Sunstone Hotel Investors, Inc.
Form 10-Q
November 09, 2011
Table of Contents

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 September 30, 2011

OR

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

For the transition period from to

Commission file number 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	**20-1296886** (I.R.S. Employer Identification Number)
120 Vantis, Suite 350 **Aliso Viejo, California** (Address of Principal Executive Offices)	**92656** (Zip Code)

Registrant s telephone number, including area code: **(949) 330-4000**

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

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

118,672,242 shares of Common Stock, $0.01 par value, as of November 1, 2011

Table of Contents

SUNSTONE HOTEL INVESTORS, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended September 30, 2011

TABLE OF CONTENTS

		Page
	PART I FINANCIAL INFORMATION	
Item 1.	Financial Statements:	
	Consolidated Balance Sheets as of September 30, 2011 (unaudited) and December 31, 2010	1
	Unaudited Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2011 and 2010	2
	Consolidated Statement of Equity as of September 30, 2011 (unaudited) and December 31, 2010	3
	Unaudited Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010	4
	Notes to Unaudited Consolidated Financial Statements	5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	46
Item 4.	Controls and Procedures	46
	PART II OTHER INFORMATION	
Item 1.	Legal Proceedings	46
Item 1A.	Risk Factors	46
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	47
Item 3	Defaults Upon Senior Securities	47
Item 4.	Removed and Reserved	47
Item 5.	Other Information	47

Item 6.	Exhibits	48
SIGNATURES		49

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents ($1,492 and $1,365 related to VIEs)	$ 159,974	$ 276,034
Restricted cash ($3,962 and $3,581 related to VIEs)	63,767	54,954
Accounts receivable, net ($2,843 and $1,885 related to VIEs)	25,416	17,285
Due from affiliates	6	44
Inventories ($215 and $159 related to VIEs)	2,388	2,101
Prepaid expenses	9,611	7,808
Investment in hotel properties of discontinued operations, net	15,041	131,404
Investment in other real estate of discontinued operations, net		896
Other current assets of discontinued operations, net	3,249	5,128
Total current assets	279,452	495,654
Investment in hotel properties, net	2,793,900	1,902,819
Other real estate, net	11,945	11,116
Investments in unconsolidated joint ventures		246
Deferred financing fees, net	11,408	8,855
Interest rate cap derivative agreements	6	
Goodwill	13,088	4,673
Other assets, net ($0 and $3 related to VIEs)	99,757	12,743
Total assets	$ 3,209,556	$ 2,436,106
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses ($858 and $713 related to VIEs)	$ 26,257	$ 20,889
Accrued payroll and employee benefits ($1,055 and $1,123 related to VIEs)	19,520	12,674
Due to Third-Party Managers	6,576	7,573
Dividends payable	7,437	5,137
Other current liabilities ($3,361 and $1,439 related to VIEs)	31,896	16,907
Current portion of notes payable	324,279	16,196
Note payable of discontinued operations	11,557	11,773
Other current liabilities of discontinued operations, net	873	21,600
Total current liabilities	428,395	112,749
Notes payable, less current portion	1,342,022	1,115,334
Interest rate swap derivative agreement	1,572	

Other liabilities ($0 and $30 related to VIEs)		10,723		8,724
Total liabilities		1,782,712		1,236,807
Commitments and contingencies *(Note 13)*				
Preferred stock, Series C Cumulative Convertible Redeemable Preferred Stock, $0.01 par value, 4,102,564 shares authorized, issued and outstanding at September 30, 2011 and December 31, 2010, liquidation preference of $24.375 per share		100,000		100,000
Equity:				
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 September 30, 2011 and December 31, 2010, stated at liquidation preference of $25.00 per share		176,250		176,250
8.0% Series D Cumulative Redeemable Preferred Stock, 4,600,000 shares issued and outstanding at September 30, 2011 and zero issued and outstanding at December 31, 2010, stated at liquidation preference of $25.00 per share		115,000		
Common stock, $0.01 par value, 500,000,000 shares authorized, 117,265,090 shares issued and outstanding at September 30, 2011 and 116,950,504 shares issued and outstanding at December 31, 2010		1,173		1,170
Additional paid in capital		1,311,918		1,313,498
Retained earnings		103,091		29,593
Cumulative dividends		(437,959)		(418,075)
Accumulated other comprehensive loss		(3,137)		(3,137)
Total stockholders equity		1,266,336		1,099,299
Non-controlling interest in consolidated joint ventures		60,508		
Total equity		1,326,844		1,099,299
Total liabilities and equity	$	3,209,556	$	2,436,106

The abbreviation VIE above refers to Variable Interest Entities.

See accompanying notes to consolidated financial statements.

Table of Contents

SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
REVENUES				
Room	$ 150,584	$ 105,927	$ 407,344	$ 302,033
Food and beverage	44,153	34,671	134,481	111,206
Other operating	17,597	11,877	47,821	34,415
Total revenues	212,334	152,475	589,646	447,654
OPERATING EXPENSES				
Room	37,894	27,033	102,782	77,378
Food and beverage	34,882	27,656	100,714	82,768
Other operating	6,871	5,734	19,059	17,113
Advertising and promotion	10,338	7,776	29,325	22,782
Repairs and maintenance	8,349	6,452	23,870	19,247
Utilities	8,441	6,593	22,518	17,750
Franchise costs	7,942	5,727	20,676	15,878
Property tax, ground lease and insurance	17,197	10,671	45,762	31,354
Property general and administrative	24,768	18,045	70,013	53,199
Corporate overhead	6,943	4,802	20,916	14,510
Depreciation and amortization	34,176	23,043	93,057	69,264
Impairment loss	10,862		10,862	1,943
Total operating expenses	208,663	143,532	559,554	423,186
Operating income	3,671	8,943	30,092	24,468
Equity in earnings of unconsolidated joint ventures		200	21	475
Interest income and other income (loss)	1,544	(280)	2,973	(10)
Interest expense	(21,792)	(16,506)	(60,729)	(53,235)
Gain on remeasurement of equity interests			69,230	
Income (loss) from continuing operations	(16,577)	(7,643)	41,587	(28,302)
Income from discontinued operations	24	31,296	32,124	31,172
NET INCOME (LOSS)	(16,553)	23,653	73,711	2,870
(Income) loss from consolidated joint venture attributable to non-controlling interest	31		(213)	
Distributions to non-controlling interest	(8)		(22)	
Preferred stock dividends and accretion	(7,437)	(5,141)	(19,884)	(15,515)
Undistributed income allocated to unvested restricted stock compensation		(232)	(638)	

INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS	$ (23,967)	$ 18,280	$ 52,954	$ (12,645)
Basic per share amounts:				
Income (loss) from continuing operations available (attributable) to common stockholders	$ (0.20)	$ (0.13)	$ 0.18	$ (0.45)
Income from discontinued operations		0.32	0.27	0.32
Basic income available (loss attributable) to common stockholders per common share	$ (0.20)	$ 0.19	$ 0.45	$ (0.13)
Diluted per share amounts:				
Income (loss) from continuing operations available (attributable) to common stockholders	$ (0.20)	$ (0.13)	$ 0.18	$ (0.45)
Income from discontinued operations		0.32	0.27	0.32
Diluted income available (loss attributable) to common stockholders per common share	$ (0.20)	$ 0.19	$ 0.45	$ (0.13)
Weighted average common shares outstanding:				
Basic	117,254	97,250	117,186	97,163
Diluted	117,254	97,612	117,268	97,163
Dividends declared per common share	$	$	$	$

See accompanying notes to consolidated financial statements.

Table of Contents

SUNSTONE HOTEL INVESTORS, INC.

CONSOLIDATED STATEMENT OF EQUITY

(In thousands, except share data)

	Preferred Stock											
	Series A		Series D		Common Stock							
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount	Additional Paid In Capital	Retained Earnings	Cumulative Dividends	Accumulated Other Comprehensive Loss	Non-Controlling Interest in Consolidated Joint Ventures	Total
Balance at December 31, 2010	7,050,000	$ 176,250		$	116,950,504	$ 1,170	$ 1,313,498	$ 29,593	$ (418,075)	$ (3,137)	$	$ 1,099,299
Net proceeds from sale of preferred stock (unaudited)			4,600,000	115,000			(4,062)					110,938
Vesting of restricted common stock (unaudited)					314,586	3	2,482					2,485
Non-controlling interest assumed at acquisition (unaudited)											61,067	61,067
Distributions to non-controlling interest (unaudited)											(772)	(772)
Series A preferred dividends and dividends payable at $1.50 per share year to date (unaudited)									(10,575)			(10,575)
Series C preferred dividends and dividends payable at $1.179 per share year to date (unaudited)									(4,836)			(4,836)
Series D preferred dividends and dividends payable at $0.972222 per share year to date (unaudited)									(4,473)			(4,473)
Net income and comprehensive income (unaudited)								73,498			213	73,711
Balance at September 30, 2011 (unaudited)	7,050,000	$ 176,250	4,600,000	$ 115,000	117,265,090	$ 1,173	$ 1,311,918	$ 103,091	$ (437,959)	$ (3,137)	$ 60,508	$ 1,326,844

See accompanying notes to consolidated financial statements.

Table of Contents

SUNSTONE HOTEL INVESTORS, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 73,711	$ 2,870
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	225	78
(Gain) loss on sale of hotel properties and other assets, net	(14,039)	383
Gain on remeasurement of equity interests	(69,230)	
Gain on extinguishment of debt	(18,145)	(47,220)
Loss on derivatives, net	2,091	
Depreciation	87,578	75,446
Amortization of franchise fees and other intangibles	10,401	386
Amortization and write-off of deferred financing fees	2,274	3,084
Amortization of loan discounts	792	743
Amortization of deferred stock compensation	2,170	2,405
Impairment loss	12,357	1,943
Equity in earnings of unconsolidated joint ventures	(21)	(475)
Changes in operating assets and liabilities:		
Restricted cash	12,171	(33,977)
Accounts receivable	3,060	2,846
Due from affiliates	38	25
Inventories	(125)	43
Prepaid expenses and other assets	2,470	(7,869)
Accounts payable and other liabilities	9,962	22,308
Accrued payroll and employee benefits	1,081	1,488
Due to Third-Party Managers	(991)	(1,111)
Discontinued operations	1,816	(20,475)
Net cash provided by operating activities	119,646	2,921
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of hotel properties and other assets	40,002	61
Cash received from unconsolidated joint venture		600
Restricted cash replacement reserve	(5,453)	(1,335)
Acquisitions of notes receivable		(3,700)
Acquisitions of hotel properties and BuyEfficient	(263,264)	(117,604)
Renovations and additions to hotel properties and other real estate	(82,433)	(31,443)
Net cash used in investing activities	(311,148)	(153,421)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from preferred stock offering	115,000	
Payment of preferred stock offering costs	(4,062)	
Proceeds from note payable	240,000	
Payments on notes payable	(252,189)	(117,158)
Payments of deferred financing costs and interest rate derivatives	(4,951)	(4)
Dividends paid	(17,584)	(15,411)

Distributions to non-controlling interest		(772)		
Net cash provided by (used in) financing activities		75,442		(132,573)
Net decrease in cash and cash equivalents		(116,060)		(283,073)
Cash and cash equivalents, beginning of period		276,034		353,120
Cash and cash equivalents, end of period	$	159,974	$	70,047
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid for interest	$	55,590	$	49,547
NONCASH INVESTING ACTIVITIES				
Accounts payable related to renovations and additions to hotel properties and other real estate	$	6,853	$	3,235
Deconsolidation of assets of hotel placed into receivership	$		$	18,374
Deconsolidation of liabilities of hotel placed into receivership	$		$	26,854
Amortization of deferred stock compensation construction activities	$	313	$	137
Amortization of deferred stock compensation unconsolidated joint venture	$	2	$	21
NONCASH FINANCING ACTIVITIES				
Issuance of note receivable	$	90,000	$	
Assumption of debt in connection with acquisitions of hotel properties	$	545,952	$	
Dividends payable	$	7,437	$	5,137

See accompanying notes to consolidated financial statements.

Table of Contents

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% 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 acquiring, owning, asset managing and renovating hotel properties. The Company may also sell certain hotel properties from time to time. 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 hotels 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 September 30, 2011, the Company had interests in 33 hotels, including the Valley River Inn located in Eugene, Oregon, which was classified as held for sale as of September 30, 2011 and included in discontinued operations due to its sale in October 2011, leaving 32 hotels (the 32 hotels) held for investment. The Company s third-party managers included subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, Marriott), managers of 13 of the Company s 32 hotels; a subsidiary of Interstate Hotels & Resorts, Inc., manager of 11 of the Company s 32 hotels; Highgate Hotels, manager of two of the Company s 32 hotels; Hilton Worldwide, manager of two of the Company s 32 hotels; and Davidson Hotels & Resorts, Fairmont Hotels & Resorts (U.S.), Hyatt Corporation and Sage Hospitality Resources, each managers of one of the Company s 32 hotels. In addition, as of January 2011, the Company owns 100% of BuyEfficient, LLC (BuyEfficient), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of September 30, 2011 and December 31, 2010, and for the three and nine months ended September 30, 2011 and 2010, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated. Non-controlling interests at September 30, 2011 represent the outside equity interests in various consolidated affiliates of the Company.

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, 2010, filed with the Securities and Exchange

Commission on February 17, 2011.

Certain prior year amounts have been reclassified in the consolidated financial statements in order to conform to the current year presentation.

The Company has evaluated subsequent events through the date of issuance of these financial statements.

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 differ materially from those estimates.

Reporting Periods

The results the Company reports in its consolidated statements of operations 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 each for 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.

Table of Contents

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 2011 results of operations for the Marriott-managed hotels include results from January 1 through March 25 for the first quarter, March 26 through June 17 for the second quarter, June 18 through September 9 for the third quarter, and September 10 through December 30 for the fourth quarter. The Company s 2010 results of operations for the Marriott-managed hotels include results from January 2 through March 26 for the first quarter, March 27 through June 18 for the second quarter, June 19 through September 10 for the third quarter, and September 11 through December 31 for the fourth quarter.

Fair Value of Financial Instruments

As of September 30, 2011 and December 31, 2010, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

The Company follows the requirements of the Fair Value Measurements and Disclosure Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), which establishes a framework for measuring fair value and disclosing fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Unobservable inputs reflecting the Company s own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

As discussed in Note 7, during the first nine months of 2011, the Company entered into interest rate protection agreements to manage, or hedge, interest rate risks in conjunction with its acquisitions of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square and the JW Marriott New Orleans during the first quarter of 2011, as well as the acquisition of a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront during the second quarter of 2011. The Company records interest rate protection agreements on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in the consolidated statements of operations as they are not designated as hedges. In accordance with the Fair Value Measurements and Disclosure Topic of the FASB ASC, the Company estimates the fair value of its interest rate protection agreements based on quotes obtained from the counterparties, which are based upon the consideration that would be required to terminate the agreements. The Company has valued the derivative interest rate cap agreements related to the Doubletree Guest Suites Times Square and the Hilton San Diego Bayfront using Level 2 measurements as an asset of $6,000 as of September 30, 2011. The Company has valued the derivative interest rate swap agreement related to the JW Marriott New Orleans using Level 2 measurements as a liability of $1.6 million as of September 30, 2011.

The Company currently pays the premiums for a $5,000,000 split life insurance policy for its former Chief Executive Officer and current Executive Chairman, Robert A. Alter. The Company has valued this policy using Level 2 measurements at $1.9 million as of both September 30, 2011 and December 31, 2010. These amounts are included in other assets, net in the accompanying consolidated balance sheets.

The Company also has a Retirement Benefit Agreement with Mr. Alter. The Company has valued this agreement using Level 2 measurements at $1.9 million as of both September 30, 2011 and December 31, 2010. These amounts are included in accrued payroll and employee benefits in the accompanying consolidated balance sheets.

On an annual basis and periodically when indicators of impairment exist, the Company has analyzed the carrying values of its hotel properties and other assets using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its hotel properties and other assets taking into account each property s expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition included anticipated operating cash flow in the year of disposition and terminal capitalization rate. In June 2011, the Company recognized a $1.5 million impairment on its commercial laundry facility located in Salt Lake City, Utah based on proceeds received from its sale in July 2011. In September 2011, the Company recognized a $10.9 million impairment loss on the $90.0 million mortgage-secured purchase money loan the Company received from the buyer of the Royal Palm Miami Beach (the Royal Palm

Table of Contents

note) in anticipation of its sale in October 2011. The Company sold the Royal Palm note in October 2011 for net proceeds of approximately $79.2 million. In June 2010, the Company recognized a $1.9 million impairment on an office building and land adjacent to one of its hotels based on estimated proceeds expected to be received from the potential sale of this property during 2010.

The Company also analyzes the carrying value of its goodwill using Level 3 measurements including a discounted cash flow analysis to estimate the fair value of its reporting units. For the three and nine months ended September 30, 2011 and 2010, the Company did not identify any properties with indicators of goodwill impairment.

As of September 30, 2011 and December 31, 2010, 69.5% and 100%, respectively, of the Company s outstanding debt had fixed interest rates, including the effect of an interest rate swap agreement. The Company s carrying value of its debt secured by properties not classified as discontinued operations totaled $1.7 billion and $1.1 billion as of September 30, 2011 and December 31, 2010, respectively. Using Level 3 measurements, including the Company s weighted average cost of capital ranging between 6.0% and 7.0%, the Company estimates that the fair market value of its debt as of September 30, 2011 and December 31, 2010 totaled $1.6 billion and $1.1 billion, respectively.

The following tables present our assets and liabilities measured at fair value on a recurring and non-recurring basis at September 30, 2011 and December 31, 2010 (in thousands):

	Total September 30, 2011 (unaudited)	Fair Value Measurements at Reporting Date Level 1 (unaudited)	Level 2 (unaudited)	Level 3 (unaudited)
Assets:				
Interest rate cap derivative agreements	$ 6	$	$ 6	$
Life insurance policy	1,874		1,874	
Royal Palm note	79,200			79,200
Total assets	$ 81,080	$	$ 1,880	$ 79,200
Liabilities:				
Retirement benefit agreement	$ 1,874	$	$ 1,874	$
Interest rate swap derivative agreement	1,572		1,572	
Total liabilities	$ 3,446	$	$ 3,446	$

	Total December 31, 2010	Fair Value Measurements at Reporting Date Level 1	Level 2	Level 3
Assets:				
Other real estate, net (1)	$ 2,506	$	$	$ 2,506
Life insurance policy	1,868		1,868	
Goodwill	4,673			4,673
Total assets	$ 9,047	$	$ 1,868	$ 7,179
Liabilities:				
Retirement benefit agreement	$ 1,868	$	$ 1,868	$

Total liabilities	$	1,868	$		$	1,868	$

(1) Includes the office building and land adjacent to one of the Company s hotels that was impaired and recorded at fair value in June 2010.

Table of Contents

The following table presents the goodwill account balance rollforward from the prior period, as well as the activity recorded for assets measured at fair value on a non-recurring basis using Level 3 inputs during the reporting period (in thousands):

		Goodwill
Balance at December 31, 2010	$	4,673
Purchase of outside 50.0% equity interest in BuyEfficient (unaudited)		8,415
Balance at September 30, 2011 (unaudited)	$	13,088

The following table presents the gains and impairment charges included in earnings as a result of applying Level 3 measurements for the three and nine months ended September 30, 2011 and 2010 (in thousands):

		Three Months Ended September 30, 2011 (unaudited)		Three Months Ended September 30, 2010 (unaudited)		Nine Months Ended September 30, 2011 (unaudited)		Nine Months Ended September 30, 2010 (unaudited)
Gains:								
Investment in unconsolidated joint ventures (1)	$		$		$	69,230	$	
Impairment charges:								
Other real estate, net	$		$		$		$	(1,943)
Other assets, net (2)		(10,862)				(10,862)		
Other real estate of discontinued operations, net						(1,495)		
Total impairment charges		(10,862)				(12,357)		(1,943)
Total Level 3 measurement gains (charges) included in earnings	$	(10,862)	$		$	56,873	$	(1,943)

(1) Includes the gains recorded by the Company on the remeasurements of the Company s equity interests in its Doubletree Guest Suites Times Square and BuyEfficient joint ventures.

(2) Includes the impairment loss recorded by the Company on the Royal Palm note in anticipation of the note s sale in October 2011.

Accounts Receivable

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes, among other things, receivables from customers who utilize the Company s commercial laundry facility in Rochester, Minnesota, receivables from customers who utilize purchase volume rebates through BuyEfficient, as well as tenants who lease space in the Company s hotels. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company s accounts receivable at both September 30, 2011 and December 31, 2010 includes an allowance for doubtful accounts of $0.1 million.

Acquisitions of Hotel Properties and Other Entities

Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property and equipment and intangible assets. During the first nine months of 2011 and 2010, the Company used all available information to make these fair value determinations, and engaged an independent valuation specialist to assist in the fair value determination of the long-lived assets acquired in the Company s purchases of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture, the outside 50.0% equity interests in the BuyEfficient joint venture, the JW Marriott New Orleans, the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront, and the purchase of the Royal Palm Miami Beach. Due to inherent subjectivity in determining the estimated fair value of long-lived assets, the Company believes that the recording of acquired assets and liabilities is a significant accounting policy.

Table of Contents

Goodwill

The Company follows the requirements of the Intangibles Goodwill and Other Topic of the FASB ASC, which states that goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests. As a result, the carrying value of goodwill allocated to the hotel properties and other assets is reviewed at least annually for impairment. In addition, when facts and circumstances suggest that the Company s goodwill may be impaired, an interim evaluation of goodwill is prepared. Such review entails comparing the carrying value of the individual hotel property or other asset (the reporting unit) including the allocated goodwill to the fair value determined for that reporting unit (see Fair Value of Financial Instruments for detail on the Company s valuation methodology). If the aggregate carrying value of the reporting unit exceeds the fair value, the goodwill of the reporting unit is impaired to the extent of the difference between the fair value and the aggregate carrying value, not to exceed the carrying amount of the allocated goodwill. The Company s annual impairment evaluation is performed each year as of December 31.

During the first quarter ended March 31, 2011, the Company recorded additional goodwill of $8.4 million related to its purchase of the outside 50.0% equity interest in its BuyEfficient joint venture.

Deferred Financing Fees

Deferred financing fees consist of loan fees and other financing costs related to the Company s outstanding indebtedness and are amortized to interest expense over the terms of the related debt. Upon repayment or refinancing of the underlying debt, any related unamortized deferred financing fee is charged to interest expense. Upon any loan modification, any related unamortized deferred financing fee is amortized over the remaining terms of the modified loan.

During the three and nine months ended September 30, 2011, approximately zero and $4.8 million, respectively of deferred financing fees were incurred and paid related to new debt entered into in connection with the Company s acquisitions of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square and the JW Marriott New Orleans during the first quarter of 2011, the acquisition of a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront during the second quarter of 2011 as well as to the Company s line of credit. During the three and nine months ended September 30, 2010, approximately zero and $4,000, respectively, were incurred and paid related to the modification of the loan on the Renaissance Baltimore.

Total amortization and write-off of deferred financing fees for the three and nine months ended September 30, 2011 and 2010 was as follows (in thousands):

	Three Months Ended September 30, 2011 (unaudited)	Three Months Ended September 30, 2010 (unaudited)	Nine Months Ended September 30, 2011 (unaudited)	Nine Months Ended September 30, 2010 (unaudited)
Continuing operations:				
Amortization of deferred financing fees	$ 840	$ 300	$ 2,265	$ 1,093
Write-off of deferred financing fees (1)				1,585

Total deferred financing fees continuing operations	840	300	2,265	2,678
Discontinued operations:				
Amortization of deferred financing fees	3	134	9	406
Total amortization and write-off of deferred financing fees	$ 843	$ 434	$ 2,274	$ 3,084

(1) Includes $1.5 million in unamortized deferred financing costs written off due to the termination of the Company s credit facility during the first quarter of 2010, and $0.1 million in unamortized deferred financing costs written off related to the release of three hotels from the Mass Mutual loan during the second quarter of 2010.

Earnings Per Share

The Company applies the two-class method when computing its earnings per share as required by the Earnings Per Share Topic of the FASB ASC, which 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 is 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 or interim period, the Company will follow the two-class method of computing earnings per share.

Table of Contents

The Company follows the requirements of ASC 260-10, which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. For the three and nine months ended September 30, 2011, zero and $0.6 million, respectively, were allocated to the participating securities. For the three and nine months ended September 30, 2010, $0.2 million and zero, respectively, were allocated to the participating securities.

In accordance with the Earnings Per Share Topic of the FASB ASC, basic earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period, plus potential common shares considered outstanding during the period, as long as the inclusion of such awards is not anti-dilutive. Potential common shares consist of unvested restricted stock awards (using the treasury stock method), the incremental common shares issuable upon the exercise of stock options (using the treasury stock method) and the conversion of the Company s Series C Cumulative Convertible Redeemable Preferred Stock (Series C preferred stock).

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

	Three Months Ended September 30, 2011 (unaudited)	Three Months Ended September 30, 2010 (unaudited)	Nine Months Ended September 30, 2011 (unaudited)	Nine Months Ended September 30, 2010 (unaudited)
Numerator:				
Net income (loss)	$ (16,553)	$ 23,653	$ 73,711	$ 2,870
(Income) loss from consolidated joint venture attributable to non-controlling interest	31		(213)	
Distributions to non-controlling interest	(8)		(22)	
Preferred stock dividends and accretion	(7,437)	(5,141)	(19,884)	(15,515)
Undistributed income allocated to unvested restricted stock compensation		(232)	(638)	
Numerator for basic and diluted earnings available (loss attributable) to common stockholders	$ (23,967)	$ 18,280	$ 52,954	$ (12,645)
Denominator:				
Weighted average basic common shares outstanding	117,254	97,250	117,186	97,163
Unvested restricted stock awards		362	82	
Weighted average diluted common shares outstanding	117,254	97,612	117,268	97,163
Basic earnings available (loss attributable) to common stockholders per common share	$ (0.20)	$ 0.19	$ 0.45	$ (0.13)
Diluted earnings available (loss attributable) to common stockholders per common share	$ (0.20)	$ 0.19	$ 0.45	$ (0.13)

The Company s shares of Series C preferred stock issuable upon conversion and shares associated with common stock options have been excluded from the above calculation of earnings (loss) per share for the three and nine months ended September 30, 2011 and 2010, as their inclusion would have been anti-dilutive. The Company s unvested restricted shares associated with its long-term incentive plan have been excluded from the above calculation of earnings (loss) per share for the three months ended September 30, 2011 and the nine months ended September 30, 2010 as their inclusion would have been anti-dilutive.

Table of Contents

Segment Reporting

The Company reports its consolidated financial statements in accordance with the Segment Reporting Topic of the FASB ASC. Currently, the Company operates in one segment, operations held for investment. In 2010, the Company operated in an additional segment, operations held for non-sale disposition. As a result of deed backs and title transfers, the Company has disposed of all assets and liabilities from its operations held for non-sale disposition segment. Accordingly, all assets, liabilities and the operations from its non-sale disposition segment have been reclassified to discontinued operations.

3. Investment in Hotel Properties

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

	September 30, 2011 (unaudited)	December 31, 2010
Land	$ 265,108	$ 237,758
Buildings and improvements	2,621,142	1,867,786
Furniture, fixtures and equipment	337,673	251,743
Intangibles	164,961	34,081
Franchise fees	1,031	983
Construction in process	26,257	38,135
	3,416,172	2,430,486
Accumulated depreciation and amortization	(622,272)	(527,667)
	$ 2,793,900	$ 1,902,819

In January 2011, the Company purchased the outside 62.0% equity interests in its Doubletree Guest Suites Times Square joint venture for $37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel located in New York City, New York. The purchase price included $13.0 million of unrestricted cash held on the partnership s balance sheet. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets and liabilities. The Company recognized acquisition-related costs of zero and $2.5 million during the three and nine months ended September 30, 2011, respectively, which are included in corporate overhead on the Company s statements of operations. The results of operations for the Doubletree Guest Suites Times Square have been included in the Company s statements of operations from the acquisition date of January 14, 2011 through the third quarter ended September 30, 2011. Preferred dividends earned by investors from an entity that owns the Doubletree Guest Suites Times Square, less administrative fees, totaled $8,000 and $22,000 during the three and nine months ended September 30, 2011, respectively, and are included in distributions to non-controlling interest on the Company s statements of operations.

In February 2011, the Company purchased the 494-room JW Marriott New Orleans located in New Orleans, Louisiana for approximately $51.6 million in cash and the assumption of a $42.2 million floating-rate, non-recourse senior mortgage. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets. The Company recognized acquisition-related costs of zero and $0.4 million during the three and nine months ended

September 30, 2011, respectively, which are included in corporate overhead on the Company s statements of operations. The results of operations for the JW Marriott New Orleans have been included in the Company s statements of operations from the acquisition date of February 15, 2011 through the end of Marriott s third quarter September 9, 2011.

In April 2011, the Company paid $182.8 million to acquire a 75.0% majority interest in the joint venture that owns the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California, which implied a gross value of approximately $475.0 million. The purchase price included $3.7 million of unrestricted cash held on the joint venture s balance sheet. The Company recorded the acquisition at fair value using an independent third-party analysis, with the purchase price allocated to investment in hotel properties, notes payable and hotel working capital assets and liabilities. The Company recognized acquisition-related costs of zero and $0.5 million for the three and nine months ended September 30, 2011, respectively, which are included in corporate overhead on the Company s statements of operations. The results of operations for the Hilton San Diego Bayfront have been included in the Company s statements of operations from the acquisition date of April 15, 2011 through the third quarter ended September 30, 2011. The remaining 25.0% interest in the joint venture continues to be owned by Hilton Worldwide, and is included in non-controlling interest in consolidated joint ventures on the Company s consolidated balance sheets and in (income) loss from consolidated joint venture attributable to non-controlling interest in the Company s statements of operations.

Table of Contents

The fair values of the assets acquired and liabilities assumed at the dates of acquisition for the Doubletree Guest Suites Times Square, the JW Marriott New Orleans and the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront were consistent with the purchase prices of these three acquisitions and were allocated based on independent third-party analyses. The following table summarizes the fair values of assets acquired and liabilities assumed in these three acquisitions (in thousands):

Assets:		
Investment in hotel properties (1)	$	907,654
Cash		16,680
Restricted cash		17,105
Accounts receivable		10,060
Other assets		7,473
Total assets acquired		958,972
Liabilities:		
Notes payable		545,952
Accounts payable and other current liabilities		19,558
Total liabilities acquired		565,510
Non-controlling interest		61,067
Gain on remeasurement of equity interest (2)		60,501
Total cash paid for acquisitions	$	271,894

(1) Investment in hotel properties was allocated to land ($27.4 million), buildings and improvements ($700.1 million), furniture, fixtures and equipment ($49.3 million) and intangibles ($130.9 million).

(2) Gain on remeasurement of equity interests includes a gain of $30.1 million recognized on the remeasurement of the Company s equity interest in its Doubletree Guest Suites Times Square joint venture to its fair market value, and a gain of $30.4 million recognized on the remeasurement of the Company s investment in a $30.0 million, 8.5% mezzanine loan secured by the Doubletree Guest Suites Times Square to its fair market value in connection with the Company s purchase of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture.

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 of the Doubletree Guest Suites Times Square in January 2011, the JW Marriott New Orleans in February 2011 and the 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront in April 2011 had all been acquired on January 1, 2010. In the Company s opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made (in thousands, except per share data):

Table of Contents

	Three Months Ended September 30, 2011 (unaudited)	Three Months Ended September 30, 2010 (unaudited)	Nine Months Ended September 30, 2011 (unaudited)	Nine Months Ended September 30, 2010 (unaudited)
Revenues	$ 212,334	$ 198,406	$ 628,423	$ 581,784
Income available (loss attributable) to common stockholders from continuing operations	$ (16,577)	$ (6,117)	$ 44,675	$ (23,384)
Income (loss) per diluted share available (attributable) to common stockholders from continuing operations	$ (0.20)	$ (0.12)	$ 0.20	$ (0.40)

For the three and nine months ended September 30, 2011, the Company has included $70.3 million and $159.8 million of revenues, respectively, and $19.4 million and $43.6 million of net income, respectively, in its consolidated statements of operations related to the Company s 2011 acquisitions.

4. Discontinued Operations

In April 2011, the Company sold the Royal Palm Miami Beach hotel for $130.0 million, including $40.0 million in cash and the $90.0 million Royal Palm note, and recognized a gain on the sale of $14.0 million. The Company reclassified the hotel s results of operations for the first four months of 2011 as well as the three and nine months ended September 30, 2010 to discontinued operations on its statements of operations. The Royal Palm note matures in December 2013, and bears interest at a floating rate of LIBOR plus 500 basis points through December 2012, and LIBOR plus 600 basis points for 2013, both subject to a 1% LIBOR floor. The Company retained an earn-out right on the Royal Palm hotel which will enable it to receive future payments of up to $20.0 million in the event that the hotel achieves certain return hurdles.

In July 2011, the Company sold its commercial laundry facility located in Salt Lake City, Utah for gross proceeds of $87,500, and recognized a loss of $52,000. In anticipation of this sale, the Company recorded an impairment loss of $1.5 million to discontinued operations in June 2011. The Company reclassified the laundry s results of operations for the three and nine months ended September 30, 2011 and 2010 to discontinued operations on its statements of operations.

In June 2011, the Company classified the Valley River Inn located in Eugene, Oregon as held for sale in anticipation of its sale in October 2011. The Company reclassified the hotel s assets and liabilities as of September 30, 2011 and December 31, 2010 to discontinued operations on its balance sheets and the hotel s results of operations for the three and nine months ended September 30, 2011 and 2010 to discontinued operations on its statements of operations.

In 2009, pursuant to a secured debt restructuring program, the Company elected to cease the subsidization of debt service on four loans secured by 11 of its hotels: W San Diego, Renaissance Westchester, Marriott Ontario Airport, and the Mass Mutual eight (Renaissance Atlanta Concourse, Hilton Huntington, Residence Inn by Marriott Manhattan Beach, Marriott Provo, Courtyard by Marriott San Diego (Old Town), Holiday Inn Downtown San Diego, Holiday Inn Express San Diego (Old Town), and Marriott Salt Lake City (University Park)). In December 2009, the Company transferred possession and control of the Renaissance Westchester to a court-appointed receiver. In June 2010, the Company reacquired the Renaissance Westchester, and the $29.2 million non-recourse mortgage secured by the hotel was cancelled. The Company

recorded a gain on extinguishment of debt of $6.7 million to discontinued operations in June 2010. In July 2010, the Company completed the deed back of the W San Diego, and title to the hotel was transferred to the lender. The Company recorded a gain on extinguishment of debt of $35.4 million to discontinued operations in July 2010, and removed the hotel s net assets and liabilities from its 2010 balance sheet. In August 2010, the Marriott Ontario Airport was sold by the receiver, and title to the hotel was transferred to the new owner. In connection with this sale, the Company recorded a $5.1 million gain on extinguishment of debt to discontinued operations in August 2010, and removed the net assets and liabilities from its 2010 balance sheet.

In November 2010, the Company completed the deed back of the Mass Mutual eight hotels, and titles to the hotels were transferred to the lender. In connection with such transfer, Mass Mutual delivered to the Company a covenant and agreement pursuant to which Mass Mutual agreed to not sue the Company for any matter or claim which Mass Mutual may ever have relating to the hotels, the loan or the loan documents. There are certain customary carveouts from this covenant not to sue, including fraud, a breach of the deed in lieu agreement itself and the environmental indemnity agreement delivered at the time the loan was originated. Five of the Mass Mutual eight hotels remained subject to franchise agreements which contained corporate guaranties. If the franchise

Table of Contents

agreements on these five hotels were to be terminated, the Company was potentially liable for up to $19.6 million in termination fees. The Company recorded a gain on extinguishment of debt of $39.0 million to discontinued operations in the fourth quarter of 2010, and the net assets and liabilities were removed from its 2010 balance sheet. Additional gain of $19.6 million was to be deferred until all significant contingencies were resolved. In June 2011, the Company paid $1.5 million in termination fees on the Residence Inn by Marriott Manhattan Beach. All contingencies relating to the remaining $18.1 million in termination fees were resolved in June 2011, and the Company recorded a gain on extinguishment of debt of $18.1 million to discontinued operations in June 2011. The Company no longer has any financial liabilities related to the Mass Mutual debt restructuring.

The following sets forth the discontinued operations for the three and nine months ended September 30, 2011 and 2010, related to the hotel property and the commercial laundry facility sold in 2011, the hotel property classified as held for sale as of September 30, 2011, the 10 hotel properties deeded back to lenders or sold by the receiver during 2010, and the Renaissance Westchester held in receivership until its reacquisition by the Company in June 2010 (in thousands):

	Three Months Ended September 30, 2011 (unaudited)	**Three Months Ended September 30, 2010 (unaudited)**	**Nine Months Ended September 30, 2011 (unaudited)**	**Nine Months Ended September 30, 2010 (unaudited)**
Operating revenues	$ 2,789	$ 25,239	$ 17,263	$ 73,667
Operating expenses	(2,552)	(26,996)	(13,323)	(67,334)
Interest expense	(161)	(5,040)	(481)	(16,039)
Depreciation and amortization expense		(2,380)	(1,951)	(6,342)
Impairment loss			(1,495)	
Gain on extinguishment of debt		40,473	18,145	47,220
Gain (loss) on sale of hotels and other assets	(52)		13,966	