates whereby we have paid, and may continue to pay, certain fees to, or reimburse certain expenses of, our advisor or its affiliates for acquisition and advisory fees and expenses, financing coordination fees, organization and offering costs, sales commissions, dealer manager fees, asset and property management fees and expenses, leasing fees and reimbursement of certain operating costs. See Note 7, "Related Party Arrangements," to the consolidated financial statements included in this Quarterly Report for a discussion of our related-party transactions, agreements and fees.

Off-Balance Sheet Arrangements

As of June 30, 2017, we had no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Subsequent Events

Distributions Declared

On June 30, 2017, we declared a distribution in the aggregate amount of \$676,447, of which \$466,609 was paid in cash on July 15, 2017 and \$209,838 was paid pursuant to the DRP in the form of additional shares of our common stock. On July 31, 2017, we declared a distribution in the aggregate amount of \$709,553 which is scheduled to be paid in cash and through the DRP in the form of additional shares of our common stock on or about August 15, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market Risk

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. We may be exposed to interest rate changes primarily as a result of long-term debt used to maintain liquidity, fund capital expenditures and expand our real estate investment portfolio and operations. Market fluctuations in real estate financing may affect the availability and cost of funds needed to expand our investment portfolio. In addition, restrictions upon the availability of real estate financing or high interest rates for real estate loans could adversely affect our ability to dispose of real estate in the future. We will seek to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. We may use derivative financial instruments to hedge exposures to changes in interest rates on loans secured by our assets. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

With regard to variable rate financing, our advisor will assess our interest rate cash flow risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. Our advisor will maintain risk management control systems to monitor interest rate cash flow risk attributable to both our outstanding and forecasted debt obligations as well as our potential offsetting hedge positions. While this hedging strategy will be designed to minimize the impact on our net income and funds from operations from changes in interest rates, the overall returns on your investment may be reduced.

As of June 30, 2017, our indebtedness was comprised of notes secured by the Residence Inn Austin, the Springhill Suites Seattle, and the MN TX II note, as described below. All such notes accrue interest at a fixed rate and, therefore, an increase or decrease in interest rates would have no effect on our interest expense with respect such notes. Interest rate changes will affect the fair value of any fixed rate instruments that we hold. As we expect to hold our fixed rate instruments to maturity and the amounts due under such instruments would be limited to the outstanding principal balance and any accrued and unpaid interest, we do not expect that fluctuations in interest rates, and the resulting change in fair value of our fixed rate instruments, would have a significant impact on our operations.

As of June 30, 2017 and December 31, 2016, our mortgage notes payable, secured by the respective real properties and mortgage note receivable, consisted of the following:

Mortgage Loan	Principal as of June 30, 2017	Principal as of December 31, 2016	Interest Rate at June 30, 2017	Maturity Date
Residence Inn Austin ⁽¹⁾	\$ 16,575,000	\$ 16,575,000	4.580%	November 1, 2025
Springhill Suites Seattle ⁽²⁾	45,000,000	45,000,000	4.380%	October 1, 2026
MN TX II Note ⁽³⁾	8,400,000	8,400,000	3.750%	October 6, 2018
Total notes payable.....	69,975,000	69,975,000		
Less unamortized debt issuance costs.....	(776,346)	(931,498)		
Total notes payable, net of unamortized debt issuance costs	<u>\$ 69,198,654</u>	<u>\$ 69,043,502</u>		

- (1) Monthly payments of interest are due and payable until the maturity date. Monthly payments of principal are due and payable beginning on December 2017 until the maturity date.
- (2) Monthly payments of interest only are due and payable in calendar year 2017, after which monthly payments of principal and interest are due and payable until the maturity date.
- (3) Monthly payments of interest only are due until the maturity date.

Credit Risk

We will also be exposed to credit risk. Credit risk in our investments in debt and securities relates to each individual borrower's ability to make required interest and principal payments on scheduled due dates. We seek to manage credit risk through our advisor's comprehensive credit analysis prior to making an investment, actively monitoring our asset portfolio and the underlying credit quality of our holdings and subordination and diversification of our portfolio. Our analysis is based on a broad range of real estate, financial, economic and borrower-related factors which we believe are critical to the evaluation of credit risk inherent in a transaction. We believe that the MN TX II note is adequately secured and that the borrower is creditworthy.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report, management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act). Based upon, and as of the date of, the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file and submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.