STRATEGIC HOTELS & RESORTS, INC
Form 424B5
May 15, 2006
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The information in this preliminary prospectus supplement is not complete and may be changed. The registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(5)
Registration no. 333-133353

Subject to completion, dated May 15, 2006

PROSPECTUS SUPPLEMENT

(To Prospectus dated April 18, 2006)

Strategic Hotels & Resorts, Inc.

14,000,000 Shares

Common Stock

This is a public offering of common stock of Strategic Hotels & Resorts, Inc. We are offering 14,000,000 shares of our common stock. Our common stock is traded on the New York Stock Exchange under the symbol BEE. On May 12, 2006, the last reported sale price of our common stock was $21.84 per share.

Investing in our common stock involves risk. See Risk Factors beginning on page S-17 of this prospectus supplement and Risk Factors beginning on page 5 of the accompanying prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us.	$	$

We have granted the underwriters the right, exercisable for 30 days from the date of this prospectus supplement, to purchase up to 2,100,000 shares of our common stock, to cover over-allotments.

Delivery of the shares of common stock will be made on or about , 2006.

Joint Book-Running Managers

Deutsche Bank Securities **Wachovia Securities**

Citigroup

Raymond James JMP Securities

The date of this prospectus supplement is May , 2006.

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ABOUT THIS PROSPECTUS SUPPLEMENT

As used in this prospectus supplement, references to we, our, us, the Company and the REIT are to Strategic Hotels & Resorts, Inc. and, exc as the context otherwise requires, our consolidated subsidiaries, including Strategic Hotel Funding, L.L.C., our operating company, and its consolidated subsidiaries. References to SHC Funding or the limited liability company are to Strategic Hotel Funding, L.L.C.

This prospectus supplement 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®, Ritz-Carlton®, Starwood® and Westin®. None of the owners of these trademarks, their affiliates or any of their respective officers, directors, agents or employees is an issuer or underwriter of the securities being offered hereby. In addition, 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 arising out of or related to the sale or offer of the securities being offered hereby, including any liability or responsibility for any financial statements, projections or other financial information or other information contained in this prospectus supplement or otherwise disseminated in connection with the offer or sale of the securities offered hereby.

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of the common stock we are offering and certain other matters relating to us. This first part also adds to and updates information contained in the accompanying prospectus and the documents incorporated by reference into this prospectus supplement or the accompanying prospectus. The second part, the accompanying prospectus, gives more general information about our company and securities we may offer from time to time, some of which may not apply to this offering or the common stock. To the extent there is a conflict between the information contained in this prospectus supplement, on the one hand, and the information contained in the accompanying prospectus or any document incorporated by reference therein, on the other hand, the information in this prospectus supplement shall control.

It is important for you to read and consider all information contained in this prospectus supplement and the accompanying prospectus, including the documents incorporated by reference therein, in making your investment decision. You should also read and consider the information in the documents we have referred you to in Where You Can Find More Information below.

This prospectus supplement and the accompanying prospectus are not an offer to sell any security other than the shares of common stock and are not soliciting an offer to buy any security other than the common stock. This prospectus supplement and the accompanying prospectus are not an offer to sell our common stock to any person, and it is not soliciting an offer from any person to buy our common stock, in any jurisdiction where the offer or sale to that person is not permitted.

FORWARD-LOOKING STATEMENTS

On one or more occasions, we may make statements regarding our assumptions, projections, expectations, targets, intentions or beliefs about future events. All statements other than statements of historical facts included or incorporated by reference in this prospectus supplement or in the accompanying prospectus, including, without limitation, the statements under Prospectus Supplement Summary and located elsewhere in this prospectus supplement or incorporated by reference herein relating to expectations of future financial performance, continued growth, changes in economic conditions or capital markets and changes in customer usage patterns and preferences, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act).

Words or phrases such as anticipates, believes, estimates, expects, intends, may, plans, potential, predicts, projects, should, continue, will likely result or other comparable expressions or the negative of these terms identify forward-looking statements. Forward-looking statements reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause actual results or outcomes to differ materially from those expressed in any forward-looking statement. We caution that while we make such statements in good faith and we believe such statements are based on reasonable assumptions, including without limitation, management s examination of historical operating trends, data contained in records and other data available from third parties, we cannot assure you that our projections will be achieved.

In addition to other factors and matters discussed elsewhere in our quarterly, annual and current reports that we file with the Securities and Exchange Commission (the SEC), and which are incorporated by reference into this prospectus supplement, some important factors that could cause actual results or outcomes for us to differ materially from those discussed in forward-looking statements include, but are not limited to:

- The factors discussed in this prospectus supplement under the section titled Risk Factors and the accompanying prospectus under the section titled Risk Factors ;
- Our failure to maintain effective internal control over financial reporting and disclosure controls and procedures;
- Availability of capital;
- Risks related to natural disasters (including the damage sustained by our New Orleans property as a result of Hurricane Katrina);
- Increases in interest rates and operating costs;
- Difficulties in identifying properties to acquire and completing acquisitions;
- Availability to obtain or refinance debt;
- The failure of closing conditions to be satisfied;

Rising insurance premiums;

Delays in construction and development;

Marketing challenges associated with entering new lines of business or pursuing new business strategies;

Our ability to dispose of existing properties in a manner consistent with our investment strategy;

Downturns in economic and market conditions, particularly levels of spending in the travel and leisure industries in the markets where we invest;

General volatility of the capital markets and the market price of our common shares;

Our failure to maintain our status as a REIT;

Increases in real property tax rates;

Changes in the competitive environment in our industry and the markets where we invest;

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- Changes in real estate and zoning laws or regulations; and

- Hostilities, including future terrorist attacks, or apprehension of hostilities that affect travel within or to the United States, Mexico, Czech Republic, Germany, France or other countries where we invest.

Any forward-looking statement speaks only as of the date on which such statement is made. New factors emerge from time to time and it is not possible for management to predict all such factors. We do not intend, and disclaim any duty or obligation, to update or revise any industry information or forward-looking statements set forth in this prospectus supplement to reflect new information, future events or otherwise, except as required by law. Readers are urged to carefully review and consider the various disclosures made in this prospectus supplement and in our other documents filed with the SEC, including the accompanying prospectus and the risk factors described in that filing, that attempt to advise interested parties of the risks and other factors that may affect our business, prospects and results of operations and financial condition.

PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights selected information contained elsewhere or incorporated by reference into this prospectus supplement and the accompanying prospectus. This summary does not contain all the information that you should consider before investing in our common stock. You should read the entire prospectus supplement and the accompanying prospectus carefully, including the risk factors and the financial statements included or incorporated by reference in this prospectus supplement and the accompanying prospectus.

Our Business

We are an industry-leading owner and asset manager of high-end hotels and resorts. We own a quality portfolio of upper upscale and luxury hotels and resorts in desirable North American and European locations. Our portfolio is currently comprised of 18 properties totaling 8,463 rooms. We own unique hotels with complex operations, sophisticated customers and multiple revenue streams. Our properties are diverse and include large convention hotels, business hotels and resorts, which are operated by internationally known hotel management companies under management contracts or operating leases. Our existing hotels are operated under the widely recognized upper upscale and luxury brands of Fairmont®, Four Seasons®, Hilton®, Hyatt®, InterContinental®, Loews®, Marriott®, Ritz-Carlton® and under the independent name Del Coronado .

We operate as a self-administered and self-managed real estate investment trust, or REIT, managed by our board of directors and executive officers and conduct our operations through our direct and indirect subsidiaries including our operating company, SHC Funding. Our operating company holds substantially all of our assets. We are the sole managing member of our operating company and hold approximately 98% of its membership units. We manage all business aspects of our operating company, including the sale and purchase of hotels, the investment in these hotels and the financing of our operating company and its assets. We currently:

- own the fee interest in 11 hotels, comprising 5,121 rooms, located in Arizona, California, Florida, Illinois, Louisiana, Washington, D.C. and in Mexico;
- lease three hotels from unaffiliated lessors: a ground lease in a hotel in Lincolnshire, Illinois and operating leases in hotels in Paris, France and Hamburg, Germany, comprising an aggregate of 858 rooms;
- own a 35% interest in a joint venture with an unaffiliated party that owns a hotel in Prague, Czech Republic comprising 372 rooms, and we asset manage such hotel on behalf of the joint venture;
- own an 85% interest in the joint ventures that own each of the InterContinental Hotel in Miami and the InterContinental Hotel in Chicago, comprising an aggregate of 1,433 rooms, and we asset manage such hotels on behalf of the joint ventures;
- own a 31% interest in and act as asset manager for a joint venture with two unaffiliated parties that is developing the Four Seasons Residence Club Punta Mita, a luxury vacation home product that will be sold in fractional ownership interests on property adjacent to our Four Seasons Punta Mita Resort hotel in Mexico;
- own a 45% interest in a joint venture with two unaffiliated parties that owns a hotel in Coronado, California (San Diego), comprising 679 rooms, and we asset manage that hotel on behalf of the joint venture;

have pending acquisitions under contract which have not yet closed to acquire the 1,195-room Westin St. Francis San Francisco, and the 393-room Ritz-Carlton Laguna Niguel. See Recent Developments Acquisitions; and

have a pending disposition under contract which has not closed to sell the Marriott Rancho Las Palmas Resort. See Recent Development Hotel Disposition.

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We also currently asset manage two hotels for Strategic Hotel Capital, L.L.C., or SHC LLC, under an asset management agreement. After the close of the purchase of the Ritz-Carlton Laguna Niguel, we will only manage one remaining hotel.

We were incorporated in Maryland in January 2004. SHC LLC, our founder and accounting predecessor, was founded in 1997 by Laurence Geller, our President and Chief Executive Officer, WHSHC, L.L.C. and W9/WHSHC, L.L.C. I, and others.

Our principal office is located at 77 West Wacker Drive, Suite 4600, Chicago, Illinois 60601 and our telephone number is (312) 658-5000. We operate under the name Strategic Hotels and Resorts and maintain an internet site at *http://www.strategichotels.com* which contains information concerning us and our subsidiaries. Information included or referred to on our website is not incorporated by reference or otherwise a part of this prospectus supplement. Our website address is included in this prospectus supplement as an inactive textual reference only.

Business Strategy

Our goal is to build upon our existing portfolio of hotel properties to become a preeminent owner of upper upscale and luxury branded hotels primarily in the United States with select international hotels. Our future growth will be driven through the execution of a two-fold business strategy, which focuses on maximizing asset values and operating results through asset management and by research-driven capital deployment through acquisitions.

Earnings Growth Through Expert Asset Management

We believe that we can enhance our earnings growth through expert asset management, which will ultimately generate higher overall investment returns. We have developed a comprehensive asset management system that we believe maximizes cash flow growth and property value. In addition, we believe that our asset management style has helped us to maximize economic benefits in an industry that has suffered reduced performance in the past, and to position our properties for the current recovery. Our value-added asset management system has the following general components:

Working in partnership with our hotel management companies, we build an asset management approach to enhance the cash flow and value of our properties:

Our senior management team has long-standing relationships with executives of most major hospitality companies. Led by Laurence Geller, our President and Chief Executive Officer, with over 40 years of experience in the hospitality industry, our senior management has developed strong relationships with hotel operators throughout the hotel industry. In addition, we generally believe we have asset managers with broader experience in hotel operations than our competitors, in large part as a result of our belief that the efficiency of our team requires in-depth knowledge of all of the components of each property.

We believe that we can more effectively influence the operating performance of our hotels if we have multi-property relationships with a select group of hotel management companies, which we call our preferred operators. We select our preferred operators based on our opinion as to whether an operator has strong brand recognition, superior marketing capabilities, management depth and an ability to work with our team to create efficient operations. Because our preferred operators provide the services, technology, human resources training and infrastructure to conduct day-to-day hotel operations, we can focus our energies on monitoring their performance, identifying areas of improvement and providing our operators with useful feedback that they can utilize to improve operating results and enhance the value of our hotels.

We have a proven track record of improving hotel operating performance through the application of value-added programs involving consumer and market research, competitive benchmarking, technology upgrades and systems development and upgrades. In addition, we have long-standing relationships with specialists with whom we consult or recommend to the managers of our hotels as needed in order to provide them more focused support and expertise in areas such as consumer research, purchasing, retailing, merchandising, food and beverage services, physical plant and equipment maintenance, labor systems and parking. Our asset management group is supported by:

- consumer-based marketing research to assess overall trends in consumer preferences and attitudes on issues such as price, brand, services, amenities and facility needs that has led to strategies that alter customer mix and improve pricing and overall total revenues; and
- well-developed techniques for measuring and analyzing departmental and overall hotel profitability and operating trends that have led to implementation of efficiency measures which result in cost savings.

We have also improved operating performance at a number of our hotels through measures including:

- appealing real estate taxes, generating annualized tax savings;
- assisting our hotel operators in conducting energy reviews and audits, generating fuel and electric savings;
- assisting our operators in a review of staffing levels and productivity standards, generating labor savings; and
- assisting our operators in a review of their food purchasing practices and vendor pricing, generating reductions in food costs.

Our hotels are operated under a number of different brands in different locations, which exposes us to diverse management approaches and provides us with an opportunity to identify, develop and apply what we believe to be the best practices in the industry. Our asset management group uses this knowledge to help our preferred operators implement revenue enhancement opportunities, improve operating performance through cost-saving actions and generate incremental profitability above a hotel s baseline results.

We provide rigorous oversight of the properties and management companies to ensure the alignment of the management companies and our interests and their compliance with the management contracts relating to our properties:

We closely monitor the management companies to which we have delegated the management of our hotels to ensure that they adhere to the terms of their contracts with us. Our asset management group systematically monitors operating decisions, which are made independently by hotel operators but impact the profitability of our hotel properties. In addition, our asset management group works with each of our preferred operators at their corporate level to seek to maximize the value of our properties through the operation of their internal programs and to ensure that cost allocations to each of our properties are appropriate.

As a result of the depth of our involvement in our hotel properties, we believe we attain more favorable terms upon renewal of management contracts. For example, where possible, we negotiate management contracts that align the interests of hotel operators with those of the hotel owner by increasing the emphasis on incentive management fees, which we believe focuses the obligation of each hotel s management to operate for the benefit of the hotel rather than for the benefit of the brand the hotel carries. In certain cases, these initiatives have included a cap on the allocation of certain chain level expenses to our hotels and, in other cases, have included persuading hotel management companies to adopt money-saving labor management and food and beverage purchasing systems.

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Our asset management team is integral to the capital planning at each hotel including both routine maintenance expenditures and innovative hotel investments to enhance revenues:

- We work with our managers to ensure that each of our hotel properties is maintained in good repair and condition in conformity with applicable laws and regulations and consistent with the brand s standards, other hotels and the provisions of the management agreements. The expense of routine repairs, maintenance and ordinary course capital expenditures performed by our management companies are deducted from a furniture, fixtures and equipment reserve, which is generally funded on a monthly basis by a portion of a hotel s gross revenue. With respect to extraordinary capital expenditures or expenditures outside the ordinary course of operating a hotel, we typically retain approval rights, spending limits or other restrictions that limit the ability of our management companies to perform significant programs of capital improvements, renovation or refurbishing that we believe are unnecessary, undesirable or would result in an unacceptable return on investment.

- Our team s creative approach often results in capital investment plans for conversion of unused or underutilized space to new revenue-generating facilities. Examples have included changing the usage of existing hotel space and the identification of expansion areas to create additional meeting rooms, guest rooms and retail outlets.

Asset Growth Through Acquisitions

Key elements. Our acquisition strategy incorporates three key elements:

- Focusing on the acquisition of upper upscale and luxury hotels in attractive markets with barriers to entry where we believe there are opportunities for us to add value by employing our asset management skills and systems;

- Targeting either hotels with existing management contracts or hotels where there is an opportunity to put in place a management contract with one of our preferred operators that would enhance asset value; and

- Building single- and multi-brand relationships with our preferred operators, which are leading hotel management companies that have strong brand recognition, superior marketing capabilities, management depth and an ability to work with our team to create efficient operations.

Acquire upper upscale and luxury hotels. We target upper upscale and luxury hotels in select urban and resort markets, including major business centers and leisure destinations, with strong growth characteristics and high barriers to entry. Typically, our target hotels would be larger than 150 rooms and have growth or expansion opportunities. We believe that the upper upscale and luxury hotel sector is an extremely attractive sector for long-term investment, especially considering the supply constraints characteristic of that sector. These supply constraints include the importance of location, lack of available land, high development costs, long development and entitlement lead times and brand trade area restrictions that prevent the addition of a certain brand or brands in close proximity. Moreover, the management-intensive nature of upper upscale and luxury hotels provides our experienced management team with the opportunity to enhance value and maximize operating results at these hotels by monitoring performance and suggesting practical strategies for creating greater revenue flow to the bottom line.

Target hotels with management contracts or where we can put value-enhancing management contracts in place. We believe that a significant percentage of upper upscale and luxury hotels in North America have management contracts with remaining durations in excess of five years. We believe that our operating skills and experience with our preferred operators enables us to acquire properties with existing management contracts and provide for opportunities to achieve higher initial investment returns than we might attain from similar-quality hotels without management contracts.

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Continuous research and disciplined investment decisions. As a result of our ongoing research, the selection of target markets and individual property targets is updated continuously to foster a proactive acquisition process. We believe our acquisition process permits us to make disciplined investment decisions quickly and efficiently, offering sellers the benefit of an expedited closing and certainty of execution.

Selected international opportunities. We have the skills and experience to acquire and asset manage hotels both domestically and internationally, which have permitted us to diversify our portfolio geographically. We currently own hotels in Mexico City and Punta Mita, Nayarit, Mexico, leasehold interests in hotels in Paris, France and Hamburg, Germany and a joint venture interest in a hotel in Prague, Czech Republic, which we asset manage for the joint venture. We believe that the international scope of our knowledge and skills places us in a unique position among lodging REITs and will permit us to take advantage of select international hotel opportunities.

Condominium hotel, fractional ownership and other development. Although our principal focus is on the development of value in our hospitality business, certain of our properties may have alternative, higher relative value residential uses. In selected cases, management intends to pursue a residential strategy in conjunction with residential for sale experts and/or partners. The goals in a residential conversion strategy would include improving the return on an existing asset, liquidating an asset at a premium that would permit reinvestment into additional hospitality assets, and/or providing a mixed use opportunity that would be complementary and therefore increasing the revenue potential of an investment.

Growth through joint ventures. While joint venture financing of new acquisitions is not a primary growth strategy, we have had a successful history of entering into joint venture arrangements and will consider opportunities in the future when:

- they are with strategic partners whose financial objectives are compatible with ours;
- they provide compelling economics that may include current asset management fee income and upside participation; and/or
- they provide access to strategically important hotel acquisitions.

Advantages of this investment strategy include allowing us to expand our portfolio, increase fee-based income, enhance the return on our real estate through fee and incentive income and foster closer relationships with our preferred operators. We can also gain additional diversification of our capital and higher return on investment by investing in a larger number of properties, although through a smaller investment in each property.

Growth through strategic asset management. We will seek to asset-manage properties when such an involvement leads to access to profitable hotel investment opportunities. Our goal is not to enter the traditional asset management business and compete with pure fee for service asset managers on price, but rather to take advantage of special opportunities, like the joint venture opportunities previously described, or strategic alliances that will allow us to earn fees to supplement the returns from our owned properties with limited or no accompanying financial commitment. Similar to our joint venture properties, through these management relationships we expect to gain familiarity with the assets we oversee which may position us favorably to acquire ownership of these properties if they are offered for sale.

Recycle capital for future investments through opportunistic dispositions. We will take advantage of opportunities to sell or enter into a joint venture with respect to our ownership in a property, thereby freeing capital for future investment, when we believe that a disposition or entering into a joint venture would be in our best interest and in compliance with continued qualification as a REIT. For example, we are likely to sell or enter into a joint venture with respect to ownership in properties in circumstances where:

- we believe that our asset management team has maximized the property s value;
- the proceeds of the disposition are unusually attractive;
- the market in which the property is located is declining or static; or
- competition in the market requires substantial capital investment which will not generate returns that meet our criteria.

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Summary of Hotel Properties

Set forth below is a summary of certain information related to our hotel properties as of May 12, 2006:

Hotel	Location	Number of Rooms	Property Interest	Date Acquired
Hyatt Regency New Orleans(1)(*)	New Orleans, LA	1,184	Fee simple	9/1997
InterContinental Chicago Hotel(2)(*)	Chicago, IL	792	Fee simple	4/2005
Hyatt Regency Phoenix(*)	Phoenix, AZ	696	Fee simple	1/1998
Fairmont Chicago Hotel(*)	Chicago, IL	691	Fee simple	9/2005
Hotel del Coronado(3)(*)	Coronado, CA	679	Fee simple	1/2006
InterContinental Miami Hotel(2)(*)	Miami, FL	641	Fee simple	4/2005
Hilton Burbank Airport and Convention Center(*)	Burbank, CA	488	Fee simple	1/1998
Marriott Rancho Las Palmas Resort(4)(*)	Rancho Mirage, CA	444	Fee simple	1/1998
Hyatt Regency La Jolla at Aventine(*)	La Jolla, CA	419	Fee simple	7/1999
Marriott Lincolnshire Resort(5)(*)	Lincolnshire, IL	389	Ground lease	9/1997
InterContinental Prague(6)(*)	Prague, Czech Republic	372	Fee simple	8/1999
Loews Santa Monica Beach Hotel(7)(*)	Santa Monica, CA	342	Fee simple	3/1998
Marriott Hamburg(8)	Hamburg, Germany	277	Leasehold	6/2000
Ritz-Carlton Half Moon Bay(*)	Half Moon Bay, CA	261	Fee simple	8/2004
Four Seasons Mexico City(*)	Mexico City, Mexico	240	Fee simple	12/1997
Four Seasons Washington, D.C.	Washington, D.C.	211	Fee simple	3/2006
Paris Marriott Champs Elysees(8)	Paris, France	192	Leasehold	2/1998
Four Seasons Punta Mita Resort(*)	Punta Mita, Mexico	145	Fee simple	2/2001
Total Number of Rooms		8,463		

(1) This property has been substantially damaged by Hurricane Katrina that struck the Gulf Coast region in August 2005 and as a result, the hotel s operations have effectively ceased.

(2) We own 85% controlling interests in two joint ventures that own these properties.

(3) We have a 45% interest in the joint venture that owns this property.

(4) On May 7, 2006, we entered into an agreement to sell the Marriott Rancho Las Palmas Resort for $56.0 million. The sale is expected to close in July 2006. See Recent Developments Hotel Disposition.

(5) We have a ground lease interest in this property.

(6) We have a 35% joint venture interest in this property.

(7) We are restricted by agreement from selling this property other than in a transaction that will qualify as a tax deferred exchange and must maintain a specific minimum level of indebtedness encumbering this property until a future date.

(8) These properties were originally acquired on the dates indicated in the table, but were subsequently sold to a third party and leased back by us in transactions that are more fully described in our Annual Report on Form 10-K/A and certain other documents incorporated by reference herein.

(*) These properties are subject to mortgages as more fully described in our Annual Report on Form 10-K/A and certain other documents incorporated by reference herein.

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Recent Developments

Restatements

On May 1, 2006, after consultation with and review of our management s conclusions as discussed below, our audit committee of the board of directors concluded that previously issued consolidated statements of cash flows contained in our consolidated financial statements for the quarter ended March 31, 2005 and for the years ended December 31, 2005 and 2004 included in our quarterly report on Form 10-Q for the quarter ended March 31, 2005 and in our annual report on Form 10-K for the year ended December 31, 2005, respectively, incorrectly classified certain items as cash flows from operating activities that should have been reported as cash flows from investing activities.

For the year ended December 31, 2005, our management determined that $40.1 million of cash spent for escrow deposits and purchased notes receivable relating to hotel and land acquisitions should have been reported as net cash used in investing activities rather than as a reduction of net cash provided by operating activities. For the quarter ended March 31, 2005, our management similarly concluded that $8.0 million of cash spent for escrow deposits related to a hotel acquisition should have been reported as net cash used in investing activities rather than as a reduction of net cash provided by operating activities. For the year ended December 31, 2004, our management concluded that $4.9 million pertaining to investments in our hotels and issuance of a note receivable should have been reported as a reduction of net cash provided by investing activities rather than as net cash used in operating activities.

Accordingly, our management concluded on May 1, 2006 that the previously filed financial statements and any related reports of our independent registered public accounting firm should no longer be relied upon and that we should file a Form 10-K/A for the year ended December 31, 2005 to correct the classification errors in the consolidated statements of cash flows for the fiscal years ended December 31, 2005 and 2004, and should include in our quarterly report on Form 10-Q for the quarterly period ended March 31, 2006 a corrected consolidated statement of cash flows for the classification errors in the consolidated statement of cash flows for the quarter ended March 31, 2005. On May 8, 2006, we filed an annual report on Form 10-K/A for the year ended December 31, 2005 to correct the classification errors in the consolidated statements of cash flows for the fiscal years ended December 31, 2005 and 2004. On May 10, 2006, we filed our quarterly report on Form 10-Q for the quarterly period ended March 31, 2006 which included the correction of the classification errors in the consolidated statement of cash flows for the quarter ended March 31, 2005. The restatements do not affect the total net change in cash and cash equivalents for the quarter ended March 31, 2005 or years ended December 31, 2005 and 2004, and have no impact on our consolidated balance sheets, consolidated statements of operations and comprehensive income (loss) or the related income (loss) per share amounts as of any date or for any quarter or year. The restatements also have no impact on the non-GAAP measures of funds from operations (FFO), FFO-Fully Converted or EBITDA which are described in the selected financial data section in our annual reports on Form 10-K for the years ended December 31, 2005 and 2004.

In connection with the restatement of our consolidated statements of cash flows for the years ended December 31, 2005 and 2004 and the quarter ended March 31, 2005, our management determined on May 1, 2006 that our company s internal control over financial reporting as of March 31, 2005 and December 31, 2005 was not effective due to the existence of a material weakness in the internal control over financial reporting relating to the proper classification of cash flows pertaining to certain escrow deposits, purchased notes receivable and investments in our hotels. Accordingly, our management concluded that its report on such internal controls included in our annual report on Form 10-K for year ended December 31, 2005 and any related report of our independent registered public accounting firm should no longer be relied upon. Subsequent to the filing of our original annual report on Form 10-K for the year ended December 31, 2005 and in connection with the preparation for filing of our quarterly report on Form 10-Q for the period ended

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March 31, 2006, we have implemented additional procedures in the preparation and review of the consolidated cash flow statement and believe that we have remediated this weakness and that our disclosure controls and procedures and internal control over financial reporting are effective.

May 12, 2006 Series C Cumulative Redeemable Preferred Stock Offering

On May 12, 2006, we entered into an underwriting agreement with Wachovia Capital Markets, LLC, as representative of the several underwriters listed therein. Pursuant to the terms and conditions of the underwriting agreement, we agreed to sell to the underwriters 5,000,000 shares of our 8.25% Series C Cumulative Redeemable Preferred Stock. These preferred shares were offered to the public at $25 per share. We expect that this financing will close on May 17, 2006. The net proceeds from the offering of Series C Cumulative Redeemable Preferred Stock will be used to fund a portion of the purchase of the Westin St. Francis San Francisco as further described below.

Terminated April 19, 2006 Series C Cumulative Redeemable Preferred Stock Offering

On April 19, 2006, we announced that we had agreed to sell in an underwritten public offering 5,000,000 shares of our 8.25% Series C Cumulative Redeemable Preferred Stock (liquidation preference $25 per share). The offering was scheduled to close on May 17, 2006. In light of the information discussed under Restatements, on May 10, 2006, we and the underwriters terminated the April 19, 2006 offering and the related underwriting agreement.

Acquisitions

Ritz-Carlton Laguna Niguel. On May 9, 2006, we entered into an agreement with SHC LLC to purchase the Ritz-Carlton Laguna Niguel for approximately $330 million and we agreed to assume up to $8.55 million in debt. The acquisition is anticipated to close in July 2006. We intend to use the net proceeds of this offering to, among other things, partially fund our acquisition of the Ritz-Carlton Laguna Niguel hotel. We expect that the remainder of the purchase price for the hotel will be comprised of available cash and a mix of property-level mortgage debt and borrowing under our revolving credit facility. The Ritz-Carlton Laguna Niguel, a 393-room luxury resort in Dana Point, California, sits upon 18 acres perched atop a bluff overlooking the Pacific Ocean. The resort contains 25,600 square feet of executive meeting space, 54,000 square feet of outdoor meeting space, five premium food and beverage outlets, and full beach access.

In 2004, the owners of the Ritz-Carlton Laguna Niguel began a major renovation of the hotel which included remodeling all guestrooms, the restaurant, the spa, and most common areas including the lobby and reception area. This renovation continued through most of 2005 until the final guestrooms were completed and returned to service in late November. Primarily as a result of this renovation and the business displaced by it, the hotel incurred significant losses in 2004 and 2005. Summary financial data of the hotel for the three years ended December 31, 2005 is provided below (in thousands), which data below does not include all expense items for the periods presented:

	2005	2004	2003
Revenues	$ 51,405	$ 56,413	$ 64,794
Certain Expenses			
Hotel operating expenses	46,641	45,219	46,617

Interest expense	10,978	9,423	9,413
Depreciation expense	9,246	6,122	6,389
Net (loss) income	(17,083)	(7,387)	1,210

Westin St. Francis San Francisco. On April 4, 2006, SHC St. Francis, L.L.C., a wholly owned subsidiary of SHC Funding, signed an agreement to acquire the Westin St. Francis San Francisco hotel from BRE/St. Francis L.L.C., a wholly owned subsidiary of Blackstone Real Estate Partners, for a purchase price of $440.0

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million, or a price of $368,200 per room. The acquisition, which is expected to close during the second quarter of 2006, remains subject to customary closing conditions. We intend to use the net proceeds of our 8.25% Series C Cumulative Redeemable Preferred Stock (liquidation preference $25 per share) to, among other things, partially fund our acquisition of the Westin St. Francis San Francisco hotel. We expect that the remainder of the purchase price for the hotel will be comprised of available cash and a mix of property-level mortgage debt and borrowing under our revolving credit facility. The 1,195-room hotel features 45 luxury suites, 50,000 square feet of meeting space, 39,000 square feet of retail space with a significant presence on Union Square, a 4,600 square foot health club and spa, and four premium food and beverage outlets. Westin, an affiliate of Starwood, will continue to manage the property subsequent to the closing of the acquisition.

LaSolana Hotel and Villas Development Site. On March 8, 2006, we acquired the LaSolana Hotel and Villas development site in Nayarit, Mexico, immediately adjacent to our existing Four Seasons Punta Mita Hotel, for an aggregate purchase price of $30.2 million plus installments with a present value of $10.6 million. The purchase includes a fee simple interest in 20.5 acres under planning for approximately 70 hillside hotel suites, spa, restaurant, pool and retail space with direct Pacific Ocean views. As part of the purchase, we obtained the exclusive rights to build approximately 55 for sale residences on an additional 27.0 adjacent acres.

Four Seasons Hotel, Washington, D.C. On March 1, 2006, SHC Washington, L.L.C., a wholly owned subsidiary of SHC Funding, acquired the Four Seasons Hotel, Washington, D.C. from Georgetown Plaza Associates LLC, an affiliate of the Louis Dreyfus Property Group, for a purchase price of $169.6 million. The acquisition was funded with proceeds raised through our public offering of common stock which closed on January 30, 2006 and February 9, 2006 and our public offering of preferred stock which closed January 31, 2006.

Hotel Disposition

On May 7, 2006, we entered into an agreement to sell the Marriott Rancho Las Palmas Resort for $56.0 million. As of March 31, 2006, the net carrying value of the property amounted to approximately $38.8 million and its related mortgage debt amounted to approximately $11.0 million. The expected gain on the sale is approximately $15.5 million, including estimated closing costs. The sale is anticipated to close in July 2006.

Dividends

In March 2006, we declared a quarterly dividend of $0.23 per share of our common stock payable on April 20, 2006 to shareholders of record as of the close of business on March 31, 2006. In addition, we declared a quarterly dividend of $0.53125 per share of our 8.50% Series A Cumulative Redeemable Preferred Stock payable on March 31, 2006 to shareholders of record as of the close of business on March 15, 2006. We also declared a quarterly dividend of $0.34375 per share of our 8.25% Series B Cumulative Redeemable Preferred Stock payable on March 31, 2006 to shareholders of record as of the close of business on March 15, 2006. Since our Series B Preferred Stock was initially issued on January 31, 2006 and was outstanding only for two months of the quarter, the dividend paid represents a portion of the normal scheduled quarterly dividend of $0.5156 per share.

SHC LLC Asset Management Agreement

On May 9, 2006, SHC LLC signed an agreement to sell to us the Ritz-Carlton Laguna Niguel, a property that we manage for SHC LLC under our asset management agreement. The sale is expected to close in July 2006. As a result of this disposition, the asset management fee under our asset management agreement with SHC LLC is expected to be reduced by approximately $1.5 million annually to $700,000 after the sale is consummated. We anticipate that in the future, SHC LLC will sell the last hotel included within the agreement, which would eliminate asset management fees earned from SHC LLC.

Termination of Rancho Las Palmas Resort Management Agreement

In March 2006, in order to increase the range of options available to us with respect to our future plans for the Marriott Rancho Las Palmas Resort in Rancho Mirage, California, including its potential sale, we reached an agreement with the hotel s manager, Marriott Hotel Services, Inc., or MHS, to terminate the hotel management agreement with MHS. Under the termination agreement, we are required to pay MHS an initial termination fee of $5.0 million in 2006 and an additional termination fee of $5.0 million in 2009. However, we will not be required to pay the additional termination fee if by December 31, 2008, we have entered into one or more hotel management agreements with MHS for a term of at least 30 years covering properties we or our affiliates own that were not previously managed or operated by MHS or its affiliates providing for total management fees of at least $1.0 million per annum. We also agreed to reimburse MHS for severance costs for MHS employees at the resort. As a result of this agreement we recorded a charge of approximately $10.4 million in our first quarter 2006 financial statements. For the year ended December 31, 2005, the Marriott Rancho Las Palmas contributed approximately $34.7 million of our revenues and $2.5 million of our EBITDA. On May 7, 2006, we entered into a agreement to sell the Marriott Rancho Las Palmas Resort for $56.0 million. The sale is anticipated to close in July 2006.

Swap Agreement

On May 12, 2006, we entered into a swap agreement with Credit Suisse International to effectively fix an additional $75 million of our floating rate debt exposure. Under this 7 year swap arrangement we pay a fixed rate of 5.5007% and receive one month LIBOR beginning June 15, 2006.

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