Sunstone Hotel Investors, Inc.
Form 10-Q
August 08, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

OR

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

For the transition period from to

Commission file number 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**20-1296886**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
903 Calle Amanecer, Suite 100 San Clemente, California	**92673**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (949) 369-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

59,821,072 shares, of Common Stock, $0.01 par value, as of July 31, 2007

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SUNSTONE HOTEL INVESTORS, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended June 30, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	June 30, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 51,245	$ 29,029
Restricted cash	59,693	65,669
Accounts receivable, net	48,481	41,695
Due from affiliates	1,315	1,383
Inventories	3,073	3,089
Prepaid expenses	5,824	7,006
Total current assets	169,631	147,871
Investment in hotel properties, net	2,818,465	2,477,514
Other real estate, net	14,314	14,673
Investment in unconsolidated joint venture	37,659	68,714
Deferred financing costs, net	13,348	7,381
Goodwill	17,365	22,249
Other assets, net	13,565	21,971
Total assets	$ 3,084,347	$ 2,760,373
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 30,642	$ 31,912
Accrued payroll and employee benefits	15,675	12,338
Due to SHP	15,199	16,607
Dividends payable	25,196	23,826
Other current liabilities	35,534	32,354
Current portion of notes payable	21,326	23,231
Total current liabilities	143,572	140,268
Notes payable, less current portion	1,726,463	1,476,597
Other liabilities	6,641	6,429
Total liabilities	1,876,676	1,623,294
Commitments and contingencies *(Note 12)*		
Preferred stock, Series C Cumulative Convertible Redeemable Preferred Stock, $0.01 par value 4,102,564 shares authorized, issued and outstanding at June 30, 2007 and December 31, 2006, liquidation preference of $24.375 per share	99,396	99,296
Stockholders equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, 8.0% Series A Cumulative Redeemable Preferred Stock, 7,050,000 shares issued and outstanding at June 30, 2007 and December 31, 2006, stated at	176,250	176,250

liquidation preference of $25.00 per share		
Common stock, $0.01 par value, 500,000,000 shares authorized, 59,291,944 shares issued and outstanding at June 30, 2007 and 57,775,089 shares issued and outstanding at December 31, 2006	593	578
Additional paid in capital	998,912	958,591
Retained earnings	144,845	65,545
Cumulative dividends	(212,325)	(163,181)
Total stockholders equity	1,108,275	1,037,783
Total liabilities and stockholders equity	$ 3,084,347	$ 2,760,373

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED INCOME STATEMENTS

(In thousands, except per share data)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
REVENUES				
Room	$ 177,080	$ 144,032	$ 325,920	$ 261,488
Food and beverage	74,472	59,667	139,536	114,973
Other operating	19,846	17,853	37,035	34,493
Total revenues	271,398	221,552	502,491	410,954
OPERATING EXPENSES				
Room	38,613	31,016	72,722	57,620
Food and beverage	52,409	41,191	99,596	79,309
Other operating	10,403	9,307	20,186	18,773
Advertising and promotion	13,891	11,999	26,981	22,857
Repairs and maintenance	9,959	8,606	19,229	16,351
Utilities	8,672	7,585	16,994	15,123
Franchise costs	9,755	7,664	17,529	13,333
Property general and administrative	30,247	25,157	56,890	47,778
Property tax, ground lease, and insurance	14,845	12,450	28,630	23,155
Corporate overhead	9,475	4,502	16,806	10,374
Depreciation and amortization	29,237	22,722	55,749	42,643
Total operating expenses	227,506	182,199	431,312	347,316
Operating income	43,892	39,353	71,179	63,638
Equity in losses of unconsolidated joint venture	(110)		(1,461)	
Interest and other income	796	513	1,475	1,611
Interest expense	(27,026)	(21,889)	(49,749)	(47,572)
Income from continuing operations	17,552	17,977	21,444	17,677
Income from discontinued operations	56,920	4,075	57,856	22,200
NET INCOME	74,472	22,052	79,300	39,877
Preferred stock dividends and accretion	(5,188)	(5,154)	(10,375)	(9,241)
Undistributed income allocated to Series C Preferred Stock	(3,113)		(1,799)	
INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 66,171	$ 16,898	$ 67,126	$ 30,636
Basic per share amounts:				
Income from continuing operations available to common stockholders	$ 0.21	$ 0.22	$ 0.19	$ 0.15
Income from discontinued operations	0.89	0.07	0.95	0.39
Basic income available to common stockholders per common share	$ 1.10	$ 0.29	$ 1.14	$ 0.54

Diluted per share amounts:				
Income from continuing operations available to common stockholders	$ 0.22	$ 0.22	$ 0.23	$ 0.15
Income from discontinued operations	0.87	0.07	0.90	0.39
Diluted income available to common stockholders per common share	$ 1.09	$ 0.29	$ 1.13	$ 0.54
Weighted average common shares outstanding:				
Basic	60,230	57,700	59,022	56,753
Diluted	64,962	58,169	63,679	57,181
Dividends paid per common share	$ 0.32	$ 0.30	$ 0.64	$ 0.60

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands, except share data)

	Preferred Stock		Common Stock					
	Number of Shares	Amount	Number of Shares	Amount	Additional Paid in Capital	Retained Earnings	Cumulative Dividends	Total
Balance at December 31, 2006 (audited)	7,050,000	$ 176,250	57,775,089	$ 578	$ 958,591	$ 65,545	$ (163,181)	$ 1,037,783
Net proceeds from sale of common stock (unaudited)			4,000,000	40	110,388			110,428
Vesting of restricted common stock (unaudited)			121,624	1	3,105			3,106
Repurchase of outstanding common stock (unaudited)			(2,604,769)	(26)	(73,072)			(73,098)
Common dividends declared and payable at $0.64 per share (unaudited)							(38,870)	(38,870)
Series A preferred dividends declared and payable at $1.00 per share (unaudited)							(7,050)	(7,050)
Series C preferred dividends declared and payable at $0.786 per share (unaudited)							(3,224)	(3,224)
Accretion of discount on Series C preferred stock (unaudited)					(100)			(100)
Net income (unaudited)						79,300		79,300
Balance at June 30, 2007 (unaudited)	7,050,000	$ 176,250	59,291,944	$ 593	$ 998,912	$ 144,845	$ (212,325)	$ 1,108,275

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 79,300	$ 39,877
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	4	266
Gain on sale of hotel properties and vacant land	(55,938)	(16,653)
Loss on early extinguishment of debt		9,976
Depreciation	57,647	48,771
Amortization of deferred franchise fees and other intangibles	211	45
Amortization of deferred financing costs	1,012	2,962
Amortization of loan premiums	(133)	(2,353)
Amortization of deferred stock compensation	3,106	1,816
Equity in losses of unconsolidated joint venture	1,461	
Changes in operating assets and liabilities:		
Restricted cash	9,511	(5,828)
Accounts receivable	(6,790)	(8,357)
Due from affiliates	68	383
Inventories	16	(354)
Prepaid expenses and other assets	621	4,786
Accounts payable and other liabilities	4,575	4,096
Accrued payroll and employee benefits	3,337	1,872
Due to SHP	(1,408)	(242)
Discontinued operations		77
Net cash provided by operating activities	96,600	81,140
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of hotel properties and other real estate	147,860	25,793
Restricted cash replacement reserve	(3,535)	(3,386)
Proceeds received from sale of note receivable	29,047	
Cash received from unconsolidated joint venture	547	
Acquisitions of hotel properties	(403,092)	(438,668)
Additions to hotel properties and other real estate	(75,748)	(66,202)
Net cash used in investing activities	(304,921)	(482,463)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from preferred stock offerings		55,000
Payment of preferred stock offering costs		(692)
Proceeds from common stock offering	110,895	158,400
Payment of common stock offering costs	(467)	(343)
Payment for repurchases of outstanding common stock	(73,098)	
Proceeds from notes payable	426,000	443,542
Payments on notes payable	(178,039)	(211,910)
Payments of deferred financing costs	(6,979)	(3,163)
Dividends paid	(47,775)	(41,384)

Net cash provided by financing activities		230,537		399,450
Net increase (decrease) in cash and cash equivalents		22,216		(1,873)
Cash and cash equivalents, beginning of period		29,029		17,538
Cash and cash equivalents, end of period	$	51,245	$	15,665
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid for interest	$	50,606	$	48,307
NONCASH FINANCING ACTIVITY				
Assumption of debt in connection with acquisitions of hotel properties	$		$	81,000
Dividends payable	$	25,196	$	22,672

See accompanying notes to consolidated financial statements.

SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sunstone Hotel Investors, Inc. (the Company) was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company, through its 100.0% controlling interest in Sunstone Hotel Partnership, LLC (the Operating Partnership), of which the Company is the sole managing member, and the subsidiaries of the Operating Partnership, including Sunstone Hotel TRS Lessee, Inc. (the TRS Lessee) and its subsidiaries, is currently engaged in owning, acquiring, asset managing, renovating and selling hotel properties. The Company operates as a real estate investment trust (REIT) for federal income tax purposes.

As a REIT, certain tax laws limit the amount of non-qualifying income the Company can earn, including income derived directly from the operation of hotels. As a result, the Company leases all of its hotel properties to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company s hotels. As of June 30, 2007, the Company owned 46 hotels, and its third-party managers included Sunstone Hotel Properties, Inc., a division of Interstate Hotels & Resorts, Inc. (SHP), the manager of 27 of the Company s hotels; Marriott International, Inc. (Marriott), manager of 13 of the Company s hotels; and Hyatt Corporation (Hyatt), Fairmont Hotels & Resorts (Fairmont), Hilton Hotels Corporation (Hilton) and Starwood Hotels & Resorts Worldwide, Inc. (Starwood), collectively manager of six of the Company s properties. In addition to its leased hotels, the Company has a 38% equity interest in a joint venture that owns the Doubletree Times Square, located in New York City, New York.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of June 30, 2007 and December 31, 2006, and for the three and six months ended June 30, 2007 and June 30, 2006, include the accounts of the Company, the Operating Partnership and the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated.

The accompanying interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and in conformity with the rules and regulations of the Securities and Exchange Commission. In the Company s opinion, the interim financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim financial statements. These financial statements should be read in conjunction with the financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006, filed with the Securities and Exchange Commission on February 8, 2007.

Application of New Accounting Standards

The Company has adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48), as of January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement 109, Accounting for Income Taxes , and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Based on its evaluation, the Company has concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. The Company s evaluation was performed for the tax years ended December 31, 2004, 2005 and 2006. These are the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2007. The Company may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. In the event the Company receives an assessment for interest and/or penalties, it will be classified in the financial statements as tax expense.

Use of Estimates

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

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Reporting Periods

The results the Company reports in its consolidated income statements are based on results reported to the Company by its hotel managers. These hotel managers use different reporting periods. Marriott uses a fiscal year ending on the Friday closest to December 31 and reports twelve weeks of operations for each of the first three quarters of the year and sixteen or seventeen weeks of operations for the fourth quarter of the year. The Company s other hotel managers report operations on a standard monthly calendar. The Company has elected to adopt quarterly close periods of March 31, June 30 and September 30, and an annual year end of December 31. As a result, the Company s 2007 results of operations for the Marriott managed hotels include results from December 30 through March 23 for the first quarter, March 24 through June 15 for the second quarter, June 16 through September 7 for the third quarter, and September 8 through December 28 for the fourth quarter. The Company s 2006 results of operations for the Marriott managed hotels include results from December 31 through March 24 for the first quarter, March 25 through June 16 for the second quarter, June 17 through September 8 for the third quarter, and September 9 through December 29 for the fourth quarter.

Accounts Receivable

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes receivables from customers who utilize the Company s laundry facilities in Salt Lake City, Utah, and Rochester, Minnesota. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company s accounts receivable at June 30, 2007 and December 31, 2006 include an allowance for doubtful accounts of $0.5 million and $0.6 million, respectively.

Deferred Financing Costs

Interest expense related to the amortization of deferred financing costs was $0.7 million and $2.0 million for the three months ended June 30, 2007 and 2006, respectively, and $1.0 million and $3.0 million for the six months ended June 30, 2007 and 2006, respectively.

Earnings Per Share

The Company applies the two-class method as required by EITF No. 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share (EITF No. 03-6). EITF No. 03-6 requires the net income per share for each class of stock (common stock and convertible preferred stock) to be calculated assuming 100% of the Company s net income are distributed as dividends to each class of stock based on their contractual rights. To the extent the Company has undistributed earnings in any calendar quarter, the Company will follow the two-class method of computing earnings per share.

Basic income available to common stockholders per share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted income available to common stockholders per share of common stock is computed based on the weighted average number of shares of common stock outstanding during each period, plus convertible redeemable preferred stock and unvested restricted stock awards considered outstanding during the period, in accordance with SFAS No. 128, Earnings per Share .

The following table sets forth the computation of basic and diluted earnings per common share (in thousands, except per share data):

	Three Months Ended June 30, 2007 (Unaudited)	Three Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Numerator for basic earnings available to common stockholders:				
Net income	$ 74,472	$ 22,052	$ 79,300	$ 39,877
Less preferred dividends and accretion	(5,188)	(5,154)	(10,375)	(9,241)
Less undistributed income allocated to Series C Preferred Stock	(3,113)		(1,799)	
Numerator for basic earnings available to common stockholders	$ 66,171	$ 16,898	$ 67,126	$ 30,636

Numerator for diluted earnings available to common stockholders:								
Net income	$	74,472	$	22,052	$	79,300	$	39,877
Less Series A preferred dividends		(3,525)		(3,492)		(7,050)		(5,917)
Less Series C preferred dividends and accretion				(1,662)				(3,324)
Numerator for diluted earnings available to common stockholders	$	70,947	$	16,898	$	72,250	$	30,636
Denominator:								
Weighted average basic common shares outstanding		60,230		57,700		59,022		56,753
Conversion of Series C Preferred Stock		4,102				4,102		
Unvested restricted stock awards		630		469		555		428
Weighted average diluted common shares outstanding		64,962		58,169		63,679		57,181
Basic earnings available to common stockholders per common share	$	1.10	$	0.29	$	1.14	$	0.54
Diluted earnings available to common stockholders per common share	$	1.09	$	0.29	$	1.13	$	0.54

For the three and six months ended June 30, 2007, shares of the Company s Series C preferred stock are reflected in the above calculation on an as-converted basis as this presentation is more dilutive. For the three and six months ended June 30, 2006, shares of the Company s Series C preferred stock are not reflected in the above calculation as their effect would have been anti-dilutive.

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Reclassifications

Certain amounts included in the financial statements for prior periods have been reclassified to conform to the most recent financial statement presentation.

3. Investment in Hotel Properties

Investment in hotel properties consisted of the following (in thousands):

	June 30, 2007 (Unaudited)	December 31, 2006
Land	$ 429,666	$ 384,242
Buildings and improvements	2,372,778	2,067,930
Fixtures, furniture and equipment	283,394	264,870
Intangibles	35,736	35,736
Franchise fees	1,396	1,382
Construction in process	28,870	30,808
	3,151,840	2,784,968
Accumulated depreciation and amortization	(333,375)	(307,454)
	$ 2,818,465	$ 2,477,514

In January 2007, the Company purchased the 499-room LAX Renaissance located in Los Angeles, California for $65.2 million and retained Marriott as manager. This hotel s results of operations from the acquisition date of January 4, 2007 through Marriott s second quarter ended June 15, 2007, have been included in the Company s income statements.

In March 2007, the Company purchased the 402-room Marriott Long Wharf located in Boston, Massachusetts for $228.5 million and retained Marriott as manager. This hotel s results of operations from the acquisition date of March 23, 2007 through Marriott s second quarter ended June 15, 2007, have been included in the Company s income statements. The allocation of the purchase price is preliminary because the Company is in the process of obtaining a purchase price allocation from an independent third party. The Company has included depreciation expense based on this preliminary purchase price allocation.

In April 2007, the Company paid an additional $0.8 million as part of a purchase price true-up for the Marriott Del Mar located in San Diego, California, originally purchased by the Company in January 2006.

In May 2007, the Company purchased the 464-room Marriott Boston Quincy Hotel located in Quincy, Massachusetts for a purchase price of $117.0 million and retained Marriott as manager. This hotel s results of operations from the acquisition date of May 1, 2007 through Marriott s second quarter ended June 15, 2007, have been included in the Company s income statements. The allocation of the purchase price is preliminary because the Company is in the process of obtaining a purchase price allocation from an independent third party. The Company has included depreciation expense based on this preliminary purchase price allocation.

Acquired properties are included in the Company s results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the Company s results as if the acquisitions had occurred on the first day of the fiscal year presented. In the Company s opinion, all significant adjustments necessary to reflect the effects of the

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acquisitions have been made; however, depreciation expense for the Marriott Long Wharf and the Marriott Boston Quincy hotels were based on preliminary purchase price allocations (in thousands, except per share data):

	Three Months Ended June 30, 2007 (Unaudited)	Three Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Revenues	$ 274,117	$ 245,169	$ 519,039	$ 453,229
Income available to common stockholders from continuing operations	$ 12,840	$ 14,239	$ 8,956	$ 7,767
Income per diluted share available to common stockholders from continuing operations	$ 0.21	$ 0.24	$ 0.15	$ 0.14

4. Discontinued Operations

As part of a strategic plan to dispose of non-core hotel assets, the Company sold six hotel properties in 2007 for net proceeds of $147.4 million and a net gain of $56.0 million. The Company sold a total of 15 hotel properties in 2006. During the first six months of 2006, the Company sold one hotel for net proceeds of $25.5 million and a net gain on sale of $16.4 million. In addition, the Company received payment in full for its $4.7 million note receivable generated from its 2004 sale of the San Marcos Resort & Conference Center in Chandler, Arizona. This note was previously written down to market value, resulting in a reserve of $350,000, expensed during the fourth quarter of 2004. Upon full payment of this note in the first quarter of 2006, this reserve was reversed. Additionally, an expense of $92,000 relating to the termination of the management agreement at the hotel was paid. These 21 hotel properties met the held for sale and discontinued operations criteria in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*.

The following sets forth the discontinued operations for the three and six months ended June 30, 2007 and 2006, related to hotel properties that have been sold (in thousands):

	Three Months Ended June 30, 2007 (Unaudited)	Three Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Operating revenues	$ 9,131	$ 27,249	$ 17,884	$ 51,216
Operating expenses	(6,136)	(19,007)	(11,870)	(37,080)
Interest expense	(1,001)	(1,047)	(2,010)	(2,416)
Depreciation and amortization expense	(1,035)	(3,120)	(2,109)	(6,173)
Gain on sale of hotels	55,961		55,961	16,653
Income from discontinued operations	$ 56,920	$ 4,075	$ 57,856	$ 22,200

5. Other Real Estate

Other real estate consists of the following (in thousands):

	June 30, 2007 (Unaudited)	December 31, 2006

Laundry facilities:		
Land	$ 3,824	$ 3,824
Buildings and improvements	9,459	9,070
Fixtures, furniture and equipment	4,630	4,465
Construction in process	2	89
	17,915	17,448
Accumulated depreciation	(4,111)	(3,708)
	13,804	13,740
Land held for investment	510	933
	$ 14,314	$ 14,673

In May 2007, the Company sold a vacant parcel of land for net proceeds of $429,000, resulting in a net loss of $23,000.

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6. Investment in Unconsolidated Joint Venture

In December 2006, the Company entered into a joint venture agreement with Whitehall Street Global Real Estate Limited Partnership 2005 and Highgate Holdings to acquire the 460-room Doubletree Guest Suites Hotel in New York City, New York. The $68.5 million initial investment was funded entirely from cash on hand and was comprised of two parts: (i) a $28.5 million mezzanine loan, which bore an interest rate of 8.5% on a face value of $30.0 million and (ii) a $40.0 million equity investment representing a 38% ownership interest in the joint venture. In April 2007, the Company sold the $28.5 million mezzanine loan for net proceeds of $29.0 million. Annual dividends on the equity investment are senior to the returns on equity to both Whitehall and Highgate and begin at 8.0% and grow to 9.25% over a nine-year period. In addition, the equity is entitled to receive a pro-rata share of any excess equity distributions of the joint venture. At June 30, 2007 and December 31, 2006, the Company s investment amounted to $37.7 million and $68.7 million, respectively. The Company s equity in the unconsolidated joint venture amounted to losses of $0.1 million and $1.5 million, respectively, for the three and six months ended June 30, 2007.

7. Other Assets

Other assets consist of the following (in thousands):

	June 30, 2007 (Unaudited)	December 31, 2006
Property and equipment, net	$ 1,583	$ 1,730
Pre-acquisition costs	477	8,985
Other receivables	8,526	8,485
Other	2,979	2,771
	$ 13,565	$ 21,971

8. Notes Payable

Notes payable consist of the following (in thousands):

	June 30, 2007 (Unaudited)	December 31, 2006
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.98% to 9.88%; maturing at dates ranging from September 2007 through August 2024. The notes are collateralized by first deeds of trust on 36 hotel properties and one laundry facility.	$ 1,497,789	$ 1,499,828
Exchangeable senior notes with a fixed interest rate of 4.60%, maturing in July 2027. The notes are guaranteed by the Company and certain of its subsidiaries.	250,000	
	1,747,789	1,499,828
Less: current portion	(21,326)	(23,231)
	$ 1,726,463	$ 1,476,597

The Company was not in default on any of its loan covenants at either June 30, 2007 or December 31, 2006.

During the first quarter of 2007, the Company drew down $138.0 million of its $200.0 million credit facility (the credit facility) in connection with the acquisitions of the LAX Renaissance, Los Angeles, California and the Marriott Long Wharf, Boston, Massachusetts, as well as other working capital requirements. During the second quarter of 2007, the Company drew down an additional $27.0 million of the credit facility in connection with the acquisition of the Marriott Boston Quincy, as well as other working capital requirements. The Company repaid $24.0 million of the credit facility in April 2007, and repaid the remaining balance in June 2007. As of June 30, 2007, the Company had no outstanding indebtedness under its credit facility, and had $11.5 million in outstanding irrevocable letters of credit backed by the credit facility, leaving, as of that date, $188.5 million available under the credit facility.

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In March 2007, the Company obtained a $176.0 million mortgage loan with a maturity date of March 2017 and a fixed interest rate of 5.58% in connection with the acquisition of the Marriott Long Wharf, Boston, Massachusetts.

In April 2007, the Company amended one of its mortgage loans to eliminate amortization and to provide for partial collateral releases, provided the Company continues to meet certain loan covenants, from May 2007 until the maturity date of May 2011, at which time the outstanding loan balance of $248.2 million will be due and payable.

In May 2007, the Company amended its credit facility. The interest rate on the amended credit facility continues to be based on grid pricing, with the interest rate spread changing based on the Company s overall leverage ratio. The pricing grid sets forth in four tiers the applicable interest rate spread at leverage ratios for the Company as follows: up to and including 50%, greater than 50% and less than or equal to 55%, greater than 55% and less than or equal to 60%, and greater than 60%. The applicable interest rate spreads for each of the various leverage ratios contained in the amended credit facility are 25 to 35 basis points lower than those contained in the prior credit facility. In addition, the Company extended the initial maturity date on the credit facility from 2010 to 2011.

In June 2007, the Operating Partnership issued an aggregate $250.0 million of exchangeable senior notes with a maturity date of July 2027 and an interest rate of 4.60%. Interest on the notes is payable semi-annually in arrears on January 15 and July 15 of each year, beginning January 15, 2008. The notes, subject to specified events and other conditions, are exchangeable into, at the Company s option, cash, the Company s common stock, or a combination of cash and the Company s common stock. The initial exchange rate for each $1,000 principal amount of notes is 28.9855 shares of the Company s common stock, representing an exchange price of approximately $34.50 per common share. The initial exchange rate is subject to adjustment under certain circumstances. The Operating Partnership does not have the right to redeem the notes, except to preserve the Company s REIT status, before January 20, 2013, and may redeem the notes, in whole or in part, thereafter at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus any accrued and unpaid interest. Upon specified change in control events as well as specified dates, holders of the notes may require the Operating Partnership to repurchase their notes, in whole or in part, for cash equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest. The notes are the senior unsecured obligations of the Operating Partnership. The Company and all of its subsidiaries that are guarantors under the Company s credit facility have guaranteed the Operating Partnership s obligations under the notes. The notes do not qualify as a derivative or an equity instrument.

In June 2007, the Company repaid a $175.0 million mortgage loan with a maturity date of December 2014. In connection with the repayment, the Company incurred prepayment penalties of $0.4 million.

Total interest incurred and expensed on the notes payable is as follows (in thousands):

	Three Months Ended June 30, 2007 (Unaudited)	Three Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2007 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)
Continuing operations:				
Interest expense	$ 25,915	$ 19,228	$ 48,360	$ 38,829
Deferred financing fees	696	1,964	974	2,670
Prepayment penalties	415		415	
Write-off of loan premium		(1,903)		(1,903)
Loss on early extinguishment of debt		2,600		9,976
	$ 27,026	$ 21,889	$ 49,749	$ 47,572
Discontinued operations:				
Interest expense	$ 973	$ 996	$ 1,972	$ 2,124
Deferred financing fees	28	51	38	292
	$ 1,001	$ 1,047	$ 2,010	$ 2,416

9. Series C Cumulative Convertible Redeemable Preferred Stock

In July 2005, the Company sold 4,102,564 shares of Series C Cumulative Convertible Redeemable Preferred Stock (Series C preferred stock) with a liquidation preference of $24.375 per share to Security Capital Preferred Growth, Incorporated, an investment vehicle advised by Security

Capital Research & Management Incorporated, for gross proceeds of $99.0 million, or $24.13 per share, which included a 1% discount to the conversion price/liquidation preference. Other costs of the offering totaled $130,000. Net proceeds of $99.0 million were contributed to the Operating Partnership in exchange for preferred membership units with economic terms substantially identical to the Series C preferred stock. The net proceeds were used to partially finance the Company s acquisition of six Renaissance hotels. The Series C preferred stock pays a base dividend of $0.393 per share per quarter. The Series C preferred stock is convertible into shares of the Company s common stock on a one-for-one basis, subject to customary antidilution provisions, including stock splits, stock dividends, non-cash distributions and above-market issuer self-tender or exchange offers. On or after July 8, 2010, the Series C preferred stock will be redeemable at the Company s option, in whole or in part, at any time or from time to time, for cash at a redemption price of $24.375 per share, plus accrued and unpaid dividends up to and including the redemption date. The holders of the Series C preferred stock have the right to require the Company to redeem the Series C preferred stock in the event of any of the following: (1) a change in control of the Company, if certain conditions are not met; (2) a REIT termination event; or (3) a termination of the Company s listing on either the New York Stock Exchange or NASDAQ. In general, holders of Series C preferred stock vote on an as-converted basis as a single class with holders of the Company s common stock. If the Company is in violation of certain financial ratios for four consecutive quarters, the holders have the right to elect one director to serve on the Company s board of directors. In addition, if the Company is in arrears on dividends on the Series C preferred stock for four or more quarters, the holders have the right to elect additional directors to serve on the Company s board of directors. Subject to a limited exception, holders of Series C preferred stock cannot elect more than an aggregate of two directors. The holders are eligible to receive a participating dividend should the Company s dividend on its common stock increase beyond $0.339 per share per quarter. The Series C preferred stock has no maturity date and, except as set forth above, the Company is not required to redeem the Series C preferred stock at any time.

The initial carrying value of the Series C preferred stock was recorded at its sales price less costs to issue on the date of issuance. This carrying value is periodically adjusted so that the carrying value will equal the redemption value on the redemption date, which is the earliest date available for the Company to redeem the Series C preferred stock. The carrying value will also be periodically adjusted for any accrued and unpaid dividends, if any. At June 30, 2007 and December 31, 2006, the Series C preferred stock carrying value consisted of the following (in thousands):

	June 30, 2007 (Unaudited)	December 31, 2006
Initial fair value, sales price of $99.0 million	$ 99,000	$ 99,000
Redemption value accretion	396	296
	$ 99,396	$ 99,296

10. Stockholders Equity

Series A Cumulative Redeemable Preferred Stock

In March 2005, the Company sold an aggregate of 4,850,000 shares of 8.0% Series A and B Cumulative Redeemable Preferred Stock (Series A preferred stock and Series B preferred stock , respectively) with a liquidation preference of $25.00 per share for gross proceeds of $121.3 million. Underwriting and other costs of the offering totaled $3.8 million. Net proceeds of $117.5 million were contributed to the Operating Partnership in exchange for preferred membership units with economic terms substantially identical to the Series A and B preferred stock. Subsequent to this offering, the shares of Series B preferred stock were exchanged for an equivalent number of shares of Series A preferred stock. The net proceeds were used to reduce borrowings under the Company s credit facility and for acquisitions. On or after March 17, 2010, the Series A preferred stock will be redeemable at the Company s option, in whole or in part, at any time or from time to time, for cash at a redemption price of $25.00 per share, plus accrued and unpaid dividends up to and including the redemption date. Holders of Series A preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series A preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series A preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company s board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series A preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. The Series A preferred stock has no maturity date and the Company is not required to redeem the Series A preferred stock at any time.

In April 2006, the Company sold an additional 2,200,000 shares of Series A preferred stock with a liquidation preference of $25.00 per share for gross proceeds of $55.0 million. The proceeds to the Company, net of offering costs, were $54.2 million, and were used together with proceeds of certain debt refinancings to repay the Company s term loan facility.

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Common Stock

In February 2006, the Company completed a follow-on offering of 5,500,000 shares of common stock at a price per share of $28.80 (before underwriting discounts and offering costs), generating gross proceeds of $158.4 million. The proceeds to the Company, net of offering costs, were $158.1 million and were used to fund a portion of the acquisition price of the Hilton Times Square and for general corporate purposes.

In July 2006, the Company entered into a forward sale agreement (the Forward Sale Agreement) with an affiliate of Citigroup Global Markets Inc. as the forward counterparty, relating to 4,000,000 shares of the Company s common stock. In connection with the execution of the Forward Sale Agreement and at the Company s request, Citigroup Global Markets Inc., as agent for the forward counterparty, borrowed and sold in a public offering 4,000,000 shares of common stock. In April 2007, the Company settled the Forward Sale Agreement for net proceeds of $110.0 million, including $0.4 million in related expenses paid in 2006. The Forward Sale Agreement was accounted for as an equity instrument and did not qualify as a derivative liability.

In June 2007, the Company s board of directors authorized the Company to repurchase up to $100.0 million of the Company s common stock prior to December 31, 2007. As of June 30, 2007, the Company has repurchased 2,604,769 shares of its common stock at a cost of $73.1 million.

11. Long-Term Incentive Plan

Restricted shares and restricted share units granted pursuant to the Company s Long-Term Incentive Plan generally vest over periods from three to five years from the date of grant. The value of shares granted has been calculated based on the share price on the date of grant and is being amortized as compensation expense in accordance with the Company s policy on a straight-line basis over the vesting periods for the entire award. For the three months ended June 30, 2007 and 2006, the Company s expense related to these restricted shares and restricted share units was $2.7 million and $1.4 million, respectively. For the six months ended June 30, 2007 and 2006, the Company s expense related to these restricted shares and restricted share units was $4.5 million and $2.5 million, respectively.

12. Commitments and Contingencies

Management Agreements

Management agreements with the Company s third-party hotel managers require the Company to pay between 1% and 3.5% of total revenue of the managed hotels to the third-party managers each month as a basic management fee. Total basic management fees incurred by the Company during the three months ended June 30, 2007 and 2006 were $7.2 million and $6.3 million, respectively. Total basic management fees included in property general and administrative expense were $7.0 million and $5.8 million, respectively, for the three months ended June 30, 2007 and 2006. Discontinued operations included $0.2 million and $0.5 million, respectively, of basic management fees for the three months ended June 30, 2007 and 2006. For the six months ended June 30, 2007 and 2006, total basic management fees incurred by the Company were $13.3 million and $11.8 million, respectively. Total basic management fees included in property general and administrative expense were $13.0 million and $10.8 million, respectively for the six months ended June 30, 2007 and 2006. Discontinued operations included $0.3 million and $1.0 million of basic management fees for the six months ended June 30, 2007 and 2006, respectively.

Provided certain operating thresholds are met, the Company may also be required to pay certain of its third-party managers an additional incentive management fee. Total incentive management fees incurred by the Company were $1.5 million and $1.3 million, respectively, for the three months ended June 30, 2007 and 2006, and $2.3 million and $2.5 million, respectively for the six months ended June 30, 2007 and 2006, all of which were included in property general and administrative expense.

Franchise Agreements

Total franchise costs incurred by the Company during the three months ended June 30, 2007 and 2006 totaled $10.4 million and $9.7 million, respectively. Of the total franchise costs, franchise royalties totaled $4.0 million and $4.4 million, for the three months ended June 30, 2007 and 2006, respectively. The remaining franchise costs included advertising, reservation and priority club assessments. Franchise costs included in discontinued operations totaled $0.7 and $2.1 million for the three months ended June 30, 2007 and 2006, respectively. For the six months ended June 30, 2007 and 2006, total franchise costs incurred by the Company totaled $18.9 million and $17.1 million, respectively. Of the total franchise costs, franchise royalties totaled $7.7 million and $8.2 million, respectively. Franchise costs included in discontinued operations totaled $1.4 million and $3.8 million, respectively for the six months ended June 30, 2007 and 2006.

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Renovation and Construction Commitments

At June 30, 2007, the Company had various contracts outstanding with third parties in connection with the renovation of certain of its hotel properties. The remaining commitments under these contracts at June 30, 2007 totaled $30.4 million.

Operating Leases

Total rent expense incurred pursuant to ground lease agreements for the three months ended June 30, 2007 and 2006 totaled $1.9 million and $2.8 million, respectively. Rent expense included in property tax, ground lease and insurance totaled $1.9 million and $2.5 million for the three months ended June 30, 2007 and 2006, respectively. Rent expense included in discontinued operations was zero for the three months ended June 30, 2007, and totaled $0.3 million for the same time period in 2006. For the six months ended June 30, 2007 and 2006, total rent expense was $3.8 million and $4.7 million, respectively. Rent expense included in property tax, ground lease and insurance totaled $3.8 million and $4.1 million for the six months ended June 30, 2007 and 2006 respectively. Rent expense included in discontinued operations was zero and $0.6 million, respectively, for the six months ended June 30, 2007 and 2006.

Rent expense incurred pursuant to the lease on the corporate offices totaled $116,000 for both the three months ended June 30, 2007 and 2006 and totaled $231,000 for both the six months ended June 30, 2007 and 2006, and is included in corporate overhead in the accompanying statements of income.

Other

The Company has provided unsecured environmental indemnities to certain lenders. The Company has performed due diligence on the potential environmental risks, including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate the Company to reimburse the indemnified parties for damages related to certain environmental matters. There is no term or damage limitation on these indemnities; however, if an environmental matter arises, the Company could have recourse against other previous owners.

At June 30, 2007, the Company had $11.5 million of outstanding irrevocable letters of credit to guaranty the Company s financial obligations related to workers compensation insurance programs and certain notes payable. The beneficiary may draw upon these letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through June 30, 2007.

13. Transactions With Affiliates

Other Reimbursements

From time to time, the Company pays for certain expenses such as payroll, insurance and other costs on behalf of certain affiliates. The affiliates generally reimburse such amounts on a monthly basis. At June 30, 2007 and December 31, 2006, amounts owed to the Company by its affiliates amounted to $1.3 million and $1.4 million, respectively, and are included in due from affiliates.

Transactions With Others

The Company purchases telecommunications equipment from Gemini Telemanagement Systems, or GTS, a telecommunications equipment provider based in Redwood City, California. The Company s Executive Chairman of the Board of Directors, Robert A. Alter, is a 5.2% stockholder in GTS, and his brother, Richard Alter, is the majority stockholder in GTS. The Company paid GTS $121,000 and $235,000, respectively, for the three and six months ended June 30, 2007, and $87,000 and $128,000, respectively, for the three and six months ended June 30, 2006.

14. Subsequent Events

In August 2007, the Company repaid a $13.1 million mortgage loan with a maturity date of September 2007.

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Cautionary Statement

This report contains forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, forecasts, expects, plans, anticipates, believes, estima potential, or continue or the negative of such terms and other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those expressed or implied by these forward-looking statements. In evaluating these statements, you should specifically consider the risks outlined in detail in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 8, 2007, under the caption Risk Factors and elsewhere in this Quarterly Report on Form 10-Q, including but not limited to the following factors:

our level of outstanding debt, including secured and variable rate debt;

financial and other covenants in our debt;

volatility in the credit markets and the effect on lodging demand or our ability to obtain financing on favorable terms or at all;

competition for the acquisition of hotels and in the operation of our hotels;

rising operating expenses;

relationships with and requirements of franchisors;

the need for renovations and other capital expenditures for our hotels;

the performance of the managers of our hotels;

the ground or air leases for ten of our hotels;

our need to operate as a REIT and comply with other applicable laws and regulations;

changes in business strategy or acquisition or disposition plans;

general economic and business conditions affecting the hotel and travel industry, both nationally and locally;

our ability to complete acquisitions;

- the performance of acquired properties after they are acquired;

- necessary capital expenditures and the impact of renovations on hotel operations and delays in renovation or other developments; and

- other events beyond our control.

These factors may cause our actual events to differ materially from the expectations expressed or implied by any forward-looking statement. We do not undertake to update any forward-looking statement.

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

Overview

We own primarily luxury, upper upscale and upscale hotels in the United States operated under leading brand names franchised or licensed from others, such as Marriott, Hilton, Hyatt, Fairmont, Starwood, and Wyndham.

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Operations

REIT structure. For us to qualify as a REIT, our income cannot be derived from our operation of hotels. Therefore, consistent with the provisions of the Internal Revenue Code of 1986, as amended, and the rules and regulations thereunder (the Code), our Operating Partnership and its subsidiaries lease our hotel properties to our TRS Lessee, which in turn contracts with third-party operators to manage our hotels. All of our third-party managers qualify as eligible independent contractors , which under the Code means they are actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us and the TRS Lessee. The Operating Partnership and the TRS Lessee are consolidated into our financial statements for accounting purposes. Since we control both the Operating Partnership and our TRS Lessee, revenues generated by our underlying portfolio of hotels remain our principal source of operating income on a consolidated basis. The earnings of the TRS Lessee are subject to taxation like other C corporations, which may reduce our operating results, funds from operations and the cash otherwise available for distribution to our stockholders.

Factors Affecting Our Results of Operations

Acquisitions. In January 2007, we acquired the 499-room LAX Renaissance hotel located in Los Angeles, California for approximately $65.2 million and retained Marriott as manager. The acquisition was initially funded through a draw on our credit facility, which we ultimately repaid with a portion of the proceeds we received in June 2007 from the sale of six hotel properties.

In March 2007, we acquired the 402-room Marriott Long Wharf hotel located in Boston, Massachusetts for approximately $228.5 million and retained Marriott as manager. In connection with this acquisition we obtained a $176.0 million mortgage loan with a maturity date of March 2017 and a fixed interest rate of 5.58%. The balance of the purchase price was funded with a draw on our credit facility, which we ultimately repaid with a portion of the proceeds we received in June 2007 from the sale of six hotel properties.

In May 2007, we acquired the 464-room Marriott Boston Quincy hotel located in Quincy, Massachusetts for approximately $117.0 million and retained Marriott as manager. The acquisition was funded primarily through the settlement of our Forward Sale Agreement, with the balance funded with a draw on our credit facility which we ultimately repaid with a portion of the proceeds we received in June 2007 from the sale of six hotel properties.

The following table sets forth the hotels that we have acquired or developed since January 1, 2006:

Hotels	Rooms	Acquisition Date
Marriott Boston Quincy, Quincy, Massachusetts	464	May 1, 2007
Marriott Long Wharf, Boston, Massachusetts	402	March 23, 2007
LAX Renaissance, Los Angeles, California	499	January 4, 2007
W Hotel, San Diego, California	259	June 26, 2006
Embassy Suites, La Jolla, California	335	May 17, 2006
Hilton Times Square, New York City, New York	444	March 17, 2006
Del Mar Marriott, San Diego, California	284	January 10, 2006

Investment in unconsolidated joint venture. In December 2006, we entered into a joint venture agreement with Whitehall Street Global Real Estate Limited Partnership 2005 and Highgate Holdings to acquire the 460-room Doubletree Guest Suites Hotel located in New York City, New York. Our total initial investment in the joint venture was approximately $68.5 million. Our total initial investment was funded entirely from cash on hand and was comprised of two parts: (i) a $28.5 million mezzanine loan, which bore an interest rate of 8.5% on a face value of $30.0 million and (ii) a $40.0 million equity investment representing a 38% ownership interest in the joint venture. In April 2007, we sold the $28.5 million mezzanine loan for net proceeds of $29.0 million. The total debt of the joint venture is $300.0 million, including the $30.0 million mezzanine loan.

Dispositions. The following table sets forth the hotels that we have sold since January 1, 2006:

Hotels	Rooms	Disposition Date
Courtyard by Marriott, Oxnard, California	166	June 29, 2007
Courtyard by Marriott, Riverside, California	163	June 29, 2007
Hawthorn Suites, Sacramento, California	272	June 29, 2007

Hilton Garden Inn, Lake Oswego, Oregon	179	June 29, 2007
Residence Inn by Marriott, Oxnard, California	251	June 29, 2007
Residence Inn by Marriott, Sacramento, California	126	June 29, 2007
Holiday Inn, Rochester, Minnesota	170	December 21, 2006

Hotels	Rooms	Disposition Date
Courtyard by Marriott, Fresno, California	116	September 13, 2006
Courtyard by Marriott, Lynnwood, Washington	164	September 13, 2006
Courtyard by Marriott, Santa Fe, New Mexico	213	September 13, 2006
Crowne Plaza, Englewood, New Jersey	194	September 13, 2006
Crowne Plaza, Williamsburg, Virginia	303	September 13, 2006
Hawthorn Suites, Kent, Washington	152	September 13, 2006
Holiday Inn, Boise, Idaho	265	September 13, 2006
Holiday Inn, Craig, Colorado	152	September 13, 2006
Holiday Inn, Price, Utah	151	September 13, 2006
Holiday Inn, Renton, Washington	226	September 13, 2006
Holiday Inn, San Diego (Stadium), California	175	September 13, 2006
Marriott, Ogden, Utah	292	September 13, 2006
Marriott, Pueblo, Colorado	164	September 13, 2006
Holiday Inn, Hollywood, California	160	March 15, 2006

Renovations. During the second quarter of 2007, we invested $38.7 million in renovations of our existing portfolio of hotels, of which $18.8 million was invested in six major repositioning projects at the following properties: Renaissance Orlando, Renaissance Baltimore, Renaissance Long Beach, Hyatt Regency Century Plaza, Hilton Times Square and Embassy Suites La Jolla. The combined capital investments in these projects were in line with budget and all major phases of each of these six projects are now substantially complete. We generally expect newly renovated properties to drive above-market improvements in RevPAR.

During the second quarter of 2007, we completed our scope and budget for guestroom renovations of the newly acquired Marriott Boston Long Wharf Hotel. The Long Wharf project will include the renovation of all guestrooms and guestroom corridors, an expansion of the concierge lounge and the addition of nine new guest rooms. The project, which is budgeted to cost approximately $14 million, is scheduled to commence during the fourth quarter of 2007 and is expected to be completed during the first quarter of 2008. At this time, we have no other major renovation projects planned or underway which would be expected to cause meaningful displacement in 2007. We are currently reviewing our 2008 capital investment plan. Considering the magnitude of the two-year, approximately $270 million renovation program completed in 2007, it is expected that few new projects will be initiated in 2008 that would cause meaningful disruption.

Indebtedness. During the first quarter of 2007, we drew down $138.0 million of our $200.0 million credit facility to fund our purchases of the Renaissance LAX and the Marriott Long Wharf, as well as to fund other working capital requirements. During the second quarter of 2007, we drew down an additional $27.0 million of the credit facility to fund our purchase of the Marriott Boston Quincy, as well as to fund other working capital requirements. We repaid $24.0 million of the credit facility in April 2007, and repaid the remaining balance in June 2007, using proceeds we received from the sale of six hotel properties. As of June 30, 2007, we had no outstanding indebtedness under our credit facility, and had $11.5 million outstanding irrevocable letters of credit backed by the credit facility, leaving, as of that date, $188.5 million available under the credit facility.

In March 2007, we obtained a $176.0 million mortgage loan with a maturity date of March 2017 and a fixed interest rate of 5.58% in connection with the acquisition of the Marriott Long Wharf. In addition, in April 2007, we amended one of our mortgage loans to eliminate amortization and to provide for partial collateral releases, provided we continue to meet certain loan covenants, from May 2007 until the maturity date of May 2011, at which time the outstanding loan balance of $248.2 million will be due and payable. We also repaid a $175.0 million mortgage loan in June 2007, which had a maturity date of December 2014. In connection with this repayment, we incurred prepayment penalties of $0.4 million.

In June 2007, the Operating Partnership issued an aggregate $250.0 million of exchangeable senior notes with a maturity date of July 2027 and an interest rate of 4.60%. Interest on the notes is payable semi-annually in arrears on January 15 and July 15 of each year, beginning January 15, 2008. The notes, subject to specified events and other conditions, are exchangeable into, at our option, cash, our common stock, or a combination of cash and our common stock. The initial exchange rate for each $1,000 principal amount of notes is 28.9855 shares of our common stock, representing an exchange price of approximately $34.50 per common share. The initial exchange rate is subject to adjustment under certain circumstances. The Operating Partnership does not have the right to redeem the notes, except to preserve our REIT status, before January 20, 2013, and may redeem the notes, in whole or in part, thereafter at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus any accrued and unpaid interest. Upon specified change of control events as well as specified dates, holders of the notes may require the Operating Partnership to repurchase their notes, in whole or in part, for cash equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest. The notes are the senior unsecured obligations of the Operating Partnership. We and all of our subsidiaries that are guarantors under our credit facility have guaranteed the Operating Partnership s obligations under the notes.

Operating Performance Indicators. The following performance indicators are commonly used in the hotel industry:

- occupancy;
- average daily rate, or ADR;
- revenue per available room, or RevPAR, which is the product of occupancy and ADR, but does not include food and beverage revenue, or other operating revenue;
- comparable RevPAR growth, which we define as the change in RevPAR generated by hotels we owned as of the end of the reporting period, but excluding those hotels that were undergoing significant renovations during the most recent reporting period and whose RevPAR growth was significantly affected by such renovations. Comparable RevPAR growth includes prior ownership activity for those periods in which we did not own the hotels. We refer to this subset of our hotels used to calculate comparable RevPAR growth as our Comparable Portfolio ;
- operating margin, which is the product of total operating income divided by total revenues; and
- operating leverage, which is the product of incremental operating income divided by incremental revenues.

Revenues. Substantially all of our revenues are derived from the operation of our hotels. Specifically, our revenues consist of the following:

- *Room revenue*, which is the product of the number of rooms sold and the ADR;
- *Food and beverage revenue*, which is comprised of revenues realized in the hotel food and beverage outlets as well as banquet and catering events; and
- *Other operating revenue*, which includes ancillary hotel revenue such as performance guaranties and other items primarily driven by occupancy such as telephone, transportation, parking, spa, entertainment and other guest services. Additionally, this category includes operating revenue from our two commercial laundry facilities located in Rochester, Minnesota and Salt Lake City, Utah and our electronic purchasing platform, Buy Efficient, L.L.C.

Expenses. Our expenses consist of the following:

- *Room expense,* which is primarily driven by occupancy and, therefore, has a significant correlation with room revenue;

Food and beverage expense, which is primarily driven by food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenue;

Other operating expense, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities, and franchise fees;

Property general and administrative expense, which includes our property-level general and administrative expenses, such as payroll and related costs, professional fees, travel expenses and management fees;

Property tax, ground lease and insurance expense, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense;

Corporate overhead expense, which includes our corporate-level expenses such as payroll and related costs, amortization of deferred stock compensation, professional fees, travel expenses and office rent; and