

STRATEGIC HOTELS & RESORTS, INC
Form 10-Q
August 04, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

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: 001-32223

STRATEGIC HOTELS & RESORTS, INC.

(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 No

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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of common stock (par value \$0.01 per share) of the registrant outstanding as of August 2, 2011 was 185,616,935.

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STRATEGIC HOTELS & RESORTS, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2011

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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®, Hilton®, Hyatt®, InterContinental®, Loews®, Marriott®, Renaissance®, 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.

Table of Contents**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)**

	June 30, 2011	December 31, 2010
Assets		
Investment in hotel properties, net	\$ 1,721,330	\$ 1,835,451
Goodwill	40,359	40,359
Intangible assets, net of accumulated amortization of \$7,807 and \$6,536	32,772	32,620
Assets held for sale		45,145
Investment in unconsolidated affiliates	130,040	18,024
Cash and cash equivalents	76,626	78,842
Restricted cash and cash equivalents	37,876	34,618
Accounts receivable, net of allowance for doubtful accounts of \$1,563 and \$1,922	51,969	35,250
Deferred financing costs, net of accumulated amortization of \$5,049 and \$15,756	5,642	3,322
Deferred tax assets	5,271	4,121
Other assets	24,195	34,564
Total assets	\$ 2,126,080	\$ 2,162,316
Liabilities, Noncontrolling Interests and Equity		
Liabilities:		
Mortgages and other debt payable	\$ 865,010	\$ 1,118,281
Bank credit facility	127,500	28,000
Liabilities of assets held for sale		93,206
Accounts payable and accrued expenses	237,383	266,773
Deferred tax liabilities	48,789	1,732
Deferred gain on sale of hotels	4,036	3,930
Total liabilities	1,282,718	1,511,922
Noncontrolling interests in SHR's operating partnership	6,043	5,050
Equity:		
SHR's shareholders' equity:		
8.50% Series A Cumulative Redeemable Preferred Stock (\$0.01 par value per share; 4,488,750 shares issued and outstanding; liquidation preference \$25.00 per share and \$136,065 and \$131,296 in the aggregate)	108,206	108,206
8.25% Series B Cumulative Redeemable Preferred Stock (\$0.01 par value per share; 4,600,000 shares issued and outstanding; liquidation preference \$25.00 per share and \$138,719 and \$133,975 in the aggregate)	110,775	110,775
8.25% Series C Cumulative Redeemable Preferred Stock (\$0.01 par value per share; 5,750,000 shares issued and outstanding; liquidation preference \$25.00 per share and \$173,398 and \$167,469 in the aggregate)	138,940	138,940
Common shares (\$0.01 par value per share; 250,000,000 common shares authorized; 185,616,935 and 151,305,314 common shares issued and outstanding)	1,856	1,513
Additional paid-in capital	1,710,932	1,553,286
Accumulated deficit	(1,165,720)	(1,185,294)

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Accumulated other comprehensive loss	(77,848)	(107,164)
Total SHR s shareholders equity	827,141	620,262
Noncontrolling interests in consolidated affiliates	10,178	25,082
Total equity	837,319	645,344
Total liabilities, noncontrolling interests and equity	\$ 2,126,080	\$ 2,162,316

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES (SHR)****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME (LOSS)****(In Thousands, Except Per Share Data)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues:				
Rooms	\$ 108,812	\$ 92,789	\$ 200,282	\$ 173,679
Food and beverage	74,441	63,696	137,323	118,395
Other hotel operating revenue	19,948	19,423	39,921	38,523
Lease revenue	1,277	1,088	2,492	2,275
Total revenues	204,478	176,996	380,018	\$ 332,872
Operating Costs and Expenses:				
Rooms	29,818	26,413	56,445	50,574
Food and beverage	50,658	43,286	96,665	83,091
Other departmental expenses	53,825	49,343	104,498	96,168
Management fees	6,550	5,924	12,324	11,596
Other hotel expenses	13,467	14,199	26,825	27,427
Lease expense	1,257	1,095	2,453	2,290
Depreciation and amortization	30,091	31,943	60,696	65,986
Corporate expenses	11,957	7,359	26,434	13,419
Total operating costs and expenses	197,623	179,562	386,340	350,551
Operating income (loss)	6,855	(2,566)	(6,322)	(17,679)
Interest expense	(25,762)	(24,864)	(45,310)	(46,370)
Interest income	51	154	83	305
Loss on early extinguishment of debt	(838)	(886)	(838)	(886)
Loss on early termination of derivative financial instruments	(29,242)	(18,263)	(29,242)	(18,263)
Equity in (losses) earnings of unconsolidated affiliates	(2,799)	459	(4,399)	(101)
Foreign currency exchange gain (loss)	147	(811)	286	(1,262)
Other income, net	436	462	4,361	694
Loss before income taxes and discontinued operations	(51,152)	(46,315)	(81,381)	(83,562)
Income tax (expense) benefit	(1,060)	(1,065)	588	(228)
Loss from continuing operations	(52,212)	(47,380)	(80,793)	(83,790)
Income from discontinued operations, net of tax	101,034	8,818	101,196	10,617
Net Income (Loss)	48,822	(38,562)	20,403	(73,173)
Loss on currency translation adjustments	(5,264)	(4,676)	(7,907)	(4,311)
Gain (loss) on derivatives activity	27,848	(1,732)	37,223	(23,132)
Comprehensive Income (Loss)	71,406	(44,970)	49,719	(100,616)
Comprehensive (income) loss attributable to the noncontrolling interests in SHR s operating partnership	(328)	286	(222)	995
	(1,338)	(1,371)	(743)	228

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Comprehensive (income) loss attributable to the noncontrolling interests in consolidated affiliates

Comprehensive Income (Loss) Attributable to SHR	\$ 69,740	\$ (46,055)	\$ 48,754	\$ (99,393)
Net Income (Loss)	\$ 48,822	\$ (38,562)	\$ 20,403	\$ (73,173)
Net (income) loss attributable to the noncontrolling interests in SHR's operating partnership	(224)	245	(86)	687
Net (income) loss attributable to the noncontrolling interests in consolidated affiliates	(1,338)	(1,371)	(743)	228
Net Income (Loss) Attributable to SHR	47,260	(39,688)	19,574	(72,258)
Preferred shareholder dividends	(7,722)	(7,722)	(15,443)	(15,443)
Net Income (Loss) Attributable to SHR Common Shareholders	\$ 39,538	\$ (47,410)	\$ 4,131	\$ (87,701)
Amounts Attributable to SHR:				
Loss from continuing operations	\$ (53,309)	\$ (48,426)	\$ (81,156)	\$ (82,772)
Income from discontinued operations	100,569	8,738	100,730	10,514
Net income (loss)	\$ 47,260	\$ (39,688)	\$ 19,574	\$ (72,258)
Basic and Diluted Income (Loss) Per Share:				
Loss from continuing operations attributable to SHR common shareholders	\$ (0.35)	\$ (0.50)	\$ (0.58)	\$ (1.05)
Income from discontinued operations attributable to SHR common shareholders	0.57	0.08	0.60	0.11
Net income (loss) attributable to SHR common shareholders	\$ 0.22	\$ (0.42)	\$ 0.02	\$ (0.94)
Weighted average common shares outstanding	176,141	111,573	166,820	93,706

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2011	2010
Operating Activities:		
Net income (loss)	\$ 20,403	\$ (73,173)
Adjustments to reconcile net income (loss) to net cash provided by operating activities (including discontinued operations):		
Deferred income tax benefit	(2,288)	(410)
Depreciation and amortization	60,696	69,540
Amortization of deferred financing costs, discount and interest rate swap costs	12,361	22,166
Loss on early extinguishment of debt	838	886
Loss on early termination of derivative financial instruments	29,242	18,263
Equity in losses of unconsolidated affiliates	4,399	101
Share-based compensation	17,973	4,122
Gain on sale of assets	(103,605)	(1,849)
Foreign currency exchange gain	(337)	(11,324)
Recognition of deferred gains	(1,323)	(2,336)
Mark to market of derivative financial instruments	(1,633)	4,103
(Increase) decrease in accounts receivable	(10,646)	455
(Increase) decrease in other assets	(2,689)	1,545
Decrease in accounts payable and accrued expenses	(8,187)	(4,588)
Net cash provided by operating activities	15,204	27,501
Investing Activities:		
Proceeds from sale of investments	9,000	
Proceeds from sale of assets	55,280	
Cash received from unconsolidated affiliates	780	523
Unconsolidated affiliates recapitalization	(92,703)	
Unrestricted cash acquired through acquisition and recapitalization	30,600	
Unrestricted cash sold or contributed	(6,935)	
Capital expenditures	(24,546)	(17,972)
Increase in restricted cash and cash equivalents	(6,377)	(10,286)
Increase in security deposits related to sale-leasebacks	(1,270)	(2,282)
Net cash used in investing activities	(36,171)	(30,017)
Financing Activities:		
Proceeds from issuance of common stock	50,000	349,140
Equity issuance costs	(531)	(16,079)
Borrowings under bank credit facility	317,500	100,500
Payments on bank credit facility	(218,000)	(223,500)
Exchangeable senior notes tender		(180,000)
Payments on mortgages and other debt	(78,135)	(30,946)
Acquisition of noncontrolling interest in consolidated affiliates	(19,402)	
Debt financing costs	(5,132)	(175)
Distributions to holders of noncontrolling interests in consolidated affiliates	(16)	(16)
Interest rate swap costs	(33,340)	(35,152)

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Other financing activities	(559)	(640)
Net cash provided by (used in) financing activities	12,385	(36,868)
Effect of exchange rate changes on cash	3,367	(5,104)
Net change in cash and cash equivalents	(5,215)	(44,488)
Change in cash of assets held for sale	2,999	
Cash and cash equivalents, beginning of period	78,842	116,310
Cash and cash equivalents, end of period	\$ 76,626	\$ 71,822

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended June 30,	
	2011	2010
Supplemental Schedule of Non-Cash Activities:		
Acquisition of hotel properties (see note 3)	\$ 89,273	\$
Acquisition of noncontrolling interest (see note 8)	\$ 70,300	\$
(Gain) loss on mark to market of derivative instruments (see notes 2 and 9)	\$ (9,783)	\$ 23,132
Increase (decrease) in capital expenditures recorded as liabilities	\$ 1,799	\$ (255)
Cash Paid For:		
Interest, net of interest capitalized	\$ 35,280	\$ 27,193
Income taxes, net of refunds	\$ 2,163	\$ 1,709

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 June 30, 2011, the Company's portfolio included 17 full-service hotel interests located in urban and resort markets in: the United States; Punta Mita, Nayarit, Mexico; Hamburg, Germany; and London, England. The Company operates in 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% of its membership units as of June 30, 2011. 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 June 30, 2011, SH Funding owned interests in or leased the following 17 hotels:

- | | |
|--|---|
| 1. Fairmont Chicago | 10. InterContinental Miami |
| 2. Fairmont Scottsdale Princess ⁽¹⁾ | 11. Loews Santa Monica Beach Hotel |
| 3. Four Seasons Jackson Hole | 12. Marriott Hamburg ⁽⁵⁾ |
| 4. Four Seasons Punta Mita Resort | 13. Marriott Lincolnshire ⁽⁶⁾ |
| 5. Four Seasons Silicon Valley | 14. Marriott London Grosvenor Square ⁽⁶⁾ |
| 6. Four Seasons Washington, D.C. | 15. Ritz-Carlton Half Moon Bay |
| 7. Hotel del Coronado ⁽²⁾ | 16. Ritz-Carlton Laguna Niguel |
| 8. Hyatt Regency La Jolla ⁽³⁾ | 17. Westin St. Francis |
| 9. InterContinental Chicago ⁽⁴⁾ | |

⁽¹⁾ This property is owned by an unconsolidated affiliate in which the Company indirectly holds a 50% interest (see note 5). One land parcel at this property is subject to a ground lease arrangement.

⁽²⁾ This property is owned by an unconsolidated affiliate in which the Company indirectly holds a 34.3% interest (see note 5).

⁽³⁾ This property is owned by a consolidated affiliate in which the Company indirectly holds a 53.5% interest (see note 8).

⁽⁴⁾ The Company owns 100% of this property after acquiring its partner's 49% noncontrolling interest on June 24, 2011 (see note 8).

⁽⁵⁾ The Company has a leasehold interest in this property.

⁽⁶⁾ These properties are subject to ground lease arrangements.

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 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

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Company believes the disclosures made are adequate to prevent the information presented from being misleading. However, the

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2010. 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 the Company determines that it is the holder of a variable interest in a variable interest entity (VIE) within the meaning of new accounting guidance adopted on January 1, 2010, which amends the consolidation guidance of VIEs, and it is the primary beneficiary under this new guidance, then the Company will consolidate the entity. For entities that are not considered VIEs, the Company 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 June 30, 2011, SH Funding owned the following interests in unconsolidated affiliates, which are accounted for using the equity method of accounting: a 31% interest in the unconsolidated affiliate that owns the Four Seasons Residence Club Punta Mita (RCPM), a 34.3% interest in the unconsolidated affiliate that owns the Hotel del Coronado (Hotel del Coronado Venture), and a 50% interest in the unconsolidated affiliate that owns the Fairmont Scottsdale Princess (Fairmont Scottsdale Princess Venture) (see note 5). At June 30, 2011, SH Funding also owned an 85.8% controlling interest in the entity that owns both a condominium-hotel development adjacent to the Hotel del Coronado (North Beach Venture) and a 40% interest in the Hotel del Coronado Venture (see note 5), and a 53.5% controlling interest in the entity that owns the Hyatt Regency La Jolla hotel, which are consolidated in the accompanying financial statements.

All significant intercompany transactions and balances have been eliminated in consolidation. Certain amounts included in the financial statements for prior periods have been reclassified to conform to the current financial statement presentation as a result of discontinued operations.

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 periods. Actual results could differ from those estimates.

Restricted Cash and Cash Equivalents:

At June 30, 2011 and December 31, 2010, restricted cash and cash equivalents included \$16,567,000 and \$15,920,000, respectively, that will be used for property and equipment replacement in accordance with hotel management or lease agreements. At June 30, 2011 and December 31, 2010, restricted cash and cash equivalents also included reserves of \$21,309,000 and \$18,698,000, 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. 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. Also, the foreign countries where the Company has operations do not recognize REITs under their respective tax laws. Accordingly, the Company is subject to tax in those jurisdictions.

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

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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.

The Company completed an equity offering during the second quarter of 2010 (see note 8), which resulted in an ownership change under Section 382 of the Tax Code. As a result, some of the Company's net operating loss carryforwards were reduced or eliminated in accordance with the provisions of Section 382. A full valuation reserve has been provided against net operating loss carryforwards not subject to Section 382 due to uncertainty of realization. Therefore, the ownership change had no impact to the statements of operations.

For the three and six months ended June 30, 2011 and 2010, income tax (expense) benefit related to continuing operations is summarized as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Current tax (expense):				
Europe	\$ (42)	\$	\$ (48)	\$
Mexico	(405)	(155)	(629)	(1,018)
United States			(1,402)	
	(447)	(155)	(2,079)	(1,018)
Deferred tax benefit (expense):				
Mexico	366	(108)	227	(183)
United States	(979)	(802)	2,440	973
	(613)	(910)	2,667	790
Total income tax (expense) benefit:	\$ (1,060)	\$ (1,065)	\$ 588	\$ (228)

Per Share Data:

Basic income (loss) per share is computed by dividing the net income (loss) attributable to SHR common shareholders by the weighted average common shares outstanding during each period. Diluted income (loss) per share is computed by dividing the net income (loss) attributable to SHR common shareholders as adjusted for the impact of dilutive securities, if any, by the weighted average common shares outstanding plus potentially dilutive securities. Dilutive securities may include restricted stock units (RSUs), options to purchase shares of SHR common stock (Options), units payable under the Company's Value Creation Plan (VCP Units), exchangeable debt securities 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. The following table sets forth the components of the calculation of loss from continuing operations attributable to SHR common shareholders for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010

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Numerator:					
Loss from continuing operations attributable to SHR		\$ (53,309)	\$ (48,426)	\$ (81,156)	\$ (82,772)
Preferred shareholder dividends		(7,722)	(7,722)	(15,443)	(15,443)
Loss from continuing operations attributable to SHR common shareholders		\$ (61,031)	\$ (56,148)	\$ (96,599)	\$ (98,215)
Denominator:					
Weighted average common shares basic and diluted		176,141	111,573	166,820	93,706

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Securities that could potentially dilute basic loss per share in the future that are not included in the computation of diluted loss per share because they are anti-dilutive at June 30, 2011 and 2010 are as follows (in thousands):

	Computation For Three Months Ended June 30,		Computation For Six Months Ended June 30,	
	2011	2010	2011	2010
Noncontrolling interests	853	955	853	955
Options, RSUs and VCP Units	3,186	1,764	3,186	1,764
Accumulated Other Comprehensive Loss:				

The Company's accumulated other comprehensive loss (OCL) results from mark to market of certain derivative financial instruments and unrealized gains or losses on foreign currency translation adjustments (CTA). The following tables provide the components of accumulated OCL as of June 30, 2011 and 2010 (in thousands):

	Derivative and Other Adjustments	CTA	Accumulated OCL
Balance at January 1, 2011	\$ (94,933)	\$ (12,231)	\$ (107,164)
Mark to market of derivative instruments	9,729		9,729
Reclassification to equity in (losses) earnings of unconsolidated affiliates	54		54
Reclassification to loss on early termination of derivative financial instruments	27,440		27,440
Reclassification to income from discontinued operations, net of tax		(5,095)	(5,095)
CTA activity		(2,812)	(2,812)
Balance at June 30, 2011	\$ (57,710)	\$ (20,138)	\$ (77,848)

	Derivative and Other Adjustments	CTA	Accumulated OCL
Balance at January 1, 2010	\$ (81,449)	\$ 12,108	\$ (69,341)
Mark to market of derivative instruments	(38,642)		(38,642)
Reclassification to equity in (losses) earnings of unconsolidated affiliates	(32)		(32)
Reclassification to loss on early termination of derivative financial instruments	15,542		15,542
CTA activity		(4,311)	(4,311)
Balance at June 30, 2010	\$ (104,581)	\$ 7,797	\$ (96,784)

New Accounting Guidance:

In June 2011, the Financial Accounting Standards Board (FASB) issued new guidance that amends current comprehensive income guidance. The new guidance eliminates the option to present the components of other comprehensive income as part of the statement of shareholders equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements.

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Additionally, the guidance requires an entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The new guidance will be effective January 1, 2012. The adoption of the new guidance will not have a material impact on the Company's financial statements.

In December 2010, the FASB issued new guidance that amends the criteria for performing the second step of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires performing the second step if qualitative factors indicate that it is more likely than not that a goodwill impairment exists. The Company adopted the new guidance on January 1, 2011, and determined that it did not have a material impact to the financial statements.

3. INVESTMENT IN HOTEL PROPERTIES, NET

The following summarizes the Company's investment in hotel properties as of June 30, 2011 and December 31, 2010, excluding the leasehold interest in the Marriott Hamburg, unconsolidated affiliates and assets held for sale (in thousands):

	June 30, 2011	December 31, 2010
Land	\$ 334,048	\$ 318,756
Land held for development	103,089	107,908
Leasehold interest	11,633	11,633
Buildings	1,318,315	1,405,462
Building and leasehold improvements	79,559	95,487
Site improvements	27,113	43,487
Furniture, fixtures and equipment	414,887	423,588
Improvements in progress	19,736	10,679
Total investment in hotel properties	2,308,380	2,417,000
Less accumulated depreciation	(587,050)	(581,549)
Total investment in hotel properties, net	\$ 1,721,330	\$ 1,835,451
Consolidated hotel properties	14	13
Consolidated hotel rooms	6,078	6,403

Acquisition of Four Seasons Silicon Valley and Four Seasons Jackson Hole

On March 11, 2011, the Company acquired the Four Seasons Silicon Valley and Four Seasons Jackson Hole hotels in exchange for an aggregate of 15,200,000 shares of SHR's common stock at a price of \$6.08 per share based on the March 11, 2011 SHR common share closing price, or approximately \$92,416,000. The allocation of the purchase price for the acquisition is as follows (in thousands):

	Four Seasons Silicon Valley	Four Seasons Jackson Hole
Land	\$ 5,518	\$ 19,669
Buildings	27,269	33,450

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Site improvements	400	444
Furniture, fixtures and equipment	2,827	4,236
Intangible assets	88	372
Net working capital	378	(2,235)
	\$ 36,480	\$ 55,936

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The results of operations of hotels sold or assets held for sale are classified as discontinued operations and segregated in the consolidated statements of operations for all periods presented. The following is a summary of income from discontinued operations for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Hotel operating revenues	\$ 938	\$ 18,971	\$ 9,743	\$ 32,492
Operating costs and expenses	828	13,833	9,510	26,410
Depreciation and amortization		1,740		3,554
Total operating costs and expenses	828	15,573	9,510	29,964
Operating income	110	3,398	233	2,528
Interest expense		(2,152)		(5,338)
Interest income		4		11
Foreign currency exchange (loss) gain	(7)	6,067	51	12,586
Other income, net			326	
Income tax expense	(20)	(348)	(379)	(407)
Gain on sale	100,951	1,849	100,965	1,237
Income from discontinued operations	\$ 101,034	\$ 8,818	\$ 101,196	\$ 10,617

Assets Sold:*Paris Marriott Champs Elysees (Paris Marriott)*

On April 6, 2011, the Company sold its leasehold interest in the Paris Marriott hotel for consideration of 29,200,000 (\$41,567,000). As part of the transaction, the Company received 10,100,000 (\$14,500,000) of an additional 11,600,000 (\$16,630,000) owed related to the release of the security deposit and other closing adjustments for total proceeds of approximately 40,800,000 (\$58,197,000). The Company expects to receive the remaining 1,500,000 within six months of the closing date. The Company recorded a gain on sale of the property of \$100,945,000 for the three and six months ended June 30, 2011 primarily due to the recognition of an existing deferred gain resulting from a sale-leaseback transaction related to this hotel (see note 6).

The hotel's assets and liabilities owned by the Company were classified as held for sale on the accompanying consolidated balance sheet as of December 31, 2010. The significant components of assets held for sale and liabilities of assets held for sale at December 31, 2010 consist of the following (in thousands):

	December 31, 2010
Investment in hotel properties, net	\$ 6,226
Cash	2,999
Restricted cash	1,320

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Accounts receivable, net of allowance for doubtful accounts	5,636
Deferred tax asset (a)	26,712
Other assets	2,252
Assets held for sale	\$ 45,145
Accounts payable and accrued expenses	\$ 6,969
Deferred gain on sale of hotel (a)	86,237
Liabilities of assets held for sale	\$ 93,206

- (a) In 2003, the Company recorded a sale-leaseback of the Paris Marriott and the related gain on sale was deferred for financial reporting purposes. The gain on sale was recognized for French income tax

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purposes, which resulted in recognition of a deferred tax asset. The deferred tax asset was reduced as the deferred gain was amortized over the life of the lease. The balance also fluctuated based on changes in foreign currency exchange rates.

InterContinental Prague

On December 15, 2010, the Company sold the InterContinental Prague hotel for an approximate consideration of 106,090,000 (\$141,368,000). The consideration included the assignment of the hotel's third party debt of 101,600,000 (\$135,385,000) and the interest rate swap liability related to the third party indebtedness, estimated to be approximately 4,490,000 (\$5,983,000). For the year ended December 31, 2010, the Company received net sales proceeds of \$3,564,000. In addition, as part of the transaction, approximately 2,000,000 (\$2,665,000) of restricted cash related to the hotel was released to the Company.

Hyatt Regency New Orleans

On December 28, 2007, the Company sold the Hyatt Regency New Orleans for a gross sales price of \$32,000,000, of which \$23,000,000 was received in cash at closing and \$9,000,000 was received in the form of a promissory note from the purchaser with a \$6,000,000 tranche and a \$3,000,000 tranche. The Company initially deferred recognition of the gain on sale of the hotel and recorded it as an offset to the promissory note. In March 2008, the Company received payment on the \$6,000,000 tranche and recognized \$416,000 of the gain. In the second quarter of 2010, the Company agreed to accept payment of \$1,850,000 to settle the remaining obligation and recognized the deferred gain in that amount in income from discontinued operations in the second quarter of 2010.

5. INVESTMENT IN UNCONSOLIDATED AFFILIATES

Investment in unconsolidated affiliates as of June 30, 2011 and December 31, 2010 includes the following (in thousands):

	June 30, 2011	December 31, 2010
Fairmont Scottsdale Princess Venture (a)	\$ 30,588	\$
Hotel del Coronado Venture (b)	95,507	
Hotel and North Beach Ventures (b)		7,787
Four Seasons RCPM (c)	3,945	3,878
BuyEfficient (d)		6,359
Total investment in unconsolidated affiliates	\$ 130,040	\$ 18,024

- (a) On June 9, 2011, the Company completed a recapitalization of the Fairmont Scottsdale Princess hotel. The Company entered into agreements with an unaffiliated third party, an affiliate of Walton Street Capital, L.L.C. (Walton Street), to form FMT Scottsdale Holdings, LLC and Walton/SHR FPH Holdings, L.L.C. (together, the Fairmont Scottsdale Princess Venture) to own the Fairmont Scottsdale Princess hotel. The Company contributed the assets and liabilities of the hotel and cash of \$34,864,000 in exchange for a 50% ownership interest in the Fairmont Scottsdale Princess Venture. The Company jointly controls the venture with Walton Street and serves as the managing member. The Company also continues to serve as the hotel's asset manager and is entitled to earn a quarterly base management fee equal to 1.0% of total revenues during years one and two following the formation of the Fairmont Scottsdale Princess Venture, 1.25% during years three and four, and 1.5% thereafter, as well as certain project management fees. For the three and six months ended June 30, 2011, the Company recognized fees of \$11,000, which are included in other income, net on the consolidated statements of operations. In connection with the Fairmont Scottsdale Princess Venture, the Company is entitled to certain promote payments after Walton Street achieves a specified return.

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As part of the recapitalization, the Fairmont Scottsdale Princess Venture retired the hotel's \$40,000,000 mezzanine debt. In addition, the hotel's \$140,000,000 first mortgage was amended and extended. The amendment included a \$7,000,000 principal payment, and the debt was extended through December 2013 with an option for a second extension through April 9, 2015, subject to certain conditions. Interest will remain payable monthly at the London Interbank Offered Rate (LIBOR) plus 0.36%.

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(b) As of December 31, 2010, the Company owned 45.0% ownership interests in SHC KSL Partners, LP (Hotel Venture), the then owner of the Hotel del Coronado, and in HdC North Beach Development, LLLP (North Beach Venture), the owner of an adjacent residential condominium-hotel development. The Company earned asset management, development and financing fees under agreements with the Hotel and North Beach Ventures. The Company recognized income of 55.0% of these fees, representing the percentage of the Hotel and North Beach Ventures not owned by the Company. These fees amounted to \$172,000 and \$307,000 for the three and six months ended June 30, 2010, respectively, and are included in other income, net in the consolidated statements of operations.

In January 2006, the Hotel Venture entered into non-recourse mortgage and mezzanine loans with principal amounts of \$610,000,000. The loans accrued interest at LIBOR plus a blended spread of 2.08%. In addition, the Hotel Venture entered into a \$20,000,000 non-recourse revolving credit facility that bore interest at LIBOR plus 2.50%. At December 31, 2010, there was a balance of \$18,500,000 on the revolving credit facility and there were no letters of credit outstanding. In December 2010, the Hotel Venture purchased a \$37,500,000 mezzanine layer of the debt structure for a discounted pay-off of \$13,000,000. The remaining principal on the loans and revolving credit facility had a maturity date of January 7, 2011. On January 7, 2011, the Hotel Venture obtained an extension of the maturity date to February 9, 2011.

On February 4, 2011, the Hotel and North Beach Ventures completed a recapitalization (the Transaction) through a series of contemporaneous transactions. Under the terms of the Transaction, the Company acquired the ownership interest of an existing member of the Hotel and North Beach Ventures, and, along with the remaining members of the Hotel Venture, formed a partnership, BSK Del Partners, L.P. (Hotel del Coronado Venture) with an unaffiliated third party, an affiliate of Blackstone Real Estate Advisors VI L.P. (Blackstone), to own the Hotel del Coronado. As part of the Transaction, the Company contributed \$57,380,000 of cash drawn from the Company's bank credit facility to fund its contribution. This payment included the purchase of the existing member's ownership in the Hotel and North Beach Ventures and is net of a \$1,700,000 financing fee earned as part of the Transaction. The Hotel Venture contributed substantially all of the assets and liabilities to the Hotel del Coronado Venture. The Hotel del Coronado Venture then settled all contributed debts outstanding by paying balances off in full or agreeing to convert debt to equity. In connection with the Transaction, the Company also acquired its partner's interest in HdC DC Corporation, a taxable corporation, with assets of \$25,597,000 and an existing deferred tax liability of approximately \$48,575,000. As a result of the Transaction, the Company recorded an equity method investment of \$97,649,000. Pursuant to the terms of the Transaction, Blackstone is the general partner of the Hotel del Coronado Venture with a 60.0% ownership interest and the Company is a limited partner with an indirect 34.3% ownership interest.

The Hotel del Coronado Venture secured \$425,000,000 of five-year debt financing at a weighted average rate of LIBOR plus 480 basis points, subject to a 1% LIBOR floor. After the third year of the loan, the final two one-year extensions require payment to the lender of a 25 basis point extension fee. Additionally, the Hotel del Coronado Venture purchased a two-year, 2.0% LIBOR cap, which was required by the loan.

The Company continues to act as asset manager and earns a quarterly asset management fee equal to 1.0% of gross revenue, certain development fees, and when applicable, an incentive fee equal to one-third of the incentive fee paid to the hotel operator under the hotel management agreement. As part of the Hotel del Coronado Venture with Blackstone, the Company and the other remaining member of the Hotel Venture earn a profit-based incentive fee of 20.0% of all distributions of the Hotel del Coronado Venture that exceed both a 20.0% internal rate of return and two times return on invested equity. For the three and six months ended June 30, 2011, the Company recognized fees of \$221,000 and \$1,514,000, respectively, which are included in other income, net on the consolidated statements of operations.

(c) The Company owns a 31% interest in and acts as asset manager for an unconsolidated affiliate with two unaffiliated parties that is developing the Four Seasons RCPM, a luxury vacation home product that is being sold in fractional ownership interests on the property adjacent to the Company's Four Seasons Punta Mita Resort in Mexico. The Company earns asset management fees and recognizes income of 69% of

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these fees, representing the percentage not owned by the Company. These fees amounted to \$13,000 and \$37,000 for the three months ended June 30, 2011 and 2010, respectively, and \$33,000 and \$76,000 for the six months ended June 30, 2011 and 2010, respectively, and are included in other income, net on the consolidated statements of operations.

- (d) On December 7, 2007, the Company acquired a 50% interest in BuyEfficient for \$6,346,000. BuyEfficient is an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment. In January 2011, the Company sold its 50% interest for \$9,000,000 and recognized a gain on sale of \$2,640,000 for the six months ended June 30, 2011, which is included in other income, net on the consolidated statement of operations.

Condensed Combined Financial Information of Investment in Unconsolidated Affiliates

The following is summarized financial information for the Company's unconsolidated affiliates as of June 30, 2011 and December 31, 2010 and for the three and six months ended June 30, 2011 and 2010 (in thousands):

	June 30, 2011	December 31, 2010
Assets		
Investment in hotel properties, net	\$ 722,145	\$ 298,362
Goodwill		23,401
Intangible assets, net	44,236	49,000
Cash and cash equivalents	29,324	22,400
Restricted cash and cash equivalents	31,688	12,087
Other assets	36,731	20,842
Total assets	\$ 864,124	\$ 426,092
Liabilities and Partners' Equity (Deficit)		
Mortgage and other debt payable	\$ 558,000	\$ 592,476
Other liabilities	46,676	33,472
Partners' equity (deficit)	259,448	(199,856)
Total liabilities and partners' equity (deficit)	\$ 864,124	\$ 426,092

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues				
Hotel operating revenue	\$ 34,338	\$ 30,748	\$ 62,600	\$ 54,484
Residential sales	905	3,360	2,543	6,873
Other		1,281		2,423
Total revenues	35,243	35,389	65,143	63,780
Expenses				
Hotel operating expenses	24,630	21,024	45,591	39,233
Residential costs of sales	298	1,749	839	3,578
Depreciation and amortization	5,826	4,369	10,289	8,605
Other operating expenses	2,193	2,613	4,071	4,655
Total operating expenses	32,947	29,755	60,790	56,071
Operating income	2,296	5,634	4,353	7,709
Interest expense, net	(7,702)	(4,463)	(14,256)	(8,733)
Other (expenses) income, net	(1,039)	(156)	(1,557)	157
Net (loss) income	\$ (6,445)	\$ 1,015	\$ (11,460)	\$ (867)
Equity in (losses) earnings in unconsolidated affiliates				
Net (loss) income	\$ (6,445)	\$ 1,015	\$ (11,460)	\$ (867)
Partners' share of loss (income) of unconsolidated affiliates	3,585	(555)	6,474	418
Adjustments for basis differences, taxes and intercompany eliminations	61	(1)	587	348
Total equity in (losses) earnings of unconsolidated affiliates	\$ (2,799)	\$ 459	\$ (4,399)	\$ (101)

As a result of the Transaction, the Company recorded the net assets of the Hotel del Coronado Venture at their fair values. To the extent that the Company's cost basis is different than the basis reflected at the unconsolidated affiliate level, the basis difference, excluding amounts attributable to land and goodwill, is amortized over the life of the related asset and included in the Company's share of equity in (losses) earnings of the unconsolidated affiliates.

6. OPERATING LEASE AGREEMENTS

In June 2004, the Company recorded a sale of the Marriott Hamburg, and the Company's leaseback of the hotel was reflected as an operating lease. A deferred gain was recorded in conjunction with the sale and is being recognized as a reduction of lease expense over the life of the lease. For the three months ended June 30, 2011 and 2010, the Company recognized \$56,000 and \$49,000 of the deferred gain, respectively, and for the six months ended June 30, 2011 and 2010, recognized \$109,000 and \$103,000, respectively. As of June 30, 2011 and December 31, 2010, the deferred gain on the sale of the Marriott Hamburg recorded on the accompanying consolidated balance sheets amounted to \$4,036,000 and \$3,930,000, respectively. On a monthly basis, the Company makes minimum rent payments aggregating to an annual total of 3,654,000 (adjusting by an index formula) (\$5,299,000 based on the foreign exchange rate as of June 30, 2011) and pays additional rent based upon the performance of the hotel, which are recorded as lease expense in the Company's consolidated statements of operations. A euro-denominated security deposit at June 30, 2011 and December 31, 2010 was \$2,755,000 and \$2,540,000, respectively, and is included in other assets on the Company's consolidated balance sheets. The Company subleases its interest in the Marriott Hamburg to a third party. The Company has reflected the sublease arrangement as an operating lease and records lease revenue.

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In June 2004, the Company recorded a sale of the Paris Marriott, and the Company's 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. On April 6, 2011, the Company sold its leasehold interest in the Paris Marriott (see note 4). The hotel's assets and liabilities owned by the Company were classified as held for sale on the accompanying consolidated balance sheet as of December 31, 2010 and

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the results of operations have been classified as discontinued operations in the consolidated statements of operations for all periods presented. As of December 31, 2010, the deferred gain on the sale of the Paris Marriott amounted to \$86,237,000, which is recorded in liabilities of assets held for sale. Prior to the sale of the hotel on April 6, 2011, the Company recognized \$62,000 and \$1,068,000 as amortization of the deferred gain in income from discontinued operations as a reduction to lease expense for the three months ended June 30, 2011 and 2010, respectively, and \$1,214,000 and \$2,233,000 for the six months ended June 30, 2011 and 2010, respectively. When the sale closed, the remaining \$90,624,000 unamortized deferred gain was recognized as a gain on sale of the Paris Marriott in income from discontinued operations. On a monthly basis, the Company made minimum rent payments and paid additional rent based upon the performance of the hotel, which was included in income from discontinued operations, in the Company's consolidated statements of operations. At December 31, 2010, a euro-denominated security deposit was \$14,459,000, and was included in other assets on the Company's consolidated balance sheet. The entire security deposit was returned to the Company after the sale of the Paris Marriott leasehold interest (see note 4).

7. INDEBTEDNESS**Mortgages and Other Debt Payable:**

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 and other debt payable at June 30, 2011 and December 31, 2010 consisted of the following (in thousands):

Debt	Spread (a) (basis points)	Maturity	Balance Outstanding at	
			June 30, 2011	December 31, 2010
InterContinental Chicago	106	October 2011(b)	\$ 121,000	\$ 121,000
InterContinental Miami	73	October 2011(b)	90,000	90,000
Loews Santa Monica Beach Hotel	63	March 2012(b)	118,250	118,250
Hyatt Regency La Jolla	100	September 2012	97,500	97,500
Marriott London Grosvenor Square (c)	110	October 2013	119,034	117,281
Fairmont Chicago (c)	Fixed	June 2017	97,750	97,750
Westin St. Francis (c)	Fixed	June 2017	220,000	220,000
Fairmont Scottsdale Princess (d)				180,000
Ritz-Carlton Half Moon Bay (e)				76,500
Total mortgages payable			863,534	1,118,281
Other debt (f)	Fixed	January 2013	1,476	
Total mortgages and other debt payable			\$ 865,010	\$ 1,118,281

- (a) Interest is paid monthly at the applicable spread over LIBOR (0.19% at June 30, 2011) for all mortgage loans except for those secured by the Marriott London Grosvenor Square, the Westin St. Francis, and the Fairmont Chicago. Interest on the Marriott London Grosvenor Square loan is paid quarterly at the applicable spread over three-month GBP LIBOR (0.83% at June 30, 2011). Interest on the Westin St. Francis and Fairmont Chicago loans is paid monthly at an annual fixed rate of 6.09%.
- (b) Subsequent to June 30, 2011, the Company refinanced these mortgage loans (see note 16). The mortgage secured by the InterContinental Chicago hotel was increased to \$145,000,000 with interest payable monthly at an annual fixed rate of 5.61% and has a maturity date of

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August 1, 2021. The mortgage secured by the InterContinental Miami hotel was reduced to \$85,000,000 with interest payable monthly at one-month LIBOR plus 3.50% and has a maturity date of July 6, 2016 with two, one-year extension options, subject to certain conditions. The mortgage secured by the Loews Santa Monica Beach Hotel was reduced to \$110,000,000 with interest payable monthly at one-month LIBOR plus 3.85% and has a maturity date of July 14, 2015 with three, one-year extension options, subject to certain conditions.

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- (c) These loan agreements require maintenance of financial covenants, all of which the Company was in compliance with at June 30, 2011.
- (d) On June 9, 2011, the Company completed a recapitalization of the Fairmont Scottsdale Princess hotel. As part of the recapitalization, the hotel's \$40,000,000 mezzanine debt was retired. In addition, the hotel's \$140,000,000 first mortgage was amended (including a \$7,000,000 principal payment) and extended (see note 5). After the recapitalization, the Company's ownership interest in the Fairmont Scottsdale Princess hotel is accounted for as an equity method investment and its mortgage debt is no longer reflected in the Company's consolidated balance sheets.
- (e) On June 29, 2011, the Company repaid the mortgage loan secured by the Ritz-Carlton Half Moon Bay, which became one of the borrowing base properties under the Company's \$300,000,000 bank credit facility agreement (as described below). The Ritz-Carlton Half Moon Bay replaced the Four Seasons Washington, D.C., which was a borrowing base property under the Company's previous \$350,000,000 bank credit facility, as collateral under the new bank credit facility. In July 2011, after being released as collateral under the bank credit facility, the Company entered into a mortgage agreement in the amount of \$130,000,000 that is secured by the Four Seasons Washington, D.C. hotel, which has a maturity date of July 20, 2014 and has two, one-year extension options, subject to certain conditions. Interest is payable monthly at a rate of one-month LIBOR plus 3.15% (see note 16).
- (f) The North Beach Venture assumed the mortgage loan on a hotel-condominium unit, which accrues interest at an annual fixed rate of 5.0% and is secured by the hotel-condominium unit. The hotel-condominium unit, with a carrying value of \$1,594,000, is included in other assets on the consolidated balance sheet as of June 30, 2011.

Other Debt:

In connection with the acquisition of a 60-acre oceanfront land parcel in Punta Mita, Nayarit, Mexico, the Company executed two \$17,500,000 non-interest bearing promissory notes. The Company recorded these notes at their present value based on an imputed interest rate of 9.5% and amortized the resulting discount over the life of the promissory notes. On September 30, 2008, the Company paid the first of the \$17,500,000 non-interest bearing promissory notes. The second note was due August 31, 2009. In August 2009, the Company entered into an agreement with the holder of the promissory note whereby the holder released the Company from its final installment payment of \$17,500,000 that was due in August 2009 in exchange for the Company agreeing to provide the note holder with the right to an interest in the property. The Company will receive a preferred position which will entitle it to receive the first \$12,000,000 of distributions generated from the property with any excess distributions split equally among the partners. The Company's obligations under this agreement, recorded as other liabilities in accounts payable and accrued expenses on the Company's consolidated balance sheets, are subject to the note holder being able to obtain certain permits and licenses to develop the land and the execution of an amended partnership agreement.

Exchangeable Notes:

On April 4, 2007, SH Funding issued \$150,000,000 in aggregate principal amount of 3.50% Exchangeable Senior Notes due 2012 (Exchangeable Notes) and on April 25, 2007 issued an additional \$30,000,000 of Exchangeable Notes in connection with the exercise by the initial purchasers of their over-allotment option. The Exchangeable Notes were issued at 99.5% of par value. The Company received proceeds of \$175,593,000, net of underwriting fees and expenses and original issue discount. On January 1, 2009, the Company adopted the provisions of new guidance on accounting for convertible debt instruments that may be settled in cash upon conversion, including partial cash settlements, and retrospectively recorded an additional discount on the Exchangeable Notes of \$20,978,000 as of the issuance date. The Exchangeable Notes paid interest in cash semi-annually in arrears on April 1 and October 1 of each year beginning October 1, 2007.

On May 10, 2010, the Company announced a cash tender offer to purchase any and all of the Exchangeable Notes outstanding. On June 7, 2010, the Company completed the tender offer and accepted for purchase, at par, \$180,000,000 of the principal amount of its outstanding Exchangeable Notes. The aggregate consideration for the Exchangeable Notes accepted for purchase was approximately \$181,208,000, which included accrued and unpaid interest of approximately \$1,208,000. The Company allocated \$169,939,000 of the consideration

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

to the settlement of the liability and \$10,061,000 to equity. This allocation was based on the fair value of the Exchangeable Notes excluding the conversion feature using unobservable (Level 3) inputs, which included a discount cash flow analysis and the Company's nonconvertible debt borrowing rate. For the three and six months ended June 30, 2010, the Company recognized a loss on early extinguishment of debt of \$886,000.

The table below presents the effect of the Exchangeable Notes on the Company's consolidated statements of operations for the three and six months ended June 30, 2010 (in thousands):

	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010
Statements of Operations:		
Coupon interest	\$ 1,208	\$ 2,783
Discount amortization	759	1,865
Total interest	\$ 1,967	\$ 4,648
Effective interest rate	6.25%	6.25%

Bank Credit Facility:

On June 30, 2011, SH Funding entered into a \$300,000,000 bank credit facility agreement. The agreement contains an accordion feature allowing for additional borrowing capacity up to \$400,000,000, subject to the satisfaction of customary conditions set forth in the agreement. The following summarizes key terms of the bank credit facility:

interest on the facility is payable monthly at LIBOR plus an applicable margin in the case of each LIBOR loan and base-rate plus an applicable margin in the case of each base rate loan whereby the applicable margins are dependent on the ratio of consolidated debt to gross asset value (Leverage Ratio) as follows:

Leverage Ratio	Applicable Margin of each LIBOR Loan (% per annum)	Applicable Margin of each Base Rate Loan (% per annum)
Greater than or equal to 60%	3.75%	2.75%
Greater than or equal to 55% but less than 60%	3.50%	2.50%
Greater than or equal to 50% but less than 55%	3.25%	2.25%
Greater than or equal to 45% but less than 50%	3.00%	2.00%
Less than 45%	2.75%	1.75%

an unused commitment fee is payable monthly based on the unused revolver balance at a rate of 0.45% per annum in the event that the bank credit facility usage is less than 50% and a rate of 0.25% per annum in the event that the bank credit facility usage is equal to or greater than 50%;

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maturity date of June 30, 2014, with the right to extend the maturity date for an additional one-year period with an extension fee equal to 25 basis points, subject to certain conditions;

lenders received collateral in the form of mortgages over four borrowing base properties, which initially include the Ritz-Carlton Laguna Niguel, the Ritz-Carlton Half Moon Bay, the Four Seasons Punta Mita Resort, and the Marriott Lincolnshire, in addition to pledges of the Company's interest in SH Funding and SH Funding's interest in certain subsidiaries and guarantees of the loan from the Company and certain of its subsidiaries;

maximum availability is determined by the lesser of 60% advance rate against the appraised value of the borrowing base properties (provided at any time the total fixed charge coverage ratio is less than 1.25 times, the percentage shall be reduced to 55%) or a 1.20 times debt service coverage on the

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STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

borrowing base properties (based on the trailing 12 months net operating income for these assets divided by the greater of the in-place interest rate or 7.0% debt constant on the balance outstanding under the bank credit facility) provided not more than 40% of aggregate appraised value and 40% of trailing 12 month net operating income is attributable to borrowing base properties located outside the United States;

minimum corporate fixed charge coverage of 1.00 times from the closing date through the fourth quarter of 2012, 1.10 times through 2013, 1.20 times from the first quarter of 2014 through the initial maturity date, and 1.30 times during the extension year, which will permanently increase to 1.35 times if cash dividends are reinstated on SHR's common stock;

maximum corporate leverage of 65% during the initial term and 60% during any extension period;

minimum tangible net worth of \$700,000,000, excluding goodwill and currency translation adjustments, plus an amount equal to 75% of the net proceeds of any new issuances of SHR's common stock, which is not used to reduce indebtedness or used in a transaction or series of transactions to redeem outstanding capital stock;

restrictions on SHR and SH Funding's ability to pay dividends. Such restrictions include:

prohibitions on SHR and SH Funding and their respective subsidiaries' ability to pay any dividends unless certain ratios and other conditions are met; and

prohibitions on SHR and SH Funding's ability to issue dividends in cash or in kind at any time an event of default shall have occurred.

Notwithstanding the dividend restrictions described above, for so long as the Company qualifies, or has taken all other actions necessary to qualify as a REIT, SH Funding may authorize, declare, and pay quarterly cash dividends to the Company when and to the extent necessary for the Company to distribute cash dividends to its shareholders generally in an aggregate amount not to exceed the minimum amount necessary for the Company to maintain its tax status as a REIT, unless certain events of default exist. In addition, provided no event of default exists, the Company is permitted to pay the outstanding cumulative accrued but unpaid preferred dividends at any time prior to June 30, 2012. Subsequent to June 30, 2012, provided no event of default exists, the Company is permitted to pay the outstanding cumulative accrued but unpaid preferred dividends subject to certain conditions set forth in the credit facility agreement.

Other terms and conditions exist including provisions to release assets from the borrowing base and limitations on the Company's ability to incur costs for discretionary capital programs and redeem, retire or repurchase common stock. Under the agreement, SH Funding has a letter of credit sub-facility of \$75,000,000, which is secured by the \$300,000,000 bank credit facility. Letters of credit reduce the borrowing capacity under the bank credit facility.

This agreement replaced the previous \$350,000,000 bank credit facility, as amended. The company wrote off \$692,000 of unamortized deferred financing costs applicable to the \$350,000,000 bank credit facility, which is included in loss on early extinguishment of debt for the three and six months ended June 30, 2011. The previous bank credit facility had a maturity date of March 9, 2012 and an interest rate of LIBOR plus a margin of 3.75% in the case of each LIBOR loan and base-rate plus a margin of 2.75% in the case of each base rate loan and a commitment fee of 0.50% per annum based on the unused revolver balance.

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The weighted average interest rate for the three and six months ended June 30, 2011 was 3.51% and 3.97%, respectively. At June 30, 2011, maximum availability under the bank credit facility was approximately \$284,000,000 and there was \$127,500,000 of borrowings outstanding under the bank credit facility and outstanding letters of credit of \$500,000 (see note 12). The agreement also requires maintenance of financial covenants, all of which SH Funding and SHR were in compliance with at June 30, 2011.

Table of Contents**STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Debt Maturity:**

The following table summarizes the aggregate maturities as of June 30, 2011 for all mortgages and other debt payable and the Company's bank credit facility (assuming the one-year extension of the bank credit facility) (in thousands):

Years ending	Amounts
December 31,	
2011 (remainder)	\$ 212,653
2012	227,454
2013	124,473
2014	9,481
2015	137,575
Thereafter	280,874
Total	\$ 992,510

Interest Expense:

Total interest expense in continuing and discontinued operations includes a reduction related to capitalized interest of \$314,000 and \$183,000 for the three months ended June 30, 2011 and 2010, respectively, and \$546,000 and \$328,000 for the six months ended June 30, 2011 and 2010, respectively. Total interest expense in continuing and discontinued operations includes amortization of deferred financing costs of \$642,000 and \$1,671,000 for the three months ended June 30, 2011 and 2010, respectively, and \$1,922,000 and \$3,501,000 for the six months ended June 30, 2011 and 2010, respectively.

8. EQUITY AND DISTRIBUTION ACTIVITY**Common Shares:**

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