STRATEGIC HOTELS & RESORTS, INC
Form 10-Q
November 05, 2015
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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 September 30, 2015
or

o	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: 001-32223
STRATEGIC HOTELS & RESORTS, INC.
(Exact name of registrant as specified in its charter)

Maryland	33-1082757
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 West Madison Street, Suite 1700, Chicago, Illinois	60606-3415
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (312) 658-5000

Former name, former address and former fiscal year, if changed since last report:
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 o
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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
The number of shares of common stock (par value $0.01 per share) of the registrant outstanding as of November 4, 2015 was 282,090,156.

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WHERE TO FIND MORE INFORMATION:

We maintain a website at www.strategichotels.com. Through our website, we make available, free of charge, our annual proxy statement, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). The SEC maintains a website that contains these reports at www.sec.gov.

This report (and Exhibit 99.1 hereto) contains registered trademarks that are the exclusive property of their respective owners, which are companies other than us, including Fairmont®, Four Seasons®, Hyatt®, InterContinental®, JW Marriott®, Loews®, Marriott®, Montage®, Ritz-Carlton® and Westin®. None of the owners of these trademarks, their affiliates or any of their respective officers, directors, agents or employees has or will have any liability or responsibility for any financial statements, projections or other financial information or other information contained in this report.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.
STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)

	September 30, 2015	December 31, 2014
Assets		
Investment in hotel properties, net*	$3,248,230	$2,828,400
Goodwill	21,629	38,128
Intangible assets, net of accumulated amortization of $14,217 and $7,288	91,502	94,324
Assets held for sale	24,674	—
Investment in unconsolidated affiliates	21,010	22,850
Cash and cash equivalents*	128,000	442,613
Restricted cash and cash equivalents*	77,657	81,510
Accounts receivable, net of allowance for doubtful accounts of $563 and $492*	68,414	51,382
Deferred financing costs, net of accumulated amortization of $9,206 and $7,814*	13,873	11,440
Deferred tax assets	769	1,729
Prepaid expenses and other assets*	49,164	46,781
Total assets	$3,744,922	$3,619,157
Liabilities, Noncontrolling Interests and Equity		
Liabilities:		
Mortgages payable, net of discount*	$1,460,206	$1,705,778
Credit facility, including an unsecured term loan of $300,000 and $0	302,000	—
Liabilities of assets held for sale	6,499	—
Accounts payable and accrued expenses*	255,645	224,505
Preferred stock redemption liability	—	90,384
Distributions payable	—	104
Deferred tax liabilities	46,117	46,137
Total liabilities	2,070,467	2,066,908
Commitments and contingencies (see note 14)		
Noncontrolling interests in SHR's operating partnership	10,944	10,500
Equity:		
SHR's shareholders' equity:		
Common stock ($0.01 par value per share; 350,000,000 shares of common stock authorized; 282,090,156 and 267,435,799 shares of common stock issued and outstanding)	2,821	2,674
Additional paid-in capital	2,508,756	2,348,284
Accumulated deficit	(844,699)	(890,469)
Accumulated other comprehensive loss	(5,131)	(13,032)
Total SHR's shareholders' equity	1,661,747	1,447,457
Noncontrolling interests in consolidated affiliates	1,764	94,292
Total equity	1,663,511	1,541,749
Total liabilities, noncontrolling interests and equity	$3,744,922	$3,619,157

See accompanying notes to unaudited condensed consolidated financial statements.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS - Continued
(In Thousands)

	September 30, 2015	December 31, 2014
*Consolidated Variable Interest Entity's Assets and Liabilities included in the above balances (see note 6):		
Investment in hotel properties, net	$—	$336,243
Cash and cash equivalents	—	62,064
Restricted cash and cash equivalents	—	3,746
Accounts receivable, net of allowance for doubtful accounts of $0 and $49	—	4,920
Deferred financing costs, net of accumulated amortization of $0 and $0	—	3,899
Prepaid expenses and other assets	—	14,603
Mortgages payable	—	225,000
Accounts payable and accrued expenses	—	10,228

See accompanying notes to unaudited condensed consolidated financial statements.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Rooms	$198,114	$176,133	$547,355	$428,107
Food and beverage	115,296	96,642	373,288	266,687
Other hotel operating revenue	40,346	31,224	113,242	77,405
Lease revenue	678	1,264	2,722	3,882
Total revenues	354,434	305,263	1,036,607	776,081
Operating Costs and Expenses:				
Rooms	52,968	48,197	151,905	123,172
Food and beverage	83,412	70,965	254,731	192,645
Other departmental expenses	89,068	74,640	260,418	194,457
Management fees	11,578	9,970	35,440	24,989
Other hotel expenses	21,688	17,998	57,143	49,248
Lease expense	682	1,215	2,733	3,733
Depreciation and amortization	39,633	32,932	117,628	83,195
Impairment losses	2,325	—	12,726	—
Corporate expenses	10,709	5,405	25,418	19,796
Total operating costs and expenses	312,063	261,322	918,142	691,235
Operating income	42,371	43,941	118,465	84,846
Interest expense	(18,575)	(21,844)	(62,069)	(59,705)
Interest income	3	46	120	123
Loss on early extinguishment of debt	—	(609)	(34,211)	(609)
Equity in (losses) earnings of unconsolidated affiliates	—	(4)	—	5,267
Foreign currency exchange gain (loss)	4	(69)	(72)	(75)
(Loss) gain on consolidation of affiliates	—	(15)	—	143,451
Other income (expenses), net	2,746	(136)	43,054	1,082
Income before income taxes and discontinued operations	26,549	21,310	65,287	174,380
Income tax expense	(3,857)	(370)	(6,528)	(616)
Income from continuing operations	22,692	20,940	58,759	173,764
Income from discontinued operations, net of tax	—	63	—	159,102
Net Income	22,692	21,003	58,759	332,866
Net income attributable to the noncontrolling interests in SHR’s operating partnership	(65)	(67)	(169)	(1,197)
Net loss (income) attributable to the noncontrolling interests in consolidated affiliates	634	1,854	(12,820)	6,112
Net Income Attributable to SHR	23,261	22,790	45,770	337,781
Preferred shareholder dividends	—	(1,802)	—	(18,795)
Net Income Attributable to SHR Common Shareholders	$23,261	$20,988	$45,770	$318,986
Amounts Attributable to SHR:				
Income from continuing operations	$23,261	$22,727	$45,770	$179,287
Income from discontinued operations	—	63	—	158,494
Net income	$23,261	$22,790	$45,770	$337,781

Basic Income Per Common Share:				
Income from continuing operations attributable to SHR common shareholders	$0.08	$0.08	$0.17	$0.71
Income from discontinued operations attributable to SHR common shareholders	—	—	—	0.70
Net income attributable to SHR common shareholders	$0.08	$0.08	$0.17	$1.41
Weighted average shares of common stock outstanding	279,579	248,509	276,580	225,932
Diluted Income Per Common Share:				
Income from continuing operations attributable to SHR common shareholders	$0.08	$0.07	$0.16	$0.65
Income from discontinued operations attributable to SHR common shareholders	—	—	—	0.67
Net income attributable to SHR common shareholders	$0.08	$0.07	$0.16	$1.32
Weighted average shares of common stock outstanding	282,659	260,257	278,583	237,680

See accompanying notes to unaudited condensed consolidated financial statements.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net Income	$22,692	$21,003	$58,759	$332,866
Other comprehensive income:				
Foreign currency exchange translation adjustments	(4)	(40)	(130)	18,739
Reclassification of amounts from accumulated other comprehensive loss to net income and effective portion of mark to market adjustments related to cash flow hedges	2,459	3,114	8,031	6,604
Other comprehensive income	2,455	3,074	7,901	25,343
Comprehensive Income	25,147	24,077	66,660	358,209
Comprehensive income attributable to the noncontrolling interests in SHR's operating partnership	(72)	(77)	(192)	(1,290)
Comprehensive loss (income) attributable to the noncontrolling interests in consolidated affiliates	634	1,854	(12,820)	6,112
Comprehensive Income Attributable to SHR	$25,709	$25,854	$53,648	$363,031

See accompanying notes to unaudited condensed consolidated financial statements.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Nine Months Ended September 30,	
	2015	2014
Operating Activities:		
Net income	$58,759	$332,866
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Deferred income tax expense	959	642
Depreciation and amortization	117,628	84,470
Amortization of deferred financing and other costs	13,124	11,761
Non-cash impairment losses	12,726	—
Loss on early extinguishment of debt	1,212	881
Equity in earnings of unconsolidated affiliates	—	(5,267)
Share-based compensation	5,598	4,330
Gain on consolidation of affiliates	—	(143,451)
Gain on disposal of assets, net of tax	(43,274)	(156,492)
Income tax on sale of assets	—	(20,451)
Foreign currency exchange loss	72	43
Recognition of deferred gains	(116)	(159)
Mark to market of derivative financial instruments	152	(2,961)
Increase in accounts receivable	(16,590)	(2,063)
Increase in prepaid expenses and other assets	(2,950)	(1,828)
Increase in accounts payable and accrued expenses	24,067	7,078
Net cash provided by operating activities	171,367	109,399
Investing Activities:		
Acquisition of hotel and other investments	(306,577)	(305,498)
Proceeds from sales of assets	118,293	416,100
Cash received from unconsolidated affiliates	1,840	2,221
Unrestricted cash sold	(2,226)	(15,634)
Unrestricted cash acquired	8,994	22,160
Capital expenditures	(68,060)	(55,155)
Decrease (increase) in restricted cash and cash equivalents	1,063	(5,438)
Net cash (used in) provided by investing activities	(246,673)	58,756
Financing Activities:		
Proceeds from issuance of common stock	—	434,700
Equity issuance costs	(616)	(18,052)
Preferred stock redemption	(90,391)	(199,489)
Borrowings under credit facility arrangements	535,000	148,000
Payments on credit facility arrangements	(233,000)	(258,000)
Proceeds from mortgages	115,000	127,000
Payments on mortgages	(510,253)	(215,592)
Contributions from holders of noncontrolling interests in consolidated affiliates	—	5,723
Debt financing costs	(6,475)	(5,392)
Interest rate swap termination	—	(22,325)
Distributions to preferred shareholders	(104)	(11,883)
Distributions to holders of noncontrolling interests in consolidated affiliates	(43,741)	(7)
Other financing activities	(2,609)	(1,034)

Net cash used in financing activities	(237,189)	(16,351)
Effect of exchange rate changes on cash	(164)	43
Net change in cash and cash equivalents	(312,659)	151,847
Change in cash of assets held for sale	(1,954)	8,903
Cash and cash equivalents, beginning of period	442,613	73,655
Cash and cash equivalents, end of period	$128,000	$234,405

See accompanying notes to unaudited condensed consolidated financial statements.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – Continued
(In Thousands)

	Nine Months Ended September 30,	
	2015	2014
Supplemental Schedule of Non-Cash Investing and Financing Activities:		
Fair value of shares of SHR common stock issued for acquisition of noncontrolling interest in consolidated affiliate (see notes 6 and 10)	$90,621	$—
Fair value of shares of SHR common stock issued for acquisition of interest in hotel property (see note 3)	$101,396	$—
Assumption of mortgage loans - hotel investment acquisition (see note 3)	$148,951	$589,507
Gain on mark to market of derivative instruments (see note 11)	$—	$(2,781)
Increase (decrease) in capital expenditures recorded as liabilities	$7,144	$(2,687)
Cash Paid For:		
Interest, net of interest capitalized	$50,073	$53,596
Income taxes, net of refunds	$4,459	$21,776

See accompanying notes to unaudited condensed consolidated financial statements.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
1. GENERAL
Strategic Hotels & Resorts, Inc. (SHR and, together with its subsidiaries, the Company) was incorporated in January 2004 to acquire and asset-manage upper upscale and luxury hotels that are subject to long-term management contracts. As of September 30, 2015, the Company’s portfolio included 17 full-service hotel interests located in urban and resort markets in the United States of America. The Company considers each hotel to be a separate operating segment because the Company allocates resources and assesses performance on an individual hotel basis. The Company aggregates the individual hotels into one reportable business segment, hotel ownership.
SHR operates as a self-administered and self-managed real estate investment trust (REIT), which means that it is managed by its board of directors and executive officers. A REIT is a legal entity that holds real estate interests and, through payments of dividends to stockholders, is permitted to reduce or avoid federal income taxes at the corporate level. For SHR to continue to qualify as a REIT, it cannot operate hotels; instead it employs internationally known hotel management companies to operate its hotels under management contracts. SHR conducts its operations through its direct and indirect subsidiaries, including its operating partnership, Strategic Hotel Funding, L.L.C. (SH Funding), which currently holds substantially all of the Company’s assets. SHR is the sole managing member of SH Funding and holds approximately 99.7% of its membership units as of September 30, 2015. SHR manages all business aspects of SH Funding, including the sale and purchase of hotels, the investment in these hotels and the financing of SH Funding and its assets.
As of September 30, 2015, SH Funding owned interests in the following 17 hotels:

1. Fairmont Chicago
2. Fairmont Scottsdale Princess (a)
3. Four Seasons Hotel Austin
4. Four Seasons Jackson Hole
5. Four Seasons Resort Scottsdale at Troon North
6. Four Seasons Silicon Valley
7. Four Seasons Washington, D.C.
8. Hotel del Coronado (b)
9. InterContinental Chicago
10. InterContinental Miami
11. JW Marriott Essex House Hotel (c)
12. Loews Santa Monica Beach Hotel
13. Marriott Lincolnshire Resort (d)
14. Montage Laguna Beach
15. Ritz-Carlton Half Moon Bay
16. Ritz-Carlton Laguna Niguel
17. Westin St. Francis

(a) This property is owned by an affiliate that was partially-owned by the Company and accounted for as an unconsolidated affiliate prior to March 31, 2014 (see note 7). On March 31, 2014, the Company acquired the remaining ownership interests in the affiliate and began accounting for it as a consolidated affiliate (see note 3). One land parcel at this property is subject to a ground lease arrangement.

(b) This property is owned by an affiliate that was partially-owned by the Company and accounted for as an unconsolidated affiliate prior to June 11, 2014 (see note 7). On June 11, 2014, the Company acquired the remaining ownership interests in the affiliate and began accounting for it as a consolidated affiliate (see note 3).

(c) The Company owns 100% of this property after acquiring its joint venture partner's noncontrolling interest on July 24, 2015 (see notes 6 and 10).

(d) This property is subject to a ground lease arrangement. On August 19, 2015, the Company entered into an agreement to sell this property (see notes 4 and 5).

Agreement and Plan of Merger:

On September 4, 2015, SHR and SH Funding (together with SHR, the Company Parties), entered into an Agreement and Plan of Merger (the Merger Agreement) with BRE Diamond Hotel Holdings LLC, a Delaware limited liability company (BRE Holdings), BRE Diamond Hotel LLC, a Delaware limited liability company whose sole member is BRE Holdings (Merger Sub), and BRE Diamond Hotel Acquisition LLC, a Delaware limited liability company whose sole member is Merger Sub (Merger Opco). BRE Holdings, Merger Sub and Merger Opco (collectively, the Buyer Parties) are affiliates of Blackstone Real Estate Partners VIII L.P. (BRE Partnership VIII), an affiliate of The

Blackstone Group L.P. (Blackstone).

Pursuant to the Merger Agreement, SHR will merge with and into Merger Sub (the Company Merger), with the Merger Sub continuing as the surviving limited liability company (the Surviving Company). As a result of the Company Merger, each share

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of common stock, par value $0.01 per share (each, a Share), of SHR issued and outstanding immediately prior to the effective time of the Company Merger (the Company Merger Effective Time) will be converted into the right to receive $14.25 in cash (Merger Consideration), without interest, less any required withholding taxes (other than Shares that are owned of record by SHR, the Buyer Parties or any of their respective wholly-owned subsidiaries, which Shares shall be cancelled and cease to exist as of the Company Merger Effective Time, with no payment being made with respect thereto).

Immediately prior to the Company Merger, Merger Opco will merge with and into SH Funding (the Partnership Merger, and, together with the Company Merger, the Mergers), with SH Funding continuing as the surviving limited liability company (the Surviving Partnership). As a result of the Partnership Merger, each membership unit of SH Funding (the OP Units) issued and outstanding immediately prior to the effective time of the Partnership Merger (the Partnership Merger Effective Time) will be converted into the right to receive the Merger Consideration, without interest, less any required withholding taxes (other than (i) OP Units held by SHR immediately prior to the Partnership Merger Effective Time, which will remain outstanding as OP Units of the Surviving Partnership and (ii) OP Units held by any of the Buyer Parties or any of their wholly-owned Subsidiaries, which will be cancelled and cease to exist as of the Partnership Merger Effective Time, with no payment being made with respect thereto). As a result of the Mergers, the Surviving Company and Surviving Partnership will become wholly-owned subsidiaries of BRE Holdings.

Restricted stock units (RSUs) and performance-based RSUs issued and outstanding under SHR's Second Amended and Restated 2004 Incentive Plan will become fully vested immediately prior to the Company Merger Effective Time and will be cancelled, and, in exchange, each holder of such units will be entitled to receive a cash payment, without interest and less required withholding taxes, in an amount equal to the product of (i) the Merger Consideration and (ii) the number of units held. RSUs and performance-based RSUs that have vested but have not yet been converted to Shares will be cancelled, and, in exchange, each holder of such units will be entitled to receive a cash payment, without interest and less required withholding taxes, in an amount equal to the product of (i) the Merger Consideration and (ii) the number of units held.

The Merger Agreement, Mergers and other transactions contemplated thereby were unanimously approved by SHR's board of directors. The consummation of the Mergers is subject to customary closing conditions, including, among others, receiving the affirmative vote of the holders of a majority of the Shares at a special meeting of stockholders, which will be held on December 8, 2015. The Merger Agreement also contains customary representations, including, among others, covenants by SHR to conduct its business, in all material respects, in the ordinary course of business consistent with past practice, subject to certain exceptions, during the period between the execution of the Merger Agreement and the consummation of the Mergers.

The consummation of the Mergers is not subject to a financing condition. If the Merger Agreement is terminated by SHR under specified circumstances, SHR would be obligated to pay BRE Holdings a termination fee of $100,000,000, including if, after following certain procedures and adhering to certain restrictions, SHR's board of directors approves, and concurrently with the termination of the Merger Agreement, SHR enters into, a definitive agreement providing the implementation of a superior proposal. Under certain other circumstances under which BRE Holdings terminates the Merger Agreement, BRE Holdings would be obligated to pay SHR a termination fee of $400,000,000. The Mergers are expected to close in the fourth quarter of 2015.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation:

The accompanying unaudited condensed consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and in conformity with the rules and regulations of the SEC applicable to interim financial information. As such, certain information and footnote disclosures normally included in complete annual financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations of the SEC. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company and its results of operations and cash flows for the interim periods presented. The Company believes the disclosures made are adequate to prevent the information presented from being misleading. However, the unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements included in SHR's annual report on Form 10-K for the year ended December 31, 2014.

Basis of Consolidation:

The accompanying unaudited condensed consolidated financial statements include the accounts of SHR, its subsidiaries and other entities in which the Company has a controlling interest. If SH Funding determines that it is the holder of a variable interest in a variable interest entity (VIE), and it is the primary beneficiary, then SH Funding will consolidate the entity (see note

6). For entities that are not considered VIEs, SH Funding consolidates those entities it controls. It accounts for those entities over which it has a significant influence but does not control using the equity method of accounting. At September 30, 2015, SH Funding owned interests in the Four Seasons Residence Club Punta Mita (Four Seasons RCPM) and the Lot H5 Venture (see note 7), which are unconsolidated affiliates in the accompanying unaudited condensed consolidated financial statements that are accounted for using the equity method of accounting.

All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates:

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

Restricted Cash and Cash Equivalents:

At September 30, 2015 and December 31, 2014, restricted cash and cash equivalents included $48,360,000 and $37,486,000, respectively, that will be used for property and equipment replacement in accordance with hotel management agreements. At September 30, 2015 and December 31, 2014, restricted cash and cash equivalents also included reserves of $29,297,000 and $44,024,000, respectively, required by loan and other agreements.

Income Taxes:

SHR has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Tax Code). As a REIT, SHR generally will not be subject to U.S. federal income tax if it distributes 100% of its annual taxable income to its shareholders and complies with certain other requirements. As a REIT, SHR is subject to a number of organizational and operational requirements. If it fails to qualify as a REIT in any taxable year, SHR will be subject to U.S. federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate tax rates. Even if it qualifies for taxation as a REIT, it may be subject to foreign, state and local income taxes and to U.S. federal income tax and excise tax on its undistributed income. In addition, taxable income from SHR’s taxable REIT subsidiaries is subject to federal, foreign, state and local income taxes.

Deferred tax assets and liabilities are established for net operating loss carryforwards and temporary differences between the financial reporting basis and the tax basis of assets and liabilities at the enacted tax rates expected to be in effect when the net operating loss carryforwards are utilized and when the temporary differences reverse. The Company evaluates uncertain tax positions in accordance with applicable accounting guidance. A valuation allowance for deferred tax assets is provided if the Company believes all or some portion of the deferred tax asset may not be realized. Any increase or decrease in the valuation allowance that results from a change in circumstances that causes a change in the estimated realizability of the related deferred tax asset is included in earnings.

For the three and nine months ended September 30, 2015 and 2014, income tax expense is summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Current tax expense	$(3,207)	$—	$(5,569)	$(699)
Deferred tax (expense) benefit	(650)	(370)	(959)	83
Total income tax expense	$(3,857)	$(370)	$(6,528)	$(616)

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Per Share Data:
The Company uses the two-class method to calculate per share data for common stock and participating securities. Under the two-class method, net earnings are allocated to common stock and participating securities as if all of the net earnings for the period had been distributed. Unvested share-based compensation awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing per share data pursuant to the two-class method. The Company's RSUs are considered participating securities because they contain non-forfeitable rights to dividend equivalents. To the extent the Company has undistributed earnings, it will follow the two-class method of computing per share data.
Basic income per common share is computed by dividing the net income attributable to SHR common shareholders by the weighted average shares of common stock outstanding during each period. Diluted income per common share is computed by dividing the net income attributable to SHR common shareholders as adjusted for the impact of dilutive securities, if any, by the weighted average shares of common stock outstanding plus potentially dilutive securities. Dilutive securities may include RSUs, performance-based RSUs, and noncontrolling interests that have an option to exchange their interests to shares of SHR common stock. No effect is shown for securities that are anti-dilutive. Potentially dilutive shares are determined using the more dilutive of either the two-class method or the treasury stock method. The following table sets forth the components of the calculation of net income attributable to SHR common shareholders used for determining per share amounts for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Numerator - Basic:				
Income from continuing operations attributable to SHR	$23,261	$22,727	$45,770	$179,287
Preferred shareholder dividends	—	(1,802)	—	(11,883)
Preferred stock redemption(a)	—	—	—	(6,912)
Undistributed earnings allocated to participating securities - basic	—	(57)	(111)	(1,011)
Income from continuing operations attributable to SHR common shareholders - basic	23,261	20,868	45,659	159,481
Discontinued operations attributable to SHR	—	63	—	158,494
Net income attributable to SHR common shareholders - basic	$23,261	$20,931	$45,659	$317,975
Numerator - Diluted:				
Income from continuing operations attributable to SHR common shareholders - basic	$23,261	$20,868	$45,659	$159,481
Undistributed earnings allocated to participating securities - basic	—	57	111	1,011
Undistributed earnings allocated to participating securities - diluted	—	(51)	(110)	(948)
Adjustment for noncontrolling interests in consolidated affiliates (see note 6)	—	(1,434)	—	(4,322)
Income from continuing operations attributable to SHR common shareholders - diluted	23,261	19,440	45,660	155,222
Discontinued operations attributable to SHR	—	63	—	158,494
Net income attributable to SHR common shareholders - diluted	$23,261	$19,503	$45,660	$313,716
Denominator:				

Weighted average shares of common stock – basic (b)	279,579	248,509	276,580	225,932
Effect of dilutive securities:				
Noncontrolling interests in consolidated affiliates (see note 6)	—	9,533	—	9,533
Performance-based RSUs	2,003	2,215	2,003	2,215
RSUs	283	—	—	—
Noncontrolling interests in SHR's operating partnership	794	—	—	—
Weighted average shares of common stock - diluted	282,659	260,257	278,583	237,680

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(a) In April 2014, SHR redeemed all of the outstanding shares of its 8.50% Series A Cumulative Redeemable Preferred Stock (Series A Preferred Stock) (see note 10). In July 2014, SHR redeemed all of the outstanding shares of its 8.25% Series C Cumulative Redeemable Preferred Stock (Series C Preferred Stock) (see note 10). For purposes of calculating per share amounts for the nine months ended September 30, 2014, the difference between the fair value of the Series A Preferred Stock and the Series C Preferred Stock and the carrying amount of the Series A Preferred Stock and the Series C Preferred Stock is an adjustment to net income attributable to SHR common shareholders.
(b) Includes RSUs and performance-based RSUs of 1,002 and 1,128 at September 30, 2015 and 2014, respectively, that have vested but have not yet been issued to shares of SHR common stock.
Securities that could potentially dilute basic income per share in the future that are not included in the computation of diluted income per share because they are anti-dilutive as of September 30, 2015 and 2014 are as follows (in thousands):

	Computation For Three Months Ended September 30,		Computation For Nine Months Ended September 30,	
	2015	2014	2015	2014
Noncontrolling interests in SHR's operating partnership	—	794	794	794

Accumulated Other Comprehensive Loss:
The Company’s accumulated other comprehensive loss (OCL) results from activity related to certain derivative financial instruments and unrealized gains or losses on foreign currency translation adjustments (CTA). The following tables provide the changes in accumulated OCL for the three-month periods ended September 30, 2015 and 2014 (in thousands):

	Derivative Activity	CTA	Accumulated OCL
Balance at June 30, 2015	$ (5,326)	$ (2,260)	$ (7,586)
Other comprehensive loss before reclassifications	—	(4)	(4)
Amounts reclassified from accumulated OCL	2,459	—	2,459
Net other comprehensive income (loss)	2,459	(4)	2,455
Balance at September 30, 2015	$ (2,867)	$ (2,264)	$ (5,131)

	Derivative Activity	CTA	Accumulated OCL
Balance at June 30, 2014	$ (17,126)	$ (2,050)	$ (19,176)
Other comprehensive loss before reclassifications	—	(40)	(40)
Amounts reclassified from accumulated OCL	3,114	—	3,114
Net other comprehensive income (loss)	3,114	(40)	3,074
Balance at September 30, 2014	$ (14,012)	$ (2,090)	$ (16,102)

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables provide the changes in accumulated OCL for the nine-month periods ended September 30, 2015 and 2014 (in thousands):

	Derivative Activity	CTA	Accumulated OCL
Balance at January 1, 2015	$ (10,898)	$ (2,134)	$ (13,032)
Other comprehensive loss before reclassifications	—	(130)	(130)
Amounts reclassified from accumulated OCL	8,031	—	8,031
Net other comprehensive income (loss)	8,031	(130)	7,901
Balance at September 30, 2015	$ (2,867)	$ (2,264)	$ (5,131)

	Derivative Activity	CTA	Accumulated OCL
Balance at January 1, 2014	$ (20,616)	$ (20,829)	$ (41,445)
Other comprehensive loss before reclassifications	(341)	(156)	(497)
Amounts reclassified from accumulated OCL	6,945	18,895	25,840
Net other comprehensive income	6,604	18,739	25,343
Balance at September 30, 2014	$ (14,012)	$ (2,090)	$ (16,102)

The reclassifications out of accumulated OCL for the three and nine months ended September 30, 2015 and 2014 are as follows (in thousands):

	Amounts Reclassified from Accumulated OCL				
	Three Months Ended September 30,		Nine Months Ended September 30,		
Details about Accumulated OCL Components	2015	2014	2015	2014	Statement of Operations Line Item
Activity related to cash flow hedges	$2,459	$3,114	$8,031	$6,945	Interest expense
Activity related to CTA	$—	$—	$—	$18,895	Income from discontinued operations, net of tax

New Accounting Guidance:

In April 2015, the Financial Accounting Standards Board (FASB) issued new guidance which changes the presentation of debt issuance costs in financial statements. Under the new guidance, an entity presents debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the debt issuance costs is reported as interest expense. The new guidance is effective on January 1, 2016, with early adoption permitted for any annual or interim period for which an entity's financial statements have not yet been made available for issuance. The new guidance must be applied retrospectively to all prior periods presented. In August 2015, the FASB provided clarification on the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line of credit arrangements. The clarification notes that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line of credit arrangement. The Company expects to adopt the new guidance on January 1, 2016 and will apply the presentation guidance to all periods presented in its consolidated financial statements.

In February 2015, the FASB issued new accounting guidance which makes certain changes to both the variable interest model and the voting model, including changes to (1) the identification of variable interests (fees paid to a decision maker or service provider), (2) the variable interest entity characteristics for a limited partnership or similar entity and (3) the primary beneficiary determination. This guidance is effective beginning January 1, 2016. The Company will apply the guidance prospectively and is evaluating the effect that the guidance will have on its consolidated financial statements and related disclosures.

In August 2014, the FASB issued new accounting guidance which requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued. The standard provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity’s ability to continue as a going concern. This guidance is effective on January 1, 2017. The Company will apply the guidance prospectively and does not anticipate the guidance will have a material impact on its consolidated financial statements or disclosures.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In May 2014, the FASB issued new guidance 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. The guidance will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new guidance is effective on January 1, 2018 with early adoption permitted on January 1, 2017. The guidance permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that the guidance will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the guidance on its consolidated financial statements.

In April 2014, the FASB issued new guidance which amends the requirements for reporting discontinued operations. Under the guidance, only disposals that represent a strategic shift that has (or will have) a major effect on the entity's results of operations would qualify as discontinued operations. In addition, the guidance expands the disclosure requirements for disposals that meet the definition of a discontinued operation and requires entities to disclose information about disposals of individually significant components. The provisions became effective in the first quarter of 2015, with early adoption permitted for any annual or interim period for which an entity's financial statements have not yet been made available for issuance. The Company adopted the guidance on January 1, 2015 and will apply the guidance prospectively to disposal activity occurring after January 1, 2015.

3. INVESTMENT IN HOTEL PROPERTIES, NET

The following summarizes the Company’s investment in hotel properties as of September 30, 2015 and December 31, 2014 (which excludes the leasehold interest in the Marriott Hamburg hotel at December 31, 2014) (in thousands):

	September 30, 2015	December 31, 2014
Land	$1,010,754	$858,670
Leasehold interest	—	11,633
Buildings	2,187,615	1,964,252
Building and leasehold improvements	104,709	106,303
Site improvements	56,369	59,038
Furniture, fixtures and equipment	654,958	611,450
Improvements in progress	39,873	21,552
Total investment in hotel properties	4,054,278	3,632,898
Less accumulated depreciation	(806,048)	(804,498)
Total investment in hotel properties, net	$3,248,230	$2,828,400
Consolidated hotel properties	17	16

Hotel Acquisitions:

The Company's hotel acquisitions, as more fully described below, are consistent with the Company's strategy of focusing on the acquisition of upper upscale and luxury hotels in select urban and resort markets with strong growth characteristics and high barriers to entry where it believes there are opportunities to add value. All of the acquisitions were accounted for under the provisions of business combination guidance. The assets and liabilities of the hotels were consolidated in the Company's condensed consolidated balance sheets at the acquisition-date fair values and the results of operations were consolidated in the Company's condensed consolidated statements of operations from the date of acquisition.

Four Seasons Hotel Austin

On May 12, 2015, the Company acquired the Four Seasons Hotel Austin for a cash payment of approximately $196,258,000, which includes net working capital prorations. For the nine months ended September 30, 2015 and 2014, the Company incurred acquisition costs related to the Four Seasons Hotel Austin of $317,000 and $0, respectively, that are included in corporate expenses on the condensed consolidated statements of operations.

Montage Laguna Beach

On January 29, 2015, the Company acquired the Montage Laguna Beach resort. The acquisition was funded through the issuance of 7,347,539 shares of SHR's common stock to an affiliated designee of the seller, the assumption of a

$150,000,000 existing mortgage loan encumbering the property, and a cash payment of approximately $110,319,000, which includes net working capital prorations. For the nine months ended September 30, 2015 and 2014, the Company incurred acquisition costs related to the Montage Laguna Beach resort of $735,000 and $0, respectively, that are included in corporate expenses on the condensed consolidated statements of operations.

Four Seasons Resort Scottsdale at Troon North

On December 9, 2014, the Company acquired the Four Seasons Resort Scottsdale at Troon North for a cash payment of approximately $140,920,000, which includes net working capital prorations. For the nine months ended September 30, 2015 and 2014, the Company incurred acquisition costs related to the Four Seasons Resort Scottsdale at Troon North of $57,000 and $0, respectively, that are included in corporate expenses on the condensed consolidated statements of operations.

Hotel del Coronado

On June 11, 2014, the Company closed on the acquisition of the 63.6% equity interests in the entity that owns the Hotel del Coronado, BSK Del Partner, L.P. (the Hotel del Coronado Venture), that were previously owned by certain affiliates of Blackstone Real Estate Partners VI L.P. (BRE Partnership VI) (see note 7) for a cash payment of $210,000,000. Additionally, the Company became fully obligated under the entire $475,000,000 mortgage and mezzanine loans outstanding secured by the Hotel del Coronado. Effective as of the closing of the transaction, the Company wholly owns and consolidates the Hotel del Coronado Venture.

As part of the consolidation of the Hotel del Coronado Venture, the Company recorded $65,547,000 as a gain on the consolidation of affiliates in the condensed consolidated statement of operations for the nine months ended September 30, 2014, which represented the difference between the $120,000,000 fair value of the Company's preexisting equity interest in the Hotel del Coronado Venture and its carrying value. The fair value of the preexisting equity interest in the Hotel del Coronado Venture was determined based on an agreed upon value between the Company and a third party, both of which are market participants, which the Company considered to be a value determined in an orderly transaction in the principal market. For the nine months ended September 30, 2015 and 2014, the Company incurred acquisition costs related to the Hotel del Coronado Venture of $0 and $186,000, respectively, which were recorded as an offset to gain on consolidation of affiliates in the condensed consolidated statements of operations.

Fairmont Scottsdale Princess Hotel

On March 31, 2014, the Company closed on the acquisition of the 50% equity interests in the entities that own the Fairmont Scottsdale Princess hotel, Walton/SHR FPH Holdings, L.L.C. and FMT Scottsdale Holdings, L.L.C. (the Fairmont Scottsdale Princess Venture), that were previously owned by an affiliate of Walton Street Capital, L.L.C. (Walton Street) (see note 7) for a cash payment of $90,616,000. Additionally, the Company became fully obligated under the entire $117,000,000 mortgage loan outstanding secured by the Fairmont Scottsdale Princess hotel, which was repaid in full on April 9, 2015. Effective as of the closing of the transaction, the Company wholly owns and consolidates the Fairmont Scottsdale Princess Venture.

As part of the consolidation of the Fairmont Scottsdale Princess Venture, the Company recorded $78,191,000 as a gain on the consolidation of affiliates in the condensed consolidated statement of operations for the nine months ended September 30, 2014, which represented the difference between the $107,853,000 fair value of the Company's preexisting equity interest in the Fairmont Scottsdale Princess Venture, which included a preferred return to the Company, and its carrying value. The fair value of the preexisting equity interest in the Fairmont Scottsdale Princess Venture was determined based on an agreed upon value between the Company and a third party, both of which are market participants, which the Company considered to be a value determined in an orderly transaction in the principal market. For the nine months ended September 30, 2015 and 2014, the Company incurred acquisition costs related to the the Fairmont Scottsdale Princess Venture of $0 and $101,000, respectively, which were recorded as an offset to gain on consolidation of affiliates in the condensed consolidated statements of operations.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
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Purchase Price Allocations of Hotel Acquisitions
The amounts recognized as assets acquired and liabilities assumed for each hotel acquisition are based on the acquisition-date fair values. The following is a summary of the allocation of the fair values for the Company's acquisitions (in thousands):

	Four Seasons Hotel Austin	Montage Laguna Beach	Four Seasons Resort Scottsdale at Troon North	Hotel del Coronado Venture	Fairmont Scottsdale Princess Venture
Land	$26,890	$138,396	$37,696	$236,497	$26,732
Buildings	138,647	175,723	75,740	404,851	213,289
Site improvements	513	4,166	7,154	6,677	16,037
Furniture, fixtures and equipment	28,227	40,830	18,866	53,943	40,341
Improvements in progress	—	—	—	1,749	151
Intangible assets	2,443	1,666	552	87,710	9,859
Below market debt discount	—	1,049	—	—	2,493
Net working capital	(462)	(115)	912	13,573	6,568
Total fair value allocated	$196,258	$361,715	$140,920	$805,000	$315,470

The allocation of fair value attributable to intangible assets acquired as part of these acquisitions include (in thousands):

	Amounts	Weighted-Average Amortization Period
Intangible assets subject to amortization:		
Advanced bookings	$10,049	1 year, 5 months
Memberships value	5,973	30 years
Below market ground lease	7,656	95 years, 9 months
Below market hotel management agreement	18,822	9 years, 2 months
Parking garage easement	1,437	39 years
	43,937	
Intangible assets not subject to amortization:		
Trade name	58,293	
Total intangible assets acquired	$102,230	

Pro Forma and Other Financial Information Related to Acquisition of Hotels
The following pro forma and other financial information is provided for the acquisitions of the Fairmont Scottsdale Princess Venture and the Hotel del Coronado Venture that were completed during the nine months ended September 30, 2014, which each had a material effect on the Company's results of operations.
The impact to revenues and net income attributable to SHR common shareholders from these acquisitions for the three and nine months ended September 30, 2015 and 2014, is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Increase in revenues	$68,288	$64,765	$217,532	$102,758
Increase in net income attributable to SHR common shareholders	$2,983	$331	$21,638	$3,806

The following unaudited pro forma information is provided for informational purposes only and does not purport to represent what the Company's results of operations would have been had it completed the acquisitions on January 1, 2013, nor is it necessarily indicative of the results that may be expected in future periods. For purposes of the pro forma financial information, 20,000,000 shares of SHR common stock (a portion of the shares issued in an underwritten public offering of common stock that was completed in June 2014) are reflected as if the offering occurred on January 1, 2013 because these shares relate directly to the acquisition of the Hotel del Coronado Venture. No adjustments were made to the pro forma

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

financial information for the remaining shares of SHR common stock issued in June 2014 because they did not relate directly to the acquisitions. Additionally, for purposes of the pro forma financial information, the gains on the consolidation of affiliates recognized as a result of the acquisitions of the Hotel del Coronado Venture and the Fairmont Scottsdale Princess Venture are assumed to have been recognized on January 1, 2013. On an unaudited pro forma basis, revenues, net income attributable to SHR common shareholders and basic and diluted income attributable to SHR common shareholders per share for the three and nine months ended September 30, 2014 are as follows as if these acquisitions had occurred on January 1, 2013 (in thousands):

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Total revenue	$305,263	$878,949
Net income	$21,003	$193,586
Preferred shareholder dividends	$(1,802)	$(18,795)
Net income attributable to SHR common shareholders	$20,988	$180,152
Net income attributable to SHR common shareholders per share:		
Basic	$0.08	$0.76
Diluted	$0.07	$0.71

4. IMPAIRMENT LOSSES

The Company performed an impairment test of the long-lived assets related to the Marriott Lincolnshire Resort during the second quarter of 2015 as a result of a change in the anticipated holding period for this hotel. The Company determined that the carrying value of the hotel's long-lived assets exceeded the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the hotel. As a result of this impairment test, the Company recorded an impairment loss of $10,401,000, which represented the amount by which the carrying amount of the hotel's long-lived assets exceeded the fair value, with fair value determined based on estimated future discounted cash flows or the relevant market data as to the fair value of the asset (Level 3 inputs). On August 19, 2015, the Company entered into an agreement to sell the Marriott Lincolnshire Resort and the asset was reclassified as held for sale (see note 5). The Company continued to evaluate the asset for subsequent decreases in the fair value less cost to sell, with fair value based on an agreed upon value between the Company and a third party, both of which are market participants, which the Company considered to be a value determined in a orderly transaction in the principal market (Level 2 input). During the third quarter of 2015, the Company recognized additional impairment losses of $2,325,000 related to identified selling costs.

5. DISPOSITION OF HOTEL PROPERTIES

Effective January 1, 2015, the Company adopted new accounting guidance that amends the requirements for reporting discontinued operations. Under the new guidance, only dispositions that represent a strategic shift that has (or will have) a major effect on the Company's results of operations will qualify as discontinued operations.

Asset Held for Sale

On August 19, 2015, the Company entered into an agreement with an unaffiliated third party to sell the Marriott Lincolnshire Resort for $20,650,000. The transaction, which is subject to customary closing conditions, is expected to close in the fourth quarter of 2015.

The hotel's assets and liabilities have been classified as held for sale on the condensed consolidated balance sheet as of September 30, 2015. The significant components of assets held for sale and liabilities of assets held for sale at September 30, 2015 consist of the following (in thousands):

Investment in hotel properties, net	$18,450
Cash	1,954
Restricted cash	1,826
Accounts receivable, net of allowance for doubtful accounts	1,318
Prepaid expenses and other assets	1,126
Assets held for sale	$24,674
Accounts payable and accrued expenses	$6,499
Liabilities of assets held for sale	$6,499

The disposition of the Marriott Lincolnshire Resort does not represent a strategic shift that will have a major effect on the Company's results of operations; therefore, the hotel's results of operations are included in continuing operations for all periods presented.

2015 Disposition

On May 21, 2015, the Company, along with its joint venture partner, sold the Hyatt Regency La Jolla hotel for sales proceeds of approximately $118,293,000. The $89,228,000 mortgage loan secured by the hotel was repaid at the time of closing. A $40,594,000 gain on the sale was recorded in other income (expenses), net, in the condensed consolidated statements of operations for the nine months ended September 30, 2015. The portion of the gain attributable to the joint venture partner was $16,640,000, which is reflected in net loss (income) attributable to the noncontrolling interests in consolidated affiliates in the condensed consolidated statements of operations for the nine months ended September 30, 2015. The disposition of the Hyatt Regency La Jolla hotel does not represent a strategic shift that has had a major effect on the Company's results of operations; therefore, the hotel's results of operations are included in continuing operations for all periods presented.

2014 Dispositions

Prior to January 1, 2015, and the adoption of the new accounting guidance that changed the criteria for reporting discontinued operations, the Company sold the following hotels:

Hotel	Location	Date Sold	Sales Proceeds		Gain on sale
Four Seasons Punta Mita Resort and La Solana land parcel	Punta Mita, Mexico	February 28, 2014	$206,867,000		$63,879,000
Marriott London Grosvenor Square	London, England	March 31, 2014	$209,407,000	(a)	$92,889,000

(a) There was an outstanding balance of £67,301,000 ($112,150,000) on the mortgage loan secured by the Marriott London Grosvenor Square hotel, which was repaid at the time of closing. The net proceeds received by the Company were $97,257,000.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The results of operations of hotels sold prior to January 1, 2015 are classified as discontinued operations and segregated in the condensed consolidated statements of operations for all periods presented. The following is a summary of income from discontinued operations, net of tax, for the three and nine months ended September 30, 2014 (in thousands):

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Hotel operating revenues	$—	$17,767
Operating costs and expenses	—	11,485
Depreciation and amortization	—	1,275
Total operating costs and expenses	—	12,760
Operating income	—	5,007
Interest expense	—	(1,326)
Interest income	—	2
Loss on early extinguishment of debt	—	(272)
Foreign currency exchange gain	—	32
Income tax expense	—	(833)
Gain on sale, net of tax	63	156,492
Income from discontinued operations, net of tax	$63	$159,102

6. VARIABLE INTEREST ENTITY

On September 14, 2012, the Company formed a joint venture (the Essex House Hotel Venture) with affiliates of KSL Capital Partners, LLC (KSL) to acquire, own, manage, and operate the JW Marriott Essex House Hotel. The Company contributed cash of $89,147,000 to acquire a 51% equity interest in the Essex House Hotel Venture, and KSL contributed cash of $85,651,000 to acquire a 49% equity interest. Pursuant to the terms of the joint venture agreements establishing the Essex House Hotel Venture, at any time prior to the third anniversary of the formation of the Essex House Hotel Venture, KSL had the right to sell its equity interest in the Essex House Hotel Venture to the Company in exchange for shares of SHR's common stock, as set forth in the joint venture agreements, at a purchase price equal to KSL's net investment plus 8.0% compounded annually (the Put Option). For purposes of paying the purchase price, SHR's common stock was to be valued at the greater of (i) $7.50 per share and (ii) the 20-day volume-weighted average price per share of SHR's common stock as of the date KSL exercised the Put Option. On July 24, 2015, KSL exercised its Put Option. In connection with the exercise of the Put Option, and in accordance with the terms of the joint venture agreements, (a) SHR issued an aggregate of 6,595,449 shares of its common stock to KSL (see note 10), (b) the borrowers under the mortgage loan secured by the JW Marriott Essex House Hotel (see note 9) became wholly owned by certain indirect subsidiaries of SHR, and (c) the joint venture with KSL terminated.

Prior to the exercise of the Put Option, the Essex House Hotel Venture was jointly controlled by the Company and KSL; however, it was considered a VIE because the Company determined that it was the only holder of equity at risk due to the Put Option. The Company also determined that it was the primary beneficiary of the Essex House Hotel Venture due to the Put Option, which impacted the Company's power to direct the activities that most significantly impact the economic performance of the entity, as well as its obligation to absorb the losses and its right to receive benefits from the entity that could potentially be significant to the entity. As such, the transactions and accounts of the Essex House Hotel Venture were included in the condensed consolidated financial statements. The Company and KSL were required to fund additional contributions to the Essex House Hotel Venture, as needed, under the terms of the joint venture agreements. For the nine months ended September 30, 2015, the Company and KSL provided no additional contributions to the Essex House Hotel Venture. For the nine months ended September 30, 2014, the Company and KSL provided additional contributions of $5,958,000 and $5,723,000, respectively, to the Essex House

Hotel Venture for property improvements. For the nine months ended September 30, 2015, the Company and KSL received distributions of $33,660,000 and $32,340,000, respectively, from the Essex House Hotel Venture paid from excess cash received from the refinancing of the mortgage loan secured by the JW Marriott Essex House Hotel in December 2014.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Subsequent to the exercise of the Put Option, the Company holds 100% of the equity interests in the entities that own the JW Marriott Essex House Hotel and continues to include the transactions and accounts of the hotel in its condensed consolidated financial statements. The fair value of the consideration transferred to KSL when it exercised its Put Option exceeded the carrying value of KSL's noncontrolling interest immediately prior to the exercise by $33,489,000, which was recorded in additional paid-in capital on the Company's condensed consolidated balance sheet as of September 30, 2015. The Company retained a controlling interest in the hotel; therefore, it did not step up the JW Marriott Essex House Hotel's net assets. Additionally, the entities that own the hotel are no longer considered VIEs because there is sufficient equity at risk and the Company has the power to direct the activities that most significantly impact the economic performance of the hotel and has the obligation to absorb the losses and the right to receive benefits from the hotel.

7. INVESTMENT IN UNCONSOLIDATED AFFILIATES

The Company's investment in unconsolidated affiliates as of September 30, 2015 and December 31, 2014, includes the following (in thousands):

	2015	2014
Four Seasons RCPM	$1,587	$3,427
Lot H5 Venture	19,423	19,423
Total investment in unconsolidated affiliates	$21,010	$22,850

Four Seasons RCPM

The Company owns a 31% interest in, and acts as asset manager for, an unconsolidated affiliate, formed with two unaffiliated parties, that developed the Four Seasons RCPM, a luxury vacation home product sold in fractional and whole ownership interests on the property adjacent to the Four Seasons Punta Mita Resort in Mexico. The Company earns asset management fees and recognizes income on the percentage not owned by the Company. These fees amounted to $0 and $3,000 for the three months ended September 30, 2015 and 2014, respectively, and $0 and $21,000 for the nine months ended September 30, 2015 and 2014, respectively, and are included in other income (expenses), net, in the condensed consolidated statements of operations. During the nine months ended September 30, 2015, the Company received distributions of $1,840,000 from the Four Seasons RCPM.

Lot H5 Venture

The Company has an interest in an unconsolidated affiliate, formed with an unaffiliated party, that owns an undeveloped, oceanfront land parcel in Punta Mita, Nayarit, Mexico, known as the Lot H5 land parcel (the Lot H5 Venture). The Company has a preferred position in the Lot H5 Venture that entitles it to receive the first $12,000,000 of distributions generated from the Lot H5 land parcel with any excess distributions split equally between the Company and its partner. The Company jointly controls the Lot H5 Venture with its partner and accounts for its interest in the Lot H5 Venture as an equity method investment.

Acquisitions of Unconsolidated Affiliates:

Fairmont Scottsdale Princess Venture

Prior to March 31, 2014, the Company had a 50% ownership interest in the Fairmont Scottsdale Princess Venture. The Company jointly controlled the venture with an unaffiliated third party, Walton Street, and served as the managing member. The Company acted as asset manager and was entitled to earn a quarterly base management fee, as well as certain project management fees. The Company recognized fees of $228,000 for the nine months ended September 30, 2014, which are included in other income (expenses), net, in the condensed consolidated statements of operations.

On March 31, 2014, the Company acquired Walton Street's 50% interest in the Fairmont Scottsdale Princess Venture. The Company now wholly owns the Fairmont Scottsdale Princess Venture. The Company has consolidated the Fairmont Scottsdale Princess Venture and no longer accounts for the investment using the equity method of accounting (see note 3).

Hotel del Coronado Venture

Prior to June 11, 2014, the Company had a 36.4% ownership interest in the Hotel del Coronado Venture. BRE Partnership VI, an unaffiliated third party, had the remaining ownership interest in the Hotel del Coronado Venture and was the general partner. The Company acted as asset manager and was entitled to earn a quarterly asset management fee, certain development fees, and if applicable, certain incentive fees. The Company recognized fees of $422,000 for the nine months ended September 30, 2014, which are included in other income (expenses), net, in the condensed consolidated statements of operations.

On June 11, 2014, the Company acquired BRE Partnership VI's 63.6% interest in the Hotel del Coronado Venture. The Company now wholly owns the Hotel del Coronado Venture. The Company has consolidated the Hotel del Coronado Venture and no longer accounts for the investment using the equity method of accounting (see note 3).

8. OPERATING LEASE AGREEMENTS

Building Lease

In June 2004, the Company recorded a sale of the Marriott Hamburg hotel, and the Company’s simultaneous leaseback of the hotel was reflected as an operating lease. A deferred gain was recorded in conjunction with the sale and was being recognized as a reduction of lease expense over the life of the lease. As part of the leaseback, the Company provided a euro-denominated security deposit to secure rent payments. The Company subleased its interest in the Marriott Hamburg hotel to a third party and reflected the sublease arrangement as an operating lease and recorded lease revenue.

Effective September 1, 2015, the Company transferred its leasehold interests in the Marriott Hamburg hotel to an unaffiliated third party. As of the transfer date, the Company was released from all of its obligations under the lease arrangements and recognized the previously deferred gain of $2,680,000 during the three and nine months ended September 30, 2015 in other income (expenses), net, in the condensed consolidated statement of operations. As of September 30, 2015, the euro-denominated security deposit was €1,900,000 ($2,124,000 based on the foreign exchange rate as of September 30, 2015) and is included in prepaid expenses and other assets on the Company's condensed consolidated balance sheet. The security deposit will be released back to the Company in four equal installments over four years beginning on March 1, 2017.

Prior to the transfer of its leasehold interests in the Marriott Hamburg hotel, the Company recognized $29,000 and $52,000 of the deferred gain as an offset to lease expense for the three months ended September 30, 2015 and 2014, respectively, and for the nine months ended September 30, 2015 and 2014, recognized $116,000 and $159,000, respectively. As of December 31, 2014, the deferred gain on the sale of the Marriott Hamburg hotel recorded in accounts payable and accrued expenses on the condensed consolidated balance sheet amounted to $2,933,000. The euro-denominated security deposit at December 31, 2014, was $2,299,000 and is included in prepaid expenses and other assets on the Company’s condensed consolidated balance sheet.

Ground Leases

The Company is subject to a ground lease agreement with a third party landlord whereby it leases one parcel of land at the Fairmont Scottsdale Princess hotel, which became a consolidated property in March 2014 (see note 3). The ground lease expires in December 2109. Annual rent payments through December 2020 are equal to $1,500,000 plus a percentage of gross revenue, as defined by the terms of the ground lease agreement. Subsequent to December 2020, annual rent payments are a percentage of gross revenue.

The Company is subject to a ground lease agreement with a third party landlord whereby it leases the land for the Marriott Lincolnshire Resort. The term of the ground lease goes through December 31, 2112, and annual rent payments are a fixed amount, subject to indexation. On August 19, 2015, the Company entered into an agreement to sell the Marriott Lincolnshire Resort (see note 5).

Lease payments related to hotel ground leases are included in other hotel expenses on the condensed consolidated statements of operations.

Office Space Lease

The Company is subject to a lease agreement with a third party landlord for its office space. The office lease expires in September 2017. Lease payments related to the office space are included in corporate expenses on the condensed consolidated statements of operations.

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9. INDEBTEDNESS
Mortgages Payable, Net of Discount:
Certain subsidiaries of SHR are the borrowers under various financing arrangements. These subsidiaries are separate legal entities and their respective assets and credit are not available to satisfy the debt of SHR or any of its other subsidiaries.
Mortgages payable, net of discount, at September 30, 2015 and December 31, 2014, consisted of the following (in thousands):

Debt	Spread (a)	Initial Maturity	Maturity Including Extension Options	Balance Outstanding at September 30, 2015	Balance Outstanding at December 31, 2014
Hotel del Coronado(b)	3.65%	March 2016	March 2018	$475,000	$475,000
Loews Santa Monica Beach Hotel(c)	2.55%	May 2017	May 2021	120,000	120,000
Four Seasons Washington, D.C.(c)	2.25%	June 2017	June 2019	120,000	120,000
JW Marriott Essex House Hotel(c)	2.95%	January 2018	January 2020	225,000	225,000
Ritz-Carlton Half Moon Bay(d)	2.40%	May 2020	May 2022	115,000	—
InterContinental Chicago	Fixed	August 2021	August 2021	141,147	142,442
Montage Laguna Beach(e)	Fixed	August 2021	August 2021	150,000	—
InterContinental Miami	Fixed	September 2024	September 2024	115,000	115,000
Fairmont Scottsdale Princess(f)				—	117,000
Fairmont Chicago(g)				—	93,124
Westin St. Francis(g)				—	209,588
Hyatt Regency La Jolla(h)				—	89,247
Total mortgages payable(i)				1,461,147	1,706,401
Unamortized discount(e) (f)				(941)	(623)
Total mortgages payable, net of discount				$1,460,206	$1,705,778

(a) Interest on mortgage loans is paid monthly at the applicable spread over London Interbank Offered Rate (LIBOR) (0.19% at September 30, 2015) for all variable-rate mortgage loans. Interest on the InterContinental Chicago mortgage loan is paid monthly at an annual fixed rate of 5.61%, interest on the Montage Laguna Beach mortgage loan is paid monthly at an annual fixed rate of 3.90%, and interest on the InterContinental Miami mortgage loan is paid monthly at an annual fixed rate of 3.99%.

(b) On June 11, 2014, the Company acquired the remaining 63.6% equity interest in the Hotel del Coronado Venture, resulting in the Hotel del Coronado Venture becoming wholly-owned by the Company. In connection with the acquisition, the Company consolidated the Hotel del Coronado Venture and became fully obligated under the entire outstanding balance of the mortgage and mezzanine loans secured by the Hotel del Coronado (see note 3). The first of three extension options related to the mortgage and mezzanine loans was exercised in March 2015 leaving two, one-year extension options available, subject to certain conditions.

(c) The mortgage loan secured by the Loews Santa Monica Beach Hotel has four, one-year extension options, subject to certain conditions. The mortgage loans secured by the Four Seasons Washington, D.C. hotel and the JW Marriott Essex House Hotel each have two, one-year extension options, subject to certain conditions.

(d) On May 27, 2015, the Company closed on a new $115,000,000 mortgage loan secured by the Ritz-Carlton Half Moon Bay hotel. The mortgage loan has two, one-year extension options, subject to certain conditions.

(e) On January 29, 2015, the Company closed on the acquisition of the Montage Laguna Beach resort. In connection with the acquisition, the Company assumed the existing mortgage loan secured by the Montage Laguna Beach resort (see note 3). The Company recorded the mortgage loan at its fair value, which included a debt discount, which is being amortized as additional interest expense over the maturity period of the loan.

(f) On March 31, 2014, the Company acquired the remaining 50% equity interest in the Fairmont Scottsdale Princess Venture, resulting in the Fairmont Scottsdale Princess Venture becoming wholly-owned by the Company. In connection with the acquisition, the Company consolidated the Fairmont Scottsdale Princess Venture and became fully obligated under the entire outstanding balance of the mortgage loan secured by the Fairmont Scottsdale Princess hotel

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(see note 3). The Company recorded the mortgage loan at its fair value, which included a debt discount, which was being amortized as additional interest expense over the maturity period of the loan. On April 9, 2015, the Company repaid the entire mortgage loan balance outstanding.

(g) On May 27, 2015, the Company repaid the mortgage loans secured by the Westin St. Francis and the Fairmont Chicago hotels using proceeds from the new mortgage loan secured by the Ritz-Carlton Half Moon Bay hotel (see (d) above) and proceeds from a new unsecured term loan (as described within "—Credit Facility Arrangements" below). The Company recorded a $23,559,000 loss on early extinguishment of debt related to the Westin St. Francis loan repayment and a $10,455,000 loss on early extinguishment of debt related to the Fairmont Chicago loan repayment in the condensed consolidated statements of operations for the nine months ended September 30, 2015, which included prepayment penalties of $22,791,000 related to the Westin St. Francis loan and $10,126,000 related to the Fairmont Chicago loan, as well as the write off of unamortized deferred financing costs related to these mortgage loans.

(h) The Company sold the Hyatt Regency La Jolla hotel on May 21, 2015, and the outstanding mortgage loan secured by the hotel was repaid at closing.

(i) All of the mortgage loan agreements require maintenance of certain financial covenants, all of which the Company was in compliance with at September 30, 2015.

Credit Facility Arrangements:

On May 27, 2015, the Company entered into a new $750,000,000 senior unsecured credit facility. The unsecured credit facility is comprised of a $450,000,000 unsecured revolving credit facility and a $300,000,000 unsecured term loan. The unsecured credit facility contains an accordion feature, which provides the option to increase the borrowing capacity up to $1,000,000,000, subject to the satisfaction of customary conditions set forth in the agreement. The accordion feature may be exercised in the form of additional revolving loan or term loan commitments. SH Funding has a letter of credit sub-facility of $60,000,000 under the unsecured credit facility. The unsecured credit facility replaced the previous $300,000,000 secured credit facility that was set to initially expire in April 2018. The following summarizes key financial terms and conditions of the unsecured credit facility:

- interest on the unsecured revolving facility is payable monthly based upon a leverage-based pricing grid with annual rates ranging from LIBOR plus 1.65% to LIBOR plus 2.40% in the case of a LIBOR loan or base rate plus 0.65% to base rate plus 1.40% in the case of a base rate loan, and interest on the unsecured term loan is payable monthly based upon a leverage-based pricing grid with annual rates ranging from LIBOR plus 1.60% to LIBOR plus 2.35% in the case of a LIBOR loan or base rate plus 0.60% to base rate plus 1.35% in the case of a base rate loan;
- an unused commitment fee is payable monthly under the unsecured revolving facility based on the unused revolver balance at a rate of 0.30% per annum in the event that the unsecured revolving facility usage is less than 50% and a rate of 0.20% per annum in the event that the unsecured revolving facility usage is equal to or greater than 50%;
- the maturity date of both the unsecured revolving facility and the unsecured term loan is May 27, 2020;
- the unsecured credit facility requires that SH Funding own, at all times, a minimum of five unencumbered assets, exclusive of assets located in Mexico, and is initially supported by a pool of unencumbered assets that as of September 30, 2015, consisted of the Fairmont Chicago hotel, the Fairmont Scottsdale Princess hotel, the Four Seasons Hotel Austin, the Four Seasons Jackson Hole hotel, the Four Seasons Resort Scottsdale at Troon North, the Four Seasons Silicon Valley hotel, the Marriott Lincolnshire Resort (which the Company entered into an agreement to sell (see note 5)), the Ritz-Carlton Laguna Niguel hotel, and the Westin St. Francis hotel;
- the borrowing capacity under the unsecured revolving facility is reduced by any amounts previously borrowed and not repaid and any outstanding letters of credit;
- financial covenants include: (a) minimum corporate fixed charge coverage of 1.50, (b) maximum corporate leverage of 60%, (c) maximum secured leverage of 50%; (d) maximum secured recourse leverage of 10%, (e) maximum unsecured leverage of 60%, (f) minimum unsecured interest coverage of 2.00, and (g) minimum tangible net worth of approximately $1,834,362,000, excluding goodwill and currency translation adjustments, plus an amount equal to 75% of the net proceeds of any new issuances of our common stock, which is not used to reduce indebtedness or used in a transaction or series of transactions to redeem outstanding capital stock; and

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• certain restrictions on SHR and SH Funding's ability to pay dividends.

Other terms and conditions exist including a limitation on mortgaging the unencumbered assets and limitations on the Company's ability to incur costs for discretionary capital programs and to redeem, retire or repurchase common stock. The annual interest rate of the unsecured revolving facility at September 30, 2015, was 1.84%. The annual interest rate of the unsecured term loan at September 30, 2015 was 1.79%. The weighted average annual interest rate for the credit facility arrangements for the nine months ended September 30, 2015 was 1.83%, which included interest under the previous secured bank credit facility for a portion of the nine-month period. At September 30, 2015, the maximum availability under the unsecured credit facility was $448,000,000, which was reduced by $2,000,000 outstanding under the unsecured revolving facility and $300,000,000 outstanding under the unsecured term loan. Additionally, at September 30, 2015, there were no outstanding letters of credit. SH Funding and SHR were in compliance with all financial covenants under the unsecured credit facility at September 30, 2015.

Debt Maturity:

The following table summarizes the aggregate maturities as of September 30, 2015, for all mortgages and the Company's unsecured credit facility based on initial maturity dates and maturity dates that assume all extension options have been exercised (in thousands):

Years ending December 31,	Initial Maturities	Extended Maturities
2015 (remainder)	$655	$655
2016	477,040	2,040
2017	243,066	3,066
2018	230,033	480,033
2019	5,276	125,276
Thereafter	807,077	1,152,077
	1,763,147	1,763,147
Unamortized discount	(941)	(941)
Total	$1,762,206	$1,762,206

Interest Expense:

Total interest expense in continuing and discontinued operations includes a reduction related to capitalized interest of $329,000 and $212,000 for the three months ended September 30, 2015 and 2014, respectively, and $644,000 and $607,000 for the nine months ended September 30, 2015 and 2014, respectively. Total interest expense in continuing and discontinued operations includes amortization of deferred financing costs of $1,003,000 and $962,000 for the three months ended September 30, 2015 and 2014, respectively, and $2,830,000 and $3,516,000 for the nine months ended September 30, 2015 and 2014, respectively.

10. EQUITY AND DISTRIBUTION ACTIVITY

Common Stock:

The following table presents the changes in the issued and outstanding shares of SHR common stock since December 31, 2014 (excluding 793,618 OP Units outstanding at both September 30, 2015 and December 31, 2014, which are redeemable for shares of SHR common stock on a one-for-one basis, or the cash equivalent thereof, subject to certain restrictions and at the option of SHR) (in thousands):

Outstanding at December 31, 2014	267,436
RSUs and performance-based RSUs redeemed for shares of SHR common stock	711
Common stock issued	13,943
Outstanding at September 30, 2015	282,090

On August 19, 2015, SHR issued 6,595,449 shares of its common stock in connection with the exercise of KSL's Put Option related to the JW Marriott Essex House Hotel on July 24, 2015, valued at a price of $12.82 per share based on the 20-day

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volume-weighted average price per share of SHR's common stock as of the date KSL exercised its Put Option (see note 6 and Noncontrolling Interests below).

On January 29, 2015, the Company issued 7,347,539 shares of SHR's common stock valued at a price of $13.61 per share based on the volume-weighted average price per share of SHR's common stock over the 10 trailing days ending on an including the date that was five business days prior to January 28, 2015 to partially fund the acquisition of the Montage Laguna Beach resort (see note 3).

In February 2015, the Company entered into a stock distribution agreement whereby the Company may sell, from time to time, through certain agents, shares of SHR's common stock, having an aggregate offering price of up to $250,000,000 by means of ordinary brokers' transactions at market prices or as otherwise agreed between the Company and the agents. The net proceeds from any sale of shares of SHR's common stock are expected to be used for working capital and general corporate purposes, which may include the repayment of indebtedness. However, any transactions under the stock distribution agreement are limited by restrictions under the Merger Agreement. No shares were sold under the stock distribution agreement during the nine months ended September 30, 2015.

Distributions to Shareholders and Unitholders

On November 4, 2008, SHR’s board of directors elected to suspend the quarterly dividend to holders of shares of SHR common stock. Under the terms of the Merger Agreement, SHR may not declare or pay any other dividends to holders of SHR common stock (unless such distribution is of a minimum amount necessary for SHR to maintain REIT status or to avoid the incurrence of certain taxes) without the prior written consent of BRE Holdings.

Preferred Stock:

On January 5, 2015, the Company redeemed all of the outstanding 3,615,375 shares of it 8.25% Series B Cumulative Redeemable Preferred Stock (Series B Preferred Stock). The shares of Series B Preferred Stock were redeemed at a redemption price of $25.00 per share, or approximately $90,384,000 in total, plus accrued and unpaid dividends up to and including the redemption date in the amount of $0.028646 per share, or approximately $104,000 in total. Following the redemption, dividends on the Series B Preferred Stock ceased to accrue.

On July 3, 2014, the Company redeemed all of the outstanding 3,827,727 shares of its Series C Preferred Stock. The shares of Series C Preferred Stock were redeemed at a redemption price of $25.00 per share, or approximately $95,693,000 in total, plus accrued and unpaid dividends up to and including the redemption date in the amount of $0.01719 per share, or $66,000 in total. Following the redemption, dividends on the Series C Preferred Stock ceased to accrue.

On April 3, 2014, the Company redeemed all of the outstanding 4,148,141 shares of its Series A Preferred Stock. The shares of Series A Preferred Stock were redeemed at a redemption price of $25.00 per share, or approximately $103,704,000 in total, plus accrued and unpaid dividends up to and including the redemption date in the amount of $0.54896 per share, or $2,227,000 in total. Following the redemption, dividends on the Series A Preferred Stock ceased to accrue.

After the redemption of the Series B Preferred Stock in January 2015, there are no remaining shares of preferred stock outstanding.

Noncontrolling Interests:

On July 24, 2015, the Company acquired the 49% interest in the JW Marriott Essex House Hotel previously owned by KSL when KSL exercised its Put Option. Effective July 24, 2015, the Company wholly owns the hotel (see note 6). As part of the transaction, on August 19, 2015, SHR issued 6,595,449 shares of its common stock to KSL at a price of $12.82 per share.

The following table discloses the effects of changes in the Company’s ownership interests in the Essex House Hotel Venture on the SHR shareholder's equity (in thousands):

	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015
Net income attributable to SHR	$23,261	$45,770
Acquisition of additional ownership interests in consolidated affiliates	(33,489)	(33,489)

Change from net income attributable to SHR and transfers from noncontrolling interests	$(10,228)	$12,281

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The following tables reflect the reconciliation of the beginning and ending balances of the equity attributable to SHR and the noncontrolling owners (in thousands):

	SHR Shareholders' Equity	Nonredeemable Noncontrolling Interests	Total Permanent Shareholders' Equity	Total Redeemable Noncontrolling Interests (Temporary Equity)(a)
Balance at December 31, 2014	$1,447,457	$94,292	$1,541,749	$10,500
Common stock issued	190,847	—	190,847	554
Net income	45,770	12,820	58,590	169
CTA	(130)	—	(130)	—
Derivative activity	8,008	—	8,008	23
Share-based compensation	2,980	—	2,980	9
Preferred stock redemption	(7)	—	(7)	—
Redemption value adjustment	54	—	54	(54)
Distributions to holders of noncontrolling interests in consolidated affiliates	—	(43,741)	(43,741)	—
Adjustment of noncontrolling interest in consolidated affiliate (b)	—	(4,628)	(4,628)	—
Acquisition of noncontrolling interest in consolidated affiliate (c)	(33,489)	(56,979)	(90,468)	—
Other	257	—	257	(257)
Balance at September 30, 2015	$1,661,747	$1,764	$1,663,511	$10,944

	SHR Shareholders' Equity	Nonredeemable Noncontrolling Interests	Total Permanent Shareholders' Equity	Total Redeemable Noncontrolling Interests (Temporary Equity)(a)
Balance at December 31, 2013	$710,513	$92,355	$802,868	$7,534
Common stock issued	415,314	—	415,314	1,334
Net income (loss)	337,781	(6,112)	331,669	1,197
CTA	18,667	—	18,667	72
Derivatives and other activity	6,583	—	6,583	21
Share-based compensation	3,283	—	3,283	10
Preferred stock redemption	(199,489)	—	(199,489)	—
Declared distributions to preferred shareholders	(11,883)	—	(11,883)	—
Redemption value adjustment	436	—	436	(436)
Contributions from holders of noncontrolling interests in consolidated affiliates	—	5,723	5,723	—
Distributions to holders of noncontrolling interests in consolidated affiliates	—	(7)	(7)	—
Other	486	—	486	(486)
Balance at September 30, 2014	$1,281,691	$91,959	$1,373,650	$9,246

(a) The historical cost of the redeemable noncontrolling interests is based on the proportional relationship between the carrying value of equity associated with SHR's common shareholders relative to that of the unitholders of SH

Funding, as OP Units may be exchanged into shares of SHR common stock on a one-for-one basis. The interests held by the noncontrolling partners are stated at the greater of carrying value or their redemption value.

(b) On May 21, 2015, the Company, along with its joint venture partner, sold the Hyatt Regency La Jolla hotel. The noncontrolling interest in the consolidated affiliate that owns that Hyatt Regency La Jolla hotel was adjusted as part of the disposition transaction.

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(c) On July 24, 2015, KSL exercised its Put Option related to the JW Marriott Essex House Hotel, and SHR subsequently issued an aggregate of 6,595,449 shares of its common stock to KSL (see note 6). The fair value of the consideration transferred to KSL when it exercised its Put Option exceeded the carrying value of KSL's noncontrolling interest immediately prior to the exercise of $56,979,000 by $33,489,000.

As of September 30, 2015 and December 31, 2014, the redeemable noncontrolling interests had a redemption value of approximately $10,944,000 (based on the September 30, 2015 SHR common stock closing price of $13.79 per share) and $10,500,000 (based on the December 31, 2014 SHR common stock closing price of $13.23 per share), respectively. As of September 30, 2014 and December 31, 2013, the redeemable noncontrolling interests had a redemption value of approximately $9,246,000 (based on the September 30, 2014 SHR common stock closing price of $11.65 per share) and $7,534,000 (based on the December 31, 2013 SHR common stock closing price of $9.45 per share), respectively.

11. DERIVATIVES

The Company manages its interest rate risk by varying its exposure to fixed and variable rates while attempting to minimize its interest costs. The Company manages its variable interest rate risk through the use of interest rate derivative instruments. The Company enters into interest rate derivative instruments with high credit quality counterparties and diversifies its positions among such counterparties in order to reduce its exposure to credit losses. The Company uses interest rate caps to limit exposure on its variable-rate debt that would result from an increase in interest rates. The Company’s lenders, as stipulated in the respective loan agreements, generally require such caps. The Company records all derivatives at fair value in either prepaid expenses and other assets or accounts payable and accrued expenses in the condensed consolidated balance sheets.

The valuation of the interest rate derivative instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Company incorporates credit valuation adjustments (CVA) to appropriately reflect its own nonperformance risk and the respective counterparty’s nonperformance risk. When assessing nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Except for the CVA, all inputs used to measure fair value of the derivative financial instruments are Level 2 inputs. The Company has concluded that the inputs used to measure its CVA are Level 3 inputs. If the inputs used to measure fair value fall in different levels of the fair value hierarchy, the level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The Company reviews the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers into and out of Level 3, or between other levels, at the fair value at the beginning of the reporting period in which the changes occur. The Company assessed the impact of the CVA on the overall fair value of its derivative instruments and concluded that the CVA does not have a significant impact to the fair values as of September 30, 2015. As of September 30, 2015 and December 31, 2014, all derivative liabilities are categorized as Level 2.

Derivatives in Cash Flow Hedging Relationships:

Historically, the Company has used interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involved the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. The effective portion of changes in the fair value of derivatives designated and that qualified as cash flow hedges were recorded in accumulated OCL and was subsequently reclassified into earnings in the period that the hedged forecasted transaction affected earnings. During the nine months ended September 30, 2014, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt. The

ineffective portion of the change in fair value of the derivatives was recognized directly in earnings.
In April 2014, the Company paid $17,428,000, which included accrued and unpaid interest, to terminate its two interest rate swaps that were in cash flow hedging relationships. There was no immediate charge to earnings based on the Company's forecasted levels of LIBOR-based debt at the date of the termination. Amounts previously recorded in accumulated OCL related to these interest rate swaps will be reclassified into earnings as additional interest expense on a straight-line basis over the original maturity period of the interest rate swaps. During the next twelve months, an additional $2,867,000 will be reclassified as an increase to interest expense.

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Derivatives Not Designated as Hedging Instruments:
Derivatives not designated as hedges are not speculative and are used to manage the Company's exposure to interest rate movements and other identified risks but do not meet hedge accounting requirements. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings.
In April 2014, the Company paid $5,281,000, which included accrued and unpaid interest, to terminate its two interest rate swaps that were not designated as hedging instruments. These interest rate swaps were marked to market through earnings through the date of termination, with no additional gain or loss recognized in earnings at the date of termination.
As of September 30, 2015, the Company had the following outstanding interest rate derivatives that were not designated as hedging instruments:

Interest Rate Derivatives	Number of Instruments	Notional Amount (in thousands)
Interest rate caps	8	$1,127,000

At September 30, 2015 and December 31, 2014, the aggregate notional amount of the Company's interest rate cap agreements was $1,127,000,000 and $1,429,000,000, respectively. The Company's interest rate caps have LIBOR strike rates ranging from 2.05% to 4.55% and maturity dates ranging from November 2015 to July 2017.
Fair Values of Derivative Instruments:
The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the condensed consolidated balance sheets as of September 30, 2015 and December 31, 2014 (in thousands):

	Balance Sheet Location	Fair Value as of September 30, 2015	December 31, 2014
Derivatives not designated as hedging instruments:			
Interest rate caps	Prepaid expenses and other assets	$6	$113

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company does not have any fair value measurements using inputs based on quoted prices in active markets (Level 1) or significant unobservable inputs (Level 3) as of September 30, 2015 or December 31, 2014. The following tables reflect changes in interest rate swap liabilities categorized as Level 2 for the nine months ended September 30, 2014 (in thousands):

Balance as of January 1, 2014	$(27,921)
Interest rate swap terminations	22,325
Mark to market adjustments	5,596
Balance as of September 30, 2014	$—

Effect of Derivative Instruments on the Condensed Consolidated Statements of Operations:

The tables below present the effect of the Company's derivative financial instruments on the condensed consolidated statements of operations for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Derivatives in Cash Flow Hedging Relationships				
Interest rate swaps:				
Effective portion of loss recognized in accumulated OCL	$—	$—	$—	$(358)
Effective portion of loss reclassified into interest expense	$(2,459)	$(3,114)	$(8,031)	$(9,611)
Derivatives Not Designated as Hedging Instruments				
Interest rate swaps:				
Ineffective losses recognized in interest expense	$—	$—	$—	$(129)
Interest rate caps:				
Loss recognized in other income (expenses), net	$(6)	$(93)	$(152)	$(127)

12. SHARE-BASED EMPLOYEE COMPENSATION PLANS

Second Amended and Restated 2004 Incentive Plan:

On June 21, 2004, SHR adopted the 2004 Incentive Plan (the Plan). The Plan provided for the grant of equity-based awards in the form of, among others, options to purchase shares of SHR common stock (Options), RSUs, and stock appreciation rights (SARs), which are collectively referred to as the Awards. On May 22, 2008, SHR's shareholders approved SHR's Amended and Restated 2004 Incentive Plan (the Amended Plan). The Amended Plan: (a) added OP Units as an additional type of award; (b) adjusted the number of authorized shares from 3,000,000 shares of SHR common stock to 4,200,000 shares of SHR common stock or OP Units; (c) limited the maximum term of Options and SARs to no more than 10 years and prohibited the repricing of Options and SARs; and (d) established minimum vesting periods for certain awards. On May 19, 2011, SHR's shareholders approved SHR's Second Amended and Restated 2004 Incentive Plan (the Amended and Restated Plan) pursuant to which the number of securities authorized and reserved for issuance increased from 4,200,000 shares of SHR common stock or OP Units to 9,700,000 shares of SHR common stock or OP Units. The termination date of the Amended and Restated Plan was also extended from June 21, 2014 to December 31, 2016.

RSUs and Performance-Based RSUs:

During the nine months ended September 30, 2015, SHR granted 294,243 RSUs to certain employees, officers and directors under the Amended and Restated Plan. These RSUs represent awards of shares of SHR's common stock that will generally vest over three years.

In February 2015, SHR granted certain employees a target grant of 322,285 performance-based RSUs under a performance share plan that provides the recipient the opportunity to earn between 0.0% and 200.0% of the target (up to a maximum of 644,570 performance-based RSUs), based on the relative total shareholder return of the shares of SHR common stock, as defined in the agreement, over the period from January 2, 2015 through December 31, 2017.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company measures compensation expense for RSUs based on the per share fair market value of SHR's common stock at the date of grant, adjusted for estimated forfeitures. The Company measures compensation expense for performance-based RSUs based on a Monte Carlo simulation to estimate the fair value on the date of grant. Compensation expense for RSUs and performance-based RSUs is recognized on a straight-line basis over the service period and is included in corporate expenses in the condensed consolidated statements of operations. The Company recorded compensation expense of $1,858,000 and $1,480,000 related to RSUs and performance-based RSUs for the three months ended September 30, 2015 and 2014, respectively, and $5,598,000 and $4,330,000 for the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015, there was unrecognized compensation expense of $3,966,000 related to unvested RSUs and $5,296,000 related to performance-based RSUs granted under the Amended and Restated Plan. The unrecognized compensation expense is expected to be recognized over a weighted average period of 1.69 years for unvested RSUs and 1.88 years for performance-based RSUs.

Pursuant to the Merger Agreement, RSUs and performance-based RSUs issued and outstanding under the Amended and Restated Plan will become fully vested immediately prior to the Company Merger Effective Time and will be cancelled, and, in exchange, each holder of such units will be entitled to receive a cash payment, without interest and less required withholding taxes, in an amount equal to the product of (i) the Merger Consideration and (ii) the number of units held (see note 1). Additionally, on October 12, 2015, the Company amended its performance-based RSU awards agreements. The amendment states that if a change of control occurs prior to the end of the performance period defined in the original agreements or is publicly announced prior to and is pending as of the end of that performance period, the relative total shareholder return of the shares of SHR common stock will be determined based on the 60-day trading average closing price with the last trading day of such 60-day period ending immediately prior to the date of the public announcement of the change in control (see note 17).

13. RELATED PARTY TRANSACTIONS

On February 28, 2014, certain direct and indirect wholly-owned subsidiaries of SH Funding sold the Four Seasons Punta Mita Resort and adjacent La Solana land parcel to affiliates of Cascade Investment, L.L.C. (Cascade) for proceeds of $206,867,000 (see note 5). Cascade beneficially owned approximately 6.4% of SHR's common stock as of the closing date.

Additionally, the Company has entered into month-to-month agreements with an affiliate of Cascade pursuant to which the Company provides advisory services for certain hotels not owned by the Company. The Company currently receives fees of $46,000 per month under these agreements (see note 16).

14. COMMITMENTS AND CONTINGENCIES

Environmental Matters:
Generally, the properties acquired by the Company have been subjected to environmental site assessments. While some of these assessments have led to further investigation and sampling, none of the environmental assessments have revealed, nor is the Company aware of any environmental liability that it believes would have a material effect on its business or financial statements.

Litigation:
The Company is party to various claims and routine litigation arising in the ordinary course of business. Based on discussions with legal counsel, the Company does not believe that the results of these claims and litigation, individually or in the aggregate, will have a material effect on its business or financial statements.

Between September 10, 2015 and November 4, 2015, eight putative class action lawsuits purportedly on behalf of holders of SHR common stock were filed in the Circuit Court for Baltimore City, Maryland against members of SHR's board of directors, as well as the Buyer Parties in connection with the Mergers (see note 1). Certain of the lawsuits also name SH Funding, Blackstone, BRE Partnership VIII and/or SHR as defendants. One lawsuit also purports to bring a derivative claim on behalf of SHR.

The lawsuits generally allege that members of SHR's board of directors breached their fiduciary duties to holders of SHR common stock by, among other things: (i) failing to undertake an adequate sales process; (ii) failing to maximize stockholder value and agreeing to a sales price that undervalues SHR; (iii) implementing preclusive or coercive deal protection devices; (iv) engaging in self-dealing and failing to act in the best interests of holders of SHR common stock; and (v) failing to act with good faith, due care and loyalty. The lawsuits also allege that SHR, SH Funding, and/or certain of the Buyer Parties aided and abetted the members of SHR's board of directors in allegedly breaching their fiduciary duties. The lawsuits seek, among other things, declaration of the action as a proper class action, equitable relief that would enjoin the consummation of the Mergers, rescinding, to the extent already implemented, the Merger Agreement and the terms thereof and fees and costs associated with the litigation.

On October 26, 2015, the defendants filed an Unopposed Motion to Consolidate Actions and Designate the Consolidated Action to the Business and Technology Case Management Program and to Stay Defendants' Obligation to Answer or Otherwise Plead. Also on October 26, 2015, certain plaintiffs filed a Motion for Consolidation and Appointment of Interim Co-Lead Counsel and Interim Liaison Counsel, and a certain plaintiff also filed a Motion for Expedited Discovery as well as a First Amended Class Action Complaint ("Amended Complaint"). The Amended Complaint includes the same claims set forth in the initial complaint and includes additional allegations for breach of fiduciary duty with respect to the definitive proxy statement that SHR filed with the SEC on October 20, 2015. On October 28, 2015, the court issued an order which, inter alia, consolidated the eight pending actions under the caption In re Strategic Hotels & Resorts, Incorporated Shareholder Litigation, Case No. 24-C-15-004668.

Letters of Credit:

As of September 30, 2015, the Company provided a $75,000 letter of credit related to its office space lease. In January 2015, the Company terminated the letter of credit that was previously provided in connection with an obligation to complete property improvements at the JW Marriott Essex House Hotel.

Purchase Commitments:

Construction Contracts

The Company has executed various contracts related to construction activities. As of September 30, 2015, the Company's obligations under these contracts amounted to approximately $35,240,000. The construction activities are expected to be completed in the next twelve months.

JW Marriott Essex House Hotel Property Improvement Plan

As required by the JW Marriott Essex House Hotel management agreement, the Essex House Hotel Venture has an obligation to renovate and improve the property. As of September 30, 2015, the Essex House Hotel Venture's obligation under this agreement is approximately $411,000. The improvements are expected to be completed by December 2015.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

As of September 30, 2015 and December 31, 2014, the carrying amounts of certain financial instruments employed by the Company, including cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses were representative of their fair values because of the short-term maturity of these instruments.

At September 30, 2015 and December 31, 2014, the Company estimated the fair value of mortgages and credit facility arrangements to be approximately $1,751,000,000 and $1,726,000,000, respectively.

The Company estimated the fair value of the debt using a future discounted cash flow analysis based on the use and weighting of multiple market inputs being considered. Based on the frequency and availability of market data, all inputs used to measure the estimated fair value of the debt are Level 2 inputs. The primary sensitivity in these calculations is based on the selection of appropriate discount rates.

Derivative financial instruments have been recorded at their estimated fair values.

16. MANAGEMENT AND ADVISORY AGREEMENTS

JW Marriott Essex House Hotel Performance Guarantee

In connection with the acquisition of the JW Marriott Essex House Hotel in September 2012, the Essex House Hotel Venture entered into a management agreement with an affiliate of Marriott International, Inc. (Marriott). In connection with the management agreement, Marriott provided the Essex House Hotel Venture with a limited performance guarantee that will ensure, subject to certain limitations, a target level of net operating profit. Guarantee payments are calculated and paid to the Essex House Hotel Venture on a monthly basis based on the cumulative year-to-date results with a final true-up at the end of each year. Monthly interim payments are recorded as deferred revenue and are recognized as other hotel operating revenue at the end of the year when the final guarantee payment for the year is determined. The maximum guarantee that could be paid to the Essex House Hotel Venture during the guarantee period is $40,000,000. Any guarantee payments that exceed $20,000,000 may be recoverable by Marriott in accordance with the terms of the limited performance guarantee. Any amounts that are recoverable will be deferred and will not be recognized in earnings. Since the commencement of the performance guarantee, the Essex House Hotel Venture has received payments of $20,000,000 which have been recognized in earnings, and has received payments of an additional $12,594,000, which have been recorded as deferred revenues in accounts payable and accrued expenses on the condensed consolidated balance sheet. The guarantee period began on September 17, 2012 and will continue through the earlier of (a) December 31, 2020, (b) the date at which the maximum guarantee has been funded, or (c) the termination of the management agreement.

Asset Management and Advisory Agreements

The Company has entered into asset management and advisory agreements with third parties to provide such services to hotels not owned by the Company. The Company earns base fees and may have the potential to earn additional incentive fees. The Company earned fees of $263,000 and $255,000 for the three months ended September 30, 2015 and 2014, respectively, and fees of $788,000 and $455,000 for the nine months ended September 30, 2015 and 2014, respectively, under these agreements, which are included in other income (expenses), net, in the condensed consolidated statements of operations.

17. SUBSEQUENT EVENTS

On October 12, 2015, the Company amended its performance-based RSU awards agreements. The amendment states that if a change of control occurs prior to the end of the performance period defined in the original agreements or is publicly announced prior to and is pending as of the end of that performance period, the relative total shareholder return of the shares of SHR common stock will be determined based on the 60-day trading average closing price with the last trading day of such 60-day period ending immediately prior to the date of the public announcement of the change in control (see note 12).

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

Throughout this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section, references to “we”, “our”, “us”, and “the Company” are references to SHR together, except as the context otherwise requires, with its consolidated subsidiaries, including SH Funding.

Note on Forward-Looking Statements

This quarterly report on Form 10-Q may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which involve certain risks and uncertainties. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. These forward-looking statements are identified by their use of such terms and phrases such as “intends,” “intend,” “intended,” “goal,” “estimate,” “estimates,” “expects,” “expect,” “expected,” “project,” “projected,” “projections,” “plans,” “predicts,” “potential,” “seeks,” “anticipates,” “ “should,” “could,” “may,” “will,” “designed to,” “foreseeable future,” “believe,” “believes” and “scheduled” and similar expres Forward-looking statements reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause actual results or outcomes to differ materially from those expressed in any forward-looking statement. We caution that while we make such statements in good faith and we believe such statements are based on reasonable assumptions, including, without limitation, management's examination of historical operating trends, data contained in records and other data available from third parties, we cannot assure you that our projections will be achieved. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Our actual results may differ significantly from any results expressed or implied by these forward looking statements. Some, but not all, of the factors that might cause such a difference include, but are not limited to: the failure to satisfy conditions to completion of the Mergers (as defined below), including receipt of stockholder approval; the failure of the Mergers to close for any other reason; the occurrence of any change, effect, event, circumstance, occurrence or state of facts that could give rise to the termination of the Merger Agreement (as defined below); the outcome of the legal proceedings that have been, or may be, instituted against us and others following the announcement of our entering into the Merger Agreement; risks that the proposed merger transaction disrupts current plans and operations including potential difficulties in relationships with employees; the amounts of the costs, fees, expenses and charges relating to the Mergers; the effects of economic conditions and disruptions in financial markets upon business and leisure travel and the hotel markets in which we invest; our liquidity and refinancing demands; our ability to obtain, refinance or extend maturing debt; our ability to maintain compliance with covenants contained in our debt facilities; stagnation or deterioration in economic and market conditions, particularly impacting business and leisure travel spending in the markets where our hotels and resorts operate and in which we invest, including luxury and upper upscale product; general volatility of the capital markets and the market price of our shares of common stock; availability of capital; our ability to dispose of properties in a manner consistent with our investment strategy and liquidity needs; hostilities and security concerns, including future terrorist attacks, or the apprehension of hostilities, in each case that affect travel within or to the United States or other countries where we invest; difficulties in identifying properties to acquire and completing acquisitions; our failure to maintain effective internal control over financial reporting and disclosure controls and procedures; risks related to natural disasters; increases in interest rates and operating costs, including insurance premiums and real property taxes; contagious disease outbreaks; delays and cost-overruns in construction and development; marketing challenges associated with entering new lines of business or pursuing new business strategies; our failure to maintain our status as a real estate investment trust, or REIT; changes in the competitive environment in our industry and the markets where we invest; changes in real estate and zoning laws or regulations; legislative or regulatory changes, including changes to laws governing the taxation of REITs; changes in generally accepted accounting principles, policies and guidelines; litigation, judgments or settlements; and the risk factors set forth in our annual report on Form 10-K for the year ended December 31, 2014.

Pending Mergers

On September 4, 2015, SHR and SH Funding entered into an Agreement and Plan of Merger (the Merger Agreement) with BRE Diamond Hotel Holdings LLC, a Delaware limited liability company (BRE Holdings), BRE Diamond Hotel LLC, a Delaware limited liability company (Merger Sub), and BRE Diamond Hotel Acquisition LLC, a Delaware limited liability company (Merger Opco), whereby Merger Opco will merge with and into SH Funding, and SHR will merge with and into Merger Sub (the Mergers). See “Item 1. Financial Statements -1. General - Agreement and Plan of Merger” for a more detailed discussion of the pending Mergers. The Mergers are expected to close in the fourth quarter of 2015, although closing is subject to various closing conditions, including the approval by SHR's common stockholders, and therefore, we cannot provide any assurance that the Mergers will close in a timely manner or at all. Our ability to execute on our business plan could be

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adversely impacted by operating restrictions included in the Merger Agreement, including restrictions on acquiring new assets and raising additional capital. We have incurred and will continue to incur a variety of merger-related costs, which while not recurring in nature, will not be recoverable if the Mergers are not consummated.

On October 20, 2015, we filed a definitive proxy statement with the Securities and Exchange Commission in connection with the Mergers. See our definitive proxy statement on Schedule 14A and the risk factors contained below under the heading "Part II - Other Information - Item 1A. Risk Factors" and elsewhere in the report for a description of conditions related to the Mergers that could adversely affect our results of operations.

Overview

Our core business is to acquire and asset-manage upper upscale and luxury hotels (as defined by Smith Travel Research, an independent provider of lodging industry statistical data). We own a unique portfolio of hotels that includes complex assets with multiple revenue streams located in select urban and resort markets that have strong growth characteristics and high barriers to entry. See “Item 1. Financial Statements -1. General” for the hotel interests owned by us as of September 30, 2015. We are committed to enhancing shareholder value through a disciplined strategy that includes internal growth through exceptional asset management; conservative balance sheet management; disciplined capital allocation; and opportunistic dispositions of hotels upon completion of our value enhancement and cash flow generating strategies.

We were incorporated in Maryland in January 2004 and completed our initial public offering of our common stock in June 2004. We made an election to be taxed as a real estate investment trust (REIT) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Tax Code). A REIT is a legal entity that holds real estate interests and, through payments of dividends to stockholders, is permitted to reduce or avoid federal income taxes at the corporate level. To continue to qualify as a REIT, we cannot operate hotels; instead we employ internationally known hotel management companies to operate our hotels under management contracts. We operate as a self-administered and self-managed REIT, which means that we are managed by our board of directors and executive officers. We conduct our operations through our direct and indirect subsidiaries including our operating partnership, SH Funding, which currently holds substantially all of our assets. We are the managing member of SH Funding and hold approximately 99.7% of its membership units as of September 30, 2015. We manage all business aspects of SH Funding, including the sale and purchase of hotels, the investment in such hotels and the financing of SH Funding and its assets.

When presenting the U.S. dollar equivalent amount for any amounts expressed in a foreign currency, the U.S. dollar equivalent amount has been computed based on the exchange rate on the date of the transaction or the exchange rate prevailing on September 30, 2015, as applicable, unless otherwise noted.

Key Indicators of Operating Performance

We evaluate the operating performance of our business using a variety of operating and other information that includes financial information prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) such as total revenues, operating income (loss), net income (loss), and earnings per share, as well as non-GAAP financial information. In addition, we use other information that may not be financial in nature, including statistical information and comparative data. We use this information to measure the performance of individual hotels, groups of hotels, and/or our business as a whole. Key performance indicators that we evaluate include average daily occupancy, average daily rate (ADR), revenue per available room (RevPAR), and Total RevPAR, which are more fully discussed under “—Factors Affecting Our Results of Operations—Revenues.” We also evaluate Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), Comparable EBITDA, Funds from Operations (FFO) attributable to SHR common shareholders, FFO-Fully Diluted, and Comparable FFO as supplemental non-GAAP measures to GAAP performance measures. We provide a more detailed discussion of the non-GAAP financial measures under “—Non-GAAP Financial Measures.”

Outlook

The current cyclical recovery of the lodging industry, which is viewed as positive RevPAR growth on a trailing twelve month basis for the industry, has been characterized by steadily improving demand, despite somewhat muted macroeconomic growth, and very limited new supply, particularly in the luxury and upper upscale segment. From a historical perspective, 2015 represents the sixth year of the current lodging recovery. The previous two upcycles lasted just over nine years (June 1992 through August 2001) and over five years (June 2003 through October 2008), respectively. Supply growth on a trailing twelve month moving average during the current upcycle has been 0.8% and has consistently run below the 2% long-term average.

As we assess lodging supply and demand dynamics looking forward, we are optimistic about the long-term prospects for the current recovery continuing, particularly in the product niche and markets in which we own assets. Group bookings pace remains our best forward indicator of demand. Definite group room nights for 2016 as of September 30, 2015 for our Total

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Portfolio (which is defined within "—Factors Affecting Our Results of Operations - Total Portfolio and Same Store Assets Definitions"), excluding the Hyatt Regency La Jolla hotel, which was sold on May 21, 2015, are expected to exceed 2015 definite group room nights by 10.7% and are booked at 3.1% higher rates. With the exception of the New York City and Austin markets and select areas of the Miami market, new supply in the luxury and upper upscale segments remains very well contained in our markets and the current significant gap between hotel trading values and replacement costs bodes favorably for very limited supply growth into the future.

Factors Affecting Our Results of Operations

Acquisitions of Consolidated Properties. On May 12, 2015, we acquired the Four Seasons Hotel Austin for a cash payment of approximately $196.3 million, which includes net working capital prorations.

On January 29, 2015, we acquired the Montage Laguna Beach resort. The acquisition was funded through the issuance of 7,347,539 shares of SHR's common stock to an affiliated designee of the seller, the assumption of a $150.0 million existing mortgage loan encumbering the property, and a cash payment of approximately $110.3 million, which includes net working capital prorations.

On December 9, 2014, we acquired the Four Seasons Resort Scottsdale at Troon North for a cash payment of approximately $140.9 million, which includes net working capital prorations.

Acquisitions of Interests in Consolidated Properties. On July 24, 2015, affiliates of KSL Capital Partners, LLC (KSL) exercised their right to sell us their equity interests in a joint venture formed with us to acquire, own, manage, and operate the JW Marriott Essex House Hotel (the Essex House Hotel Venture) (the Put Option). In connection with the exercise of the Put Option, and in accordance with the terms of the joint venture agreements, (a) on August 19, 2015, we issued an aggregate of 6,595,449 shares of our common stock to KSL, (b) the borrowers under the mortgage loan secured by the JW Marriott Essex House Hotel became wholly owned by certain of our indirect subsidiaries, and (c) the joint venture with KSL terminated.

On June 11, 2014, we acquired the 63.6% equity interests in the entity that owns the Hotel del Coronado, BSK Del Partners, L.P. (the Hotel del Coronado Venture), that were previously owned by certain affiliates of Blackstone Real Estate Partners VI L.P. for a cash payment of $210.0 million. Additionally, we became fully obligated under the entire $475.0 million mortgage and mezzanine loans outstanding. Effective as of the closing of the transaction, we consolidated the Hotel del Coronado Venture.

On March 31, 2014, we acquired the 50% equity interests in the entities that own the Fairmont Scottsdale Princess hotel, Walton/SHR FPH Holdings, L.L.C. and FMT Scottsdale Holdings, L.L.C. (the Fairmont Scottsdale Princess Venture), that were previously owned by an affiliate of Walton Street Capital, L.L.C. for a cash payment of $90.6 million. Additionally, we became fully obligated under the entire $117.0 million mortgage loan, which was previously outstanding and repaid in full on April 9, 2015. Effective as of the closing of the transaction, we consolidated the Fairmont Scottsdale Princess Venture.

Sales of Interests in Consolidated Properties. On August 19, 2015, we entered into an agreement with an unaffiliated third party to sell the Marriott Lincolnshire Resort for $20.7 million. The transaction, which is subject to certain closing conditions, is expected to close in the fourth quarter of 2015.

On May 21, 2015, we, along with our joint venture partner, sold the Hyatt Regency La Jolla hotel for sales proceeds of approximately $118.3 million. The $89.2 million mortgage loan secured by the hotel was repaid at the time of closing. In accordance with newly adopted accounting guidance that amends the requirements for reporting discontinued operations, the sale of the Hyatt Regency La Jolla hotel did not represent a strategic shift that has a major effect on our results of operations; therefore, the results of operations for this property have been classified as continuing operations for all periods presented.

On March 31, 2014, we sold our interest in the Marriott London Grosvenor Square hotel for sales proceeds, net of working capital prorations and closing costs, of approximately $209.4 million. There was an outstanding balance of £67.3 million ($112.2 million) on the mortgage loan secured by the Marriott London Grosvenor Square hotel, which was repaid at the time of closing. We received net proceeds of approximately $97.3 million. The results of operations for this property have been classified as discontinued operations for all periods presented.

On February 28, 2014, we sold our interest in the Four Seasons Punta Mita Resort and the adjacent La Solana land parcel for proceeds of $206.9 million. The results of operations for this property and the adjacent land parcel have been classified as discontinued operations for all periods presented.

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Total Portfolio and Same Store Assets Definitions. We define our Total Portfolio as properties that we wholly or partially own or lease and whose operations are included in our consolidated operating results. Our Total Portfolio excludes all sold properties and assets held for sale, if any, classified as discontinued operations.

We present certain information about our hotel operating results and key performance indicators on a comparable hotel basis, which we refer to as our Same Store analysis. We define our Same Store Assets as those hotels (a) that are owned by us, and whose operations are included in our consolidated operating results and (b) for which we reported operating results throughout the entire reporting periods presented. Our Same Store Assets Portfolio excludes all sold properties and assets held for sale, if any, classified as continuing and discontinued operations. We present the results of Same Store Assets because we believe that doing so provides useful information for evaluating the period-to-period performance of our hotels and facilitates comparisons with other hotel REITs and hotel owners. In particular, these measures assist in distinguishing whether increases or decreases in revenues and/or expenses are due to operations of the Same Store Assets or from acquisition or disposition activity.

The following table summarizes the properties that are included in our Same Store Assets Portfolio and Total Portfolio for the reporting periods presented:

	Same Store Assets Portfolio		Total Portfolio	
	Three Months Ended September 30, 2015 and 2014	Nine Months Ended September 30, 2015 and 2014	Three and Nine Months Ended September 30, 2015	2014
Marriott Lincolnshire Resort (1)			X	X
Loews Santa Monica Beach Hotel	X	X	X	X
Hyatt Regency La Jolla (2)			X	X
Ritz-Carlton Half Moon Bay	X	X	X	X
InterContinental Chicago	X	X	X	X
InterContinental Miami	X	X	X	X
Fairmont Chicago	X	X	X	X
Four Seasons Washington, D.C.	X	X	X	X
Westin St. Francis	X	X	X	X
Ritz-Carlton Laguna Niguel	X	X	X	X
Four Seasons Jackson Hole	X	X	X	X
Four Seasons Silicon Valley	X	X	X	X
JW Marriott Essex House Hotel	X	X	X	X
Fairmont Scottsdale Princess	X		X	X
Hotel del Coronado	X		X	X
Four Seasons Resort Scottsdale at Troon North			X	
Montage Laguna Beach			X	
Four Seasons Hotel Austin			X	

(1) On August 19, 2015, we entered into an agreement with an unaffiliated third party to sell the Marriott Lincolnshire Resort. The transaction, which is subject to certain closing conditions, is expected to close in the fourth quarter of 2015.

(2) The results of operations for the Hyatt Regency La Jolla hotel are included in our Total Portfolio results of operations for our period of ownership. The Hyatt Regency La Jolla hotel was sold on May 21, 2015, and the results of operations are classified as continuing operations for all periods presented.

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Revenues. Substantially all of our revenue is derived from the operation of our hotels. Specifically, our revenue for the nine months ended September 30, 2015 and 2014, consisted of:

	Total Portfolio % of Total Revenues		Same Store Assets % of Total Revenues	
	2015	2014	2015	2014
Revenues:				
Rooms	52.8 %	55.1 %	56.9 %	57.4 %
Food and beverage	36.0 %	34.4 %	34.0 %	33.5 %
Other hotel operating revenue	10.9 %	10.0 %	8.7 %	8.5 %
Lease revenue	0.3 %	0.5 %	0.4 %	0.6 %
Total revenues	100.0 %	100.0 %	100.0 %	100.0 %

- Rooms revenue. Occupancy and ADR are the major drivers of rooms revenue.
- Food and beverage revenue. Occupancy, local catering and banquet events are the major drivers of food and beverage revenue.
- Other hotel operating revenue. Other hotel operating revenue consists primarily of cancellation fees, spa, telephone, parking, golf course, internet access, space rentals, retail and other guest services and is also driven by occupancy.
- Lease revenue. We subleased our interest in the Marriott Hamburg hotel to a third party and earned annual base rent plus additional rent contingent on the hotel meeting performance thresholds. Effective September 1, 2015, we transferred our leasehold interests in the Marriott Hamburg hotel to an unaffiliated third party and no longer receive rent payments.

Changes in our revenues are most easily explained by performance indicators that are used in the hotel real estate industry:

- average daily occupancy;
- ADR, which stands for average daily rate, is equal to rooms revenue divided by the number of occupied rooms;
- RevPAR, which stands for revenue per available room, is equal to rooms revenue divided by the number of rooms available; and
- Total RevPAR, which stands for total revenue per available room, is equal to the sum of rooms revenue, food and beverage revenue and other hotel operating revenue, divided by the number of rooms available.

We generate a significant portion of our revenue from two broad categories of customers, transient and group.

Our transient customers include individual or group business and leisure travelers that occupy fewer than 10 rooms per night. Transient customers for our Total Portfolio accounted for approximately 56.2% and 58.6% of the rooms sold during the nine months ended September 30, 2015 and 2014, respectively. We divide our transient customers into the following subcategories:

- Transient Leisure – This category generates the highest room rates and includes travelers that receive published rates offered to the general public that do not have access to negotiated or discounted rates.
- Transient Negotiated – This category includes travelers, who are typically associated with companies and organizations that generate high volumes of business, that receive negotiated rates that are lower than the published rates offered to the general public.

Our group customers include groups of 10 or more individuals that occupy 10 or more rooms per night. Group customers for our Total Portfolio accounted for approximately 43.8% and 41.4% of the rooms sold during the nine months ended September 30, 2015 and 2014, respectively. We divide our group customers into the following subcategories:

- Group Association – This category includes group bookings related to national and regional association meetings and conventions.
- Group Corporate – This category includes group bookings related to corporate business.
- Group Other – This category generally includes group bookings related to social, military, education, religious, fraternal and youth and amateur sports teams.

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Fluctuations in revenues, which, for our domestic hotels, historically have been correlated with changes in the United States gross domestic product (U.S. GDP), are driven largely by general economic and local market conditions, which in turn affect levels of business and leisure travel. Guest demographics also affect our revenues.

In addition to economic conditions, supply is another important factor that can affect revenues. Room rates and occupancy tend to fall when supply increases unless the supply growth is offset by an equal or greater increase in demand. One reason we target upper upscale and luxury hotels in select urban and resort markets, including major business centers and leisure destinations, is because they tend to be in locations that have greater supply constraints such as lack of available land, high development costs, long development and entitlement lead times, and brand trade area restrictions that prevent the addition of a certain brand or brands in close proximity. Nevertheless, our hotels are not insulated from competitive pressures and our hotel operators will lower room rates to compete more aggressively for guests in periods when occupancy declines.

Hotel Operating Expenses. Our hotel operating expenses for the nine months ended September 30, 2015 and 2014 consisted of the costs and expenses to provide hotel services, including:

	Total Portfolio % of Total Hotel Operating Expenses		Same Store Assets % of Total Hotel Operating Expenses	
	2015	2014	2015	2014
Hotel Operating Expenses:				
Rooms	20.0 %	21.1 %	21.6 %	22.0 %
Food and beverage	33.5 %	32.9 %	33.8 %	33.8 %
Other departmental expenses	34.3 %	33.3 %	32.0 %	31.6 %
Management fees	4.7 %	4.3 %	4.5 %	4.2 %
Other hotel expenses	7.5 %	8.4 %	8.1 %	8.4 %
Total hotel operating expenses	100.0 %	100.0 %	100.0 %	100.0 %

- Rooms expense. Occupancy is a major driver of rooms expense, which has a significant correlation with rooms revenue.
- Food and beverage expense. Occupancy, local catering and banquet events are the major drivers of food and beverage expense, which has a significant correlation with food and beverage revenue.
- Other departmental expenses. Other departmental expenses consist of general and administrative, marketing, repairs and maintenance, utilities and expenses related to earning other operating revenue.
- Management fees. We pay base and incentive management fees to our hotel operators. Base management fees are computed as a percentage of revenue. Incentive management fees are incurred when operating profits exceed levels prescribed in our management agreements.
- Other hotel expenses. Other hotel expenses consist primarily of insurance costs and property taxes.

Salaries, wages and related benefits are included within the categories of hotel operating expenses described above and represented approximately 50.1% and 50.2% of the Total Portfolio total hotel operating expenses for the nine months ended September 30, 2015 and 2014, respectively.

Most categories of variable operating expenses, such as utilities and certain labor such as housekeeping, fluctuate with changes in occupancy. Increases in RevPAR attributable to increases in occupancy are accompanied by increases in most categories of variable operating costs and expenses while increases in RevPAR attributable to increases in ADR typically only result in increases in limited categories of operating costs and expenses, such as management fees charged by our operators, which are based on hotel revenues. Therefore, changes in ADR have a more significant impact on operating margins.

Lease Expense. As a result of the sale-leaseback transaction of the Marriott Hamburg hotel, we recorded lease expense in our condensed consolidated statements of operations. In conjunction with the sale-leaseback transaction, we also recorded a deferred gain, which was amortized as an offset to lease expense. Effective September 1, 2015, we transferred our leasehold interests in the Marriott Hamburg hotel to an unaffiliated third party. As of the transfer date, we were released from all of our obligations under the lease arrangements.

Corporate Expenses. Corporate expenses include payroll and related costs, professional fees, travel expenses, office rent and transaction costs.

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Recent Events. In addition to the pending Mergers and the changes to the consolidated hotel properties and unconsolidated affiliates noted above, we expect that the following events will cause our future results of operations to differ from our historical performance:

Marriott Hamburg hotel. Effective September 1, 2015, we transferred our leasehold interest in the Marriott Hamburg hotel to an unaffiliated third party and were released from all of our obligations under the lease arrangements. We are still entitled to a euro-denominated security deposit in the amount of €1,900,000 ($2,124,000 based on the foreign exchange rate as of September 30, 2015), which will be released back to us in four equal installments over four years beginning on March 1, 2017. As a result of this transfer, we have now completed our exit from Europe.

Unsecured Credit Facility. On May 27, 2015, we entered into a new $750.0 million senior unsecured credit facility, which also includes a $250.0 million accordion feature. The unsecured credit facility is comprised of a $450.0 million unsecured revolving credit facility and a $300.0 million unsecured term loan. The unsecured credit facility replaced the $300.0 million secured credit facility that was set to initially expire in April 2018. Interest on the unsecured revolving credit facility is payable monthly based upon a leverage-based pricing grid with annual rates ranging from London Interbank Offered Rate (LIBOR) plus 1.65% to LIBOR plus 2.40%. Interest on the unsecured term loan is also payable monthly based upon a leverage-based pricing grid with annual rates ranging from LIBOR plus 1.60% to LIBOR plus 2.35%. The facility expires on May 27, 2020. See "—Liquidity and Capital Resources—Unsecured Credit Facility."

Mortgage Loan Agreements. On May 27, 2015, we closed on a new $115.0 million mortgage loan secured by the Ritz-Carlton Half Moon Bay hotel. Interest on the loan is payable monthly at an annual rate of LIBOR plus 2.40%, and the loan has a five-year initial term with two, one-year extension options, subject to certain conditions.

On May 27, 2015, we also repaid the previously outstanding $209.6 million mortgage loan secured by the Westin St. Francis hotel and the $93.1 million mortgage loan secured by the Fairmont Chicago hotel that were cross-collateralized and set to mature in June 2017 using proceeds from the new mortgage loan secured by the Ritz-Carlton Half Moon Bay hotel and proceeds from the new unsecured term loan.

On April 9, 2015, we repaid the entire balance outstanding of the mortgage loan secured by the Fairmont Scottsdale Princess hotel.

On December 30, 2014, the Essex House Hotel Venture refinanced the mortgage loan secured by the JW Marriott Essex House Hotel and entered into a new $225.0 million limited recourse loan agreement. The initial mortgage loan maturity was extended to January 2018 with two, one-year extension options, subject to certain conditions. The interest rate decreased to an annual rate of LIBOR plus 2.95% from the previous annual rate of LIBOR plus 4.00%, subject to a 0.75% LIBOR floor. On July 24, 2015, KSL exercised its Put Option related to the Essex House Hotel Venture, and the borrowers under the mortgage loan secured by the JW Marriott Essex House Hotel became wholly owned by certain of our indirect subsidiaries.

On July 7, 2014, we paid off the outstanding balance of an $85.0 million mortgage loan secured by the InterContinental Miami hotel. On August 29, 2014, we closed on a new $115.0 million mortgage loan secured by the InterContinental Miami hotel. The interest rate changed to an annual fixed rate of 3.99% from the previous annual rate of LIBOR plus 3.50%. The loan has a maturity date of September 6, 2024.

On June 30, 2014, we refinanced the mortgage loan secured by the Four Seasons Washington, D.C. hotel. The principal was reduced to $120.0 million and the annual interest rate was reduced to LIBOR plus 2.25% from LIBOR plus 3.15%. The loan has an initial maturity date of June 30, 2017 with two, one-year extension options, subject to certain conditions.

On May 29, 2014, we refinanced the mortgage loan secured by the Loews Santa Monica Beach Hotel. The principal was increased to $120.0 million and the annual interest rate was reduced to LIBOR plus 2.55% from LIBOR plus 3.85%. The loan has an initial maturity date of May 29, 2017 with four, one-year extension options, subject to certain conditions.

Preferred Stock Redemptions. On January 5, 2015, we redeemed all of the outstanding 3,615,375 shares of our 8.25% Series B Cumulative Redeemable Preferred Stock (Series B Preferred Stock). The shares of the Series B Preferred Stock were redeemed at a redemption price of $25.00 per share, plus accrued and unpaid dividends from January 1, 2015 up to and including January 5, 2015 in the amount of $0.028646 per share, for a total redemption cost of approximately $90.5 million. Following the redemption, dividends on the Series B Preferred Stock ceased to accrue. On July 3, 2014, we redeemed all of the outstanding 3,827,727 shares of our 8.25% Series C Cumulative Redeemable Preferred Stock (Series C Preferred Stock). The shares of the Series C Preferred Stock were redeemed at a redemption price of $25.00 per share, plus accrued and unpaid dividends from July 1, 2014 up to and including July 3, 2014 in the amount of $0.01719 per

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share, for a total redemption cost of approximately $95.8 million. Following the redemption, dividends on the Series C Preferred Stock ceased to accrue.

On April 3, 2014, we redeemed all of the outstanding 4,148,141 shares of our 8.50% Series A Cumulative Redeemable Preferred Stock (Series A Preferred Stock). The shares of the Series A Preferred Stock were redeemed at a redemption price of $25.00 per share, plus accrued and unpaid dividends up to and including April 3, 2014 in the amount of $0.54896 per share, for a total redemption cost of approximately $106.0 million. Following the redemption, dividends on the Series A Preferred Stock ceased to accrue.

Common Stock. In December 2014, we completed an underwritten public offering of common stock by issuing 20.0 million shares at a price of $12.57 per share. After transaction expenses, we raised net proceeds of approximately $250.9 million. These proceeds were used to fund the acquisition of the Four Seasons Resort Scottsdale at Troon North, to redeem all of the issued and outstanding shares of our Series B Preferred Stock on January 5, 2015, and for general corporate purposes, including, without limitation, reducing debt and funding capital expenditures and working capital.

In June 2014, we completed an underwritten public offering of common stock by issuing 41.4 million shares at a public offering price of $10.50 per share. After underwriting discounts and commissions and transaction expenses, we raised net proceeds of approximately $416.7 million. These proceeds were used to fund the acquisition of the remaining equity interest in the Hotel del Coronado, to redeem all of the issued and outstanding shares of our Series C Preferred Stock, and for general corporate purposes, including, without limitation, reducing our borrowings under our credit facility arrangements, repaying other debt and funding capital expenditures and working capital.

Interest Rate Swap Terminations. On April 21, 2014, we paid $22.7 million, including accrued and unpaid interest, to terminate all of our remaining interest rate swaps with a combined notional amount of $400.0 million.

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Comparison of Three Months Ended September 30, 2015 to Three Months Ended September 30, 2014

Operating Results

The following table presents the operating results for the three months ended September 30, 2015 and 2014, including the amount and percentage change in these results between the two periods of our Total Portfolio and Same Store Assets (in thousands, except operating data).

	Total Portfolio				Same Store Assets			
	2015	2014	Change ($) Favorable/ (Unfavorable)	Change (%) Favorable/ (Unfavorable)	2015	2014	Change ($) Favorable/ (Unfavorable)	Change (%) Favorable/ (Unfavorable)
Revenues:								
Rooms	$198,114	$176,133	$21,981	12.5 %	$170,106	$166,891	$ 3,215	1.9 %
Food and beverage	115,296	96,642	18,654	19.3 %	93,710	89,522	4,188	4.7 %
Other hotel operating revenue	40,346	31,224	9,122	29.2 %	31,599	28,032	3,567	12.7 %
Lease revenue	678	1,264	(586)	(46.4)%	678	1,264	(586)	(46.4)%
Total revenues	354,434	305,263	49,171	16.1 %	296,093	285,709	10,384	3.6 %
Operating Costs and Expenses:								
Hotel operating expenses	258,714	221,770	(36,944)	(16.7)%	212,278	205,735	(6,543)	(3.2)%
Lease expense	682	1,215	533	43.9 %	682	1,215	533	43.9 %
Depreciation and amortization	39,633	32,932	(6,701)	(20.3)%	31,540	30,344	(1,196)	(3.9)%
Impairment losses	2,325	—	(2,325)	(100.0)%	—	—	—	— %
Corporate expenses	10,709	5,405	(5,304)	(98.1)%	—	—	—	— %
Total operating costs and expenses	312,063	261,322	(50,741)	(19.4)%	244,500	237,294	(7,206)	(3.0)%
Operating income	42,371	43,941	(1,570)	(3.6)%	$51,593	$48,415	$ 3,178	6.6 %
Interest expense, net	(18,572)	(21,798)	3,226	14.8 %				
Loss on early extinguishment of debt	—	(609)	609	100.0 %				
Equity in losses of unconsolidated affiliates	—	(4)	4	100.0 %				
Foreign currency exchange gain (loss)	4	(69)	73	105.8 %				
Loss on consolidation of affiliates	—	(15)	15	100.0 %				
Other income (expenses), net	2,746	(136)	2,882	2,119.1 %				
Income before income taxes and discontinued operations	26,549	21,310	5,239	24.6 %				
Income tax expense	(3,857)	(370)	(3,487)	(942.4)%				
	22,692	20,940	1,752	8.4 %				

Income from continuing operations				
Income from discontinued operations, net of tax	—	63	(63)	(100.0)%
Net income	22,692	21,003	1,689	8.0%
Net income attributable to the noncontrolling interests in SHR's operating partnership	(65)	(67)	2	3.0%
Net loss attributable to the noncontrolling interests in consolidated affiliates	634	1,854	(1,220)	(65.8)%
Net income attributable to SHR	$23,261	$22,790	$471	2.1%
Reconciliation of Same Store Assets Operating Income to Total Portfolio Operating Income:				
Same Store Assets operating income	$51,593	$48,415	$ 3,178	6.6%
Corporate expenses	(10,709)	(5,405)	(5,304)	(98.1)%
Corporate depreciation and amortization	(126)	(124)	(2)	(1.6)%
Non-Same Store Assets operating income	1,613			