UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition period from ______ to ______

Commission File No. 001-32223

STRATEGIC HOTELS & RESORTS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**33-1082757**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
77 West Wacker Drive, Suite 4600, Chicago, Illinois	**60601**
(Address of Principal executive offices)	**(Zip Code)**

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

Former name, former address and former fiscal year, if changed since last report: N/A

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in rule 12b-2 of the Exchange Act. (Check one):   Large accelerated filer ¨   Accelerated filer x   Non-accelerated filer ¨.

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

The number of shares of common stock ($0.01 par value) of the registrant outstanding as of August 4, 2006 was 75,282,402.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2006

INDEX

WHERE TO FIND MORE INFORMATION:

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

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Table of Contents

Part I. Financial Information

Item 1. Financial Statements

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

	June 30, 2006	December 31, 2005
Assets		
Property and equipment	$ 1,849,541	$ 1,300,250
Less accumulated depreciation	(236,145)	(217,695)
Net property and equipment	1,613,396	1,082,555
Goodwill	163,175	66,656
Intangible assets (net of accumulated amortization of $1,908 and $1,340, respectively)	4,761	2,129
Assets held for sale	46,602	
Investment in joint ventures	89,247	15,533
Cash and cash equivalents	153,915	65,017
Restricted cash and cash equivalents	22,257	32,115
Accounts receivable (net of allowance for doubtful accounts of $446 and $427, respectively)	49,176	31,286
Deferred financing costs (net of accumulated amortization of $1,771 and $969, respectively)	7,666	7,544
Other assets	111,041	119,687
Insurance recoveries receivable	12,702	25,588
Total assets	$ 2,273,938	$ 1,448,110
Liabilities and Shareholders Equity		
Liabilities:		
Mortgages and other debt payable	$ 699,413	$ 633,380
Bank credit facility		26,000
Liabilities of assets held for sale	18,508	
Accounts payable and accrued expenses	135,967	90,486
Distributions payable	19,115	11,531
Deferred gain on sale of hotels	106,574	99,970
Total liabilities	979,577	861,367
Minority interests in SHR s operating partnership	13,289	76,030
Minority interests in consolidated hotel joint ventures	10,494	11,616
Shareholders equity:		
8.50% Series A Cumulative Redeemable Preferred Stock ($0.01 par value; 4,000,000 shares issued and outstanding; liquidation preference $25.00 per share)	97,553	97,553
8.25% Series B Cumulative Redeemable Preferred Stock ($0.01 par value; 4,600,000 shares issued and outstanding; liquidation preference $25.00 per share)	110,878	
8.25% Series C Cumulative Redeemable Preferred Stock ($0.01 par value; 5,750,000 shares issued and outstanding; liquidation preference $25.00 per share)	138,472	
Common shares ($0.01 par value; 150,000,000 common shares authorized; 75,282,402 and 43,878,273 common shares issued and outstanding, respectively)	753	439
Additional paid-in capital	1,220,689	688,250

Deferred compensation		(1,916)
Accumulated deficit	(221,708)	(241,613)
Accumulated distributions	(93,996)	(53,142)
Accumulated other comprehensive income	17,937	9,526
Total shareholders equity	1,270,578	499,097
Total liabilities and shareholders equity	$ 2,273,938	$ 1,448,110

See accompanying notes to unaudited condensed consolidated financial statements.

3

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(In Thousands, Except Per Share Data)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenues:				
Rooms	$ 87,700	$ 65,094	$ 159,419	$ 115,793
Food and beverage	53,613	40,414	96,468	70,935
Other hotel operating revenue	14,993	12,020	27,391	21,978
	156,306	117,528	283,278	208,706
Lease revenue	3,968	3,908	7,769	7,979
Total revenues	160,274	121,436	291,047	216,685
Operating Costs and Expenses:				
Rooms	21,038	15,579	37,970	26,488
Food and beverage	36,456	27,356	66,142	48,502
Other departmental expenses	38,618	30,506	72,353	54,428
Management fees	5,215	4,227	9,093	8,340
Other hotel expenses	10,176	7,554	18,281	12,636
Lease expense	3,395	3,418	6,619	6,991
Depreciation and amortization	15,487	12,615	29,228	21,612
Corporate expenses	6,916	4,650	12,589	9,407
Total operating costs and expenses	137,301	105,905	252,275	188,404
Operating income	22,973	15,531	38,772	28,281
Interest expense	(7,752)	(9,897)	(15,358)	(16,612)
Interest income	1,294	447	2,476	726
Equity in earnings (losses) of joint ventures	672	1,156	(947)	1,558
Other income, net	1,064	1,723	2,677	2,910
Income before income taxes, minority interests and discontinued operations	18,251	8,960	27,620	16,863
Income tax expense	(1,207)	(1,440)	(2,871)	(2,380)
Minority interest expense in SHR s operating partnership	(267)	(1,780)	(632)	(3,428)
Minority interest expense in consolidated hotel joint ventures	(593)		(789)	
Income from continuing operations	16,184	5,740	23,328	11,055
Income (loss) from discontinued operations, net of tax and minority interests	1,438	392	(3,423)	2,176
Net Income	17,622	6,132	19,905	13,231
Mark to market of derivatives	4,851	(3,410)	9,310	(2,296)
Currency translation adjustment	(1,161)	1,383	(1,187)	2,213
Comprehensive Income	$ 21,312	$ 4,105	$ 28,028	$ 13,148

Net Income		17,622		6,132		19,905		13,231
Preferred shareholder dividends		(5,914)		(2,154)		(9,620)		(2,503)
Net Income Available to Common Shareholders	$	11,708	$	3,978	$	10,285	$	10,728
Basic Income Per Share:								
Income from continuing operations available to common shareholders per share	$	0.16	$	0.12	$	0.23	$	0.28
Income (loss) from discontinued operations per share		0.02		0.01		(0.06)		0.07
Net income available to common shareholders per share	$	0.18	$	0.13	$	0.17	$	0.35
Weighted-average common shares outstanding		66,187		30,257		60,750		30,247
Diluted Income Per Share:								
Income from continuing operations available to common shareholders per share	$	0.16	$	0.12	$	0.23	$	0.28
Income (loss) from discontinued operations per share		0.02		0.01		(0.06)		0.07
Net income available to common shareholders per share	$	0.18	$	0.13	$	0.17	$	0.35
Weighted-average common shares outstanding		66,387		30,406		60,950		30,395

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Six Months Ended June 30, 2006	2005
Operating Activities:		
Net income	$ 19,905	$ 13,231
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Minority interest expense in SHR s operating partnership	408	4,104
Minority interest expense in consolidated hotel joint ventures	789	
Deferred income tax (benefit) expense	(2,441)	2,168
Depreciation and amortization	30,000	24,812
Amortization of deferred financing costs	820	1,544
Equity in losses (earnings) of joint ventures	947	(1,558)
Deferred compensation expense	1,700	987
Gain on sale of assets	22	
Recognition of deferred and other gains, net	(1,471)	(1,653)
Mark to market of derivatives included in interest expense		39
Increase in accounts and insurance recoveries receivable	(14,586)	(7,152)
Increase (decrease) in other assets	1,785	(1,610)
Increase in accounts payable and accrued expenses	15,584	6,110
Net cash provided by operating activities	53,462	41,022
Investing Activities:		
Acquisition of hotel property and equipment	(609,194)	(188)
Acquisition of land held for development	(12,027)	
Acquisition of interest in unconsolidated joint venture	(50,092)	(112)
Acquisition of interest in consolidated joint venture		(285,230)
Escrow deposits	(16,500)	
Restricted and unrestricted cash acquired	752	(159)
Cash received from unconsolidated joint venture	921	
Decrease in security deposits related to sale-leasebacks	2,286	
Insurance proceeds	20,000	
Capital expenditures	(44,881)	(8,774)
Decrease in restricted cash and cash equivalents	8,458	2,550
Other investing activities	(48)	
Net cash used in investing activities	(700,325)	(291,913)
Financing Activities:		
Proceeds from issuance of common stock, net of offering costs	470,180	
Proceeds from issuance of preferred stock, net of offering costs	249,350	97,540
Proceeds from bank credit facility	187,500	70,000
Payments on bank credit facility	(213,500)	(76,000)
Proceeds from mortgage and other debt	90,000	202,000
Payments on mortgage and other debt	(8,402)	(1,165)
Financing costs	(1,075)	(2,408)
Distributions to common shareholders	(23,446)	(13,457)
Distributions to preferred shareholders	(9,620)	(2,503)

Distributions to holders of minority interests in SHR s operating partnership	(2,103)	(4,138)
Distributions to holders of minority interests in consolidated joint ventures	(430)	
Distribution to SHC LLC		(37)
Other financing activities	899	
Net cash provided by financing activities	739,353	269,832
Effect of translation adjustment on cash	899	(927)
Net change in cash and cash equivalents	93,389	18,014
Cash of assets held for sale	(4,491)	
Cash and cash equivalents, beginning of period	65,017	40,071
Cash and cash equivalents, end of period	$ 153,915	$ 58,085

See accompanying notes to unaudited condensed consolidated financial statements.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED

(In Thousands)

	Six Months Ended June 30, 2006		Six Months Ended June 30, 2005	
Supplemental Schedule of Non-Cash Investing and Financing Activities:				
Mark to Market of Derivative Instruments (see notes 2 and 9)	$	9,619	$	(3,009)
LaSolana Land Purchase (see note 3)	$	17,980	$	
Acquisition of Interests in Consolidated Hotel Joint Ventures				
- Investing	$		$	(11,616)
- Financing	$		$	11,616
Redemption of Units of Non-Managing Member Limited Liability Company Interests in SH Funding (see note 8)	$	66,681	$	
Distributions Payable to Common Shareholders (see note 8)	$	17,379	$	6,650
Distributions Payable to Holders of Minority Interests in SHR s Operating Partnership (see notes 7 and 8)	$	255	$	2,068
Distributions Payable to Holders of Minority Interests in Consolidated Hotel Joint Ventures (see notes 7 and 8)	$	1,481	$	
New Orleans Property Damage (see note 14)	$	3,000	$	
Cash Paid For:				
Interest	$	(18,570)	$	(15,031)
Income taxes, net of refunds	$	(2,277)	$	(2,982)

See accompanying notes to unaudited condensed consolidated financial statements.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

1. GENERAL

Strategic Hotels & Resorts, Inc. and subsidiaries (SHR or the Company), formerly known as Strategic Hotel Capital, Inc., is a real estate investment trust (REIT) that was formed in January 2004. SHR conducts its business activities through its operating subsidiary, Strategic Hotel Funding, L.L.C. (SH Funding).

SHR acquires luxury and upper upscale full-service hotels that are subject to long-term management contracts. SHR s portfolio includes 19 full-service hotel interests located in urban and resort markets in the United States; Paris, France; Mexico City and Punta Mita, Nayarit, Mexico; Hamburg, Germany; and Prague, Czech Republic.

On June 29, 2004, SHR completed its initial public offering (the IPO) of common stock by issuing 17,600,000 shares at a price of $14.00 per share. Prior to the IPO, 21 hotel interests were owned by Strategic Hotel Capital, L.L.C. (SHC LLC). Concurrent with the IPO, SHC LLC was restructured into two companies, a new SHC LLC, a privately-held entity, with interests, at that time, in seven hotels, and SHR, a public entity with interests in SH Funding, the operating partnership in an UPREIT structure that held interests, at that time, in the remaining 14 hotels. Contemporaneous with the IPO, SH Funding became owned by SHR, SHC LLC and Strategic Hotel Capital Limited Partnership (SHC LP). For accounting purposes, this transaction is presented as a reverse spin-off whereby SHR is treated as the continuing entity and the assets retained by the new SHC LLC, and not contributed to SH Funding, are accounted for as if they were distributed at their historical carrying value through a spin-off to the new SHC LLC.

Subsequent to the IPO, SHR exercises control over SH Funding as its managing member and majority membership interest holder and consolidates SH Funding. SHC LLC prior to the IPO is referred to as SHR s predecessor.

As of June 30, 2006, SH Funding owned or leased the following 19 hotels:

1. Fairmont Chicago
2. Four Seasons Mexico City
3. Four Seasons Punta Mita Resort
4. Four Seasons Washington D.C.
5. Hilton Burbank Airport
6. Hyatt Regency La Jolla
7. Hyatt Regency New Orleans
8. Hyatt Regency Phoenix
9. Loews Santa Monica Beach Hotel
10. Marriott Champs Elysees Paris
11. Marriott Hamburg
12. Marriott Lincolnshire
13. Marriott Rancho Las Palmas
14. Ritz-Carlton Half Moon Bay
15. Westin St. Francis
16. InterContinental Chicago Hotel (consolidated joint venture)
17. InterContinental Miami Hotel (consolidated joint venture)
18. InterContinental Prague (unconsolidated joint venture)
19. Hotel del Coronado (unconsolidated joint venture)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation:

The accompanying unaudited condensed consolidated financial statements include the financial position and the results of operations of SHR and its subsidiaries. At June 30, 2006, SH Funding owned the following interests in joint ventures, which are accounted for using the equity method of accounting: a 35% interest in the joint venture that owns the InterContinental Prague; a 45% interest in the joint venture that owns the Hotel del Coronado; and a 31% interest in the joint venture that owns the Resort Club Punta Mita (see note 5). At June 30, 2006, SH Funding also owned 85% controlling interests in two joint ventures that own the InterContinental Chicago and Miami hotels, which are consolidated in the accompanying financial statements.

Material intercompany transactions and balances have been eliminated in consolidation. Certain amounts included in the consolidated financial statements for prior periods have been reclassified to conform to the current financial statement presentation. These adjustments include reclassifying non-income related taxes from income tax expense on the statements of operations to other income, net and reclassifying the Mexican asset tax (which is a variant of income tax) from other income, net to income tax expense.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (the Commission) and, therefore, do not include all information and footnote disclosures normally included in audited financial statements. In the opinion of management, the accompanying financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company and its results of operations and cash flows for the interim periods presented. The Company believes the disclosures made are adequate to prevent the information presented from being misleading. However, the financial statements should be read in conjunction with the Company s consolidated financial statements as of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004 and 2003 and notes thereto which are included in the Company s Annual Report on Form 10-K/A.

Use of Estimates:

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

Cash and Cash Equivalents:

The Company considers all cash on hand, demand deposits with financial institutions and short-term highly liquid investments with purchased or original maturities of three months or less to be cash equivalents. As of June 30, 2006 and December 31, 2005, restricted cash and cash equivalents include $13,008,000 and $20,919,000, respectively, that will be used for property and equipment replacement in accordance with hotel management or lease agreements. At June 30, 2006 and December 31, 2005, restricted cash and cash equivalents also included reserves of $9,249,000 and $11,196,000, respectively, required by loan and other agreements.

Per Share Data:

In accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share, basic income per share for the three and six months ended June 30, 2006 and 2005 is computed based on the weighted average common shares outstanding during each period. Diluted income per share is computed based on the weighted average common shares and restricted stock units (see note 8) deemed outstanding during the period plus the weighted average common shares that would be outstanding assuming the conversion of minority interests excluding the impact of conversions if they are anti-dilutive. Securities that could potentially dilute basic income per share in the future that were not included in the computation of diluted income per share for the three and six months ended June 30, 2006 and 2005, because they would have been anti-dilutive, are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Conversion of minority interests	1,026	9,316	1,805	9,316
Conversion of minority interests option shares	66	86	66	86

8

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The following table sets forth the components of the calculation of basic and diluted income per share for the three and six months ended June 30, 2006 and 2005 (in thousands):

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net income	$ 17,622	$ 6,132	$ 19,905	$ 13,231
Preferred shareholder dividend	(5,914)	(2,154)	(9,620)	(2,503)
Net income available to common shareholders used for basic and diluted income per share	$ 11,708	$ 3,978	$ 10,285	$ 10,728
Weighted average common shares basic	66,187	30,257	60,750	30,247
Restricted stock units	200	149	200	148
Weighted average common shares - diluted	66,387	30,406	60,950	30,395

Comprehensive Income:

Comprehensive income is a measure of all changes in equity of an enterprise that result from transactions or other economic events during the period other than transactions with shareholders. SHR s accumulated other comprehensive income results from unrealized gains on foreign currency translation adjustments (CTA) and the mark to market of certain derivative financial instruments.

The following table provides the detailed components of accumulated other comprehensive income (in thousands):

	Derivative Adjustment	Currency Translation Adjustment	Accumulated Other Comprehensive Income
Balance at January 1, 2006	$ 4,988	$ 4,538	$ 9,526
Mark to market of derivative instruments	9,291		9,291
Reclassification to equity in losses of joint ventures	19		19
Other CTA activity (non-derivative)		(1,187)	(1,187)
Adjustment for minority interest ownership in SH Funding	309	(21)	288
Balance at June 30, 2006	$ 14,607	$ 3,330	$ 17,937

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Income Taxes:

The Company has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code). As a REIT, SHR generally will not be subject to U.S. federal income tax if it distributes 100% of its annual taxable income to its shareholders. As a REIT, SHR is subject to a number of organizational and operational requirements. If it fails to qualify as a REIT in any taxable year, it will be subject to U.S. federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate tax rates. Even if it qualifies for taxation as a REIT, it may be subject to foreign, state and local income taxes and to U.S. federal income tax and excise tax on its undistributed income. In addition, taxable income from SHR s taxable REIT subsidiaries is subject to federal, foreign, state and local income taxes. Also, the foreign countries where SHR has operations do not recognize REITs under their respective tax laws. Accordingly, SHR will be subject to tax in those jurisdictions. In particular, SHR s Mexican operation is subject to taxes under the Mexican tax code, which impacts SHR s current and deferred tax expense.

For the three and six months ended June 30, 2006 and 2005, income tax expense is summarized as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Current tax benefit (expense):				
Europe	$ 987	$ 76	$ 1,139	$ 1,722
Mexico	(1,238)	(1,000)	(2,751)	(1,934)
	(251)	(924)	(1,612)	(212)
Deferred tax (expense) benefit:				
Europe	(330)	(331)	(646)	(675)
Mexico	174	(185)	87	(1,493)
United States	(800)		(700)	
	(956)	(516)	(1,259)	(2,168)
Total income tax expense	$ (1,207)	$ (1,440)	$ (2,871)	$ (2,380)

In the first quarter of 2006, the Company recorded a $4,000,000 deferred tax benefit. The benefit primarily relates to net operating loss carryforwards in our taxable REIT subsidiaries. A significant portion of these carryforwards was generated from expenses associated with the termination of the hotel management agreement with Marriott Hotel Services, Inc. (see note 15) and was included in income (loss) from discontinued operations (see note 4). In the second quarter of 2006, SHR was able to utilize a portion of the carryforwards and recorded a deferred tax expense of $1,000,000, of which $800,000 was included in continuing operations and $200,000 was included in income (loss) from discontinued operations As a result, the deferred tax benefit applicable to the United States amounted to $3,000,000 for the six months ended June 30, 2006.

New Accounting Pronouncements:

In June 2006, the FASB issued Interpretation No. 48. *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will be effective for the Company beginning in the first quarter of 2007. The Company is currently evaluating the impact of adopting the Interpretation.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

3. PROPERTY AND EQUIPMENT

The following summarizes SHR s investment in property and equipment, excluding three unconsolidated joint ventures for both periods presented and assets held for sale as of June 30, 2006 (in thousands):

	June 30, 2006	December 31, 2005
Land	$ 274,648	$ 171,486
Land held for development	48,199	
Leasehold improvements	11,633	11,633
Buildings	1,197,460	866,037
Building improvements	23,513	23,965
Site improvements	14,038	14,197
Furniture, fixtures and equipment	237,277	192,889
Improvements in progress	42,773	20,043
Total property and equipment	1,849,541	1,300,250
Less accumulated depreciation	(236,145)	(217,695)
Net property and equipment	$ 1,613,396	$ 1,082,555
Consolidated hotel properties	16	15
Consolidated hotel rooms	8,163	7,213

The table below demonstrates the geographic distribution of the Company s portfolio based on its undepreciated carrying amount, excluding three unconsolidated joint ventures for both periods presented and assets held for sale as of June 30, 2006:

	June 30, 2006	December 31, 2005
Northern California	28.0%	9.2%
Chicago, IL	20.2	29.3
Southern California	15.9	26.9
Washington, D.C.	8.4	
New Orleans, LA	7.4	9.4
Miami, FL	6.0	8.7
Phoenix, AZ	4.1	6.0
United States	90.0	89.5
Mexico	9.3	9.6
Paris, France	0.7	0.9
Total	100.0%	100.0%

11

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Purchase of the Westin St. Francis

On June 1, 2006, the Company purchased the Westin St. Francis located in San Francisco with 1,195 rooms for $438,846,000. The acquisition was partially funded using available cash as a result of common and preferred stock offerings (see note 8).

The following is a summary of the preliminary allocation of the purchase price (in thousands):

Land	$ 61,400
Building	287,600
Site improvements	200
Furniture, fixtures and equipment	29,600
Goodwill	56,476
Intangible assets	3,200
Net working capital	370
Total purchase price	$ 438,846

Purchase of the Four Seasons Washington D.C.

On March 1, 2006, the Company purchased the Four Seasons Washington D.C. with 211 rooms for $169,734,000. The acquisition was funded using available cash as a result of common and preferred stock offerings (see note 8).

The following is a summary of the preliminary allocation of the purchase price (in thousands):

Land	$ 44,900
Building	74,500
Site improvements	1,100
Furniture, fixtures and equipment	9,900
Goodwill	40,043
Net working capital	(709)
Total purchase price	$ 169,734

Pro forma Information

The acquisitions of the Westin St. Francis and the Four Seasons Washington D.C. described above were accounted for under the purchase method of accounting, and the assets and liabilities and results of operations of the hotels have been consolidated in the financial statements since the dates of purchase. On an unaudited pro forma basis, revenues, net income and basic and diluted income (loss) per share for the three and six months ended June 30, 2006 and 2005 would have been reported as follows if these acquisitions, and the purchase of the 45% interest in the Hotel del Coronado described in Note 5 had occurred at the beginning of each of the respective periods (in thousands):

	For the Three Months Ended June 30,	For the Six Months Ended June 30,

	2006	2005	2006	2005
Total revenue	$ 182,952	$ 158,309	$ 349,349	$ 286,152
Net income	$ 20,741	$ 7,284	$ 12,829	$ 10,826
Preferred shareholder dividend	$ (7,462)	$ (7,491)	$ (13,935)	$ (13,176)
Net income (loss) available to common shareholders	$ 13,280	$ (206)	$ 9,894	$ (2,350)
Net income (loss) available to common shareholders per share:				
Basic	$ 0.20	$ (0.01)	$ 0.16	$ (0.08)
Diluted	$ 0.20	$ (0.01)	$ 0.16	$ (0.08)

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Purchase of the LaSolana Hotel and Villas Development Sites (LaSolana)

In the fourth quarter of 2005, the Company signed letters of intent to purchase the LaSolana Hotel and Villas development sites adjacent to the Company s existing Four Seasons Punta Mita Resort for a purchase price of approximately $30,879,000 (including net working capital) plus the assumption of an agreement, which was executed in the first quarter of 2006, to pay installments totaling $13,480,000 over the next four years. The purchase includes a fee simple interest in 20.5 acres of land with plans to develop approximately 70 hillside hotel suites, spa, restaurant, pool and retail (Hotel Site) and the right to develop 55 for-sale residences on 27 acres of land (Villa Site). The acquisition consisted of purchasing existing promissory notes totaling $17,852,000 (including accrued interest) as well as the equity interests of $13,027,000 (including acquisition costs). In 2005, the Company purchased the promissory notes and made a refundable deposit of $1,000,000 on the equity investment. This amount aggregating $18,852,000 is included in other assets in the accompanying consolidated balance sheet as of December 31, 2005. On March 8, 2006, the Company acquired the remaining equity interests to take full ownership and control of the development sites. Upon purchase of the remaining equity interests, title to the Hotel Site transferred to the Company and the previously acquired promissory notes were converted to equity. Initially, the Company assumed an agreement to purchase the Villa Site for which consideration was expected to be paid in fixed installments (estimated at $13,480,000) over a four-year period. In addition to these installments, additional payments were required (based on a formula in the agreement) upon sale of villa units. However, there have been ongoing negotiations with respect to the nature, timing and amount of the fixed and variable payments. Those negotiations resulted in termination of the previous agreement. The new agreement requires a single payment of $17,980,000 which is expected to be paid in the third quarter of 2006, with no future obligation to pay any variable amounts upon sale of the villas. The value of this payment is included in accounts payable and accrued expenses on the accompanying consolidated balance sheet as of June 30, 2006. The aggregate purchase price of $48,859,000, excluding the effect of working capital and deferred tax assets acquired, has been recorded in property and equipment as land held for development. At June 30, 2006 land held for development related to LaSolana amounted to $48,199,000. Capitalized interest of $792,000 is included in land held for development related to LaSolana.

Acquisition Agreement

On June 30, 2006, the Company entered into an agreement to acquire the Fairmont Scottsdale Princess hotel for a purchase price of $345,000,000 and an adjacent 10-acre development parcel for $15,000,000. The acquisition, expected to close in the third quarter of 2006, remains subject to contractual closing conditions. The acquisition is expected to be financed using mortgage debt and borrowings on the bank credit facility.

4. DISCONTINUED OPERATIONS

The results of operations of hotels sold or held for sale have been classified as discontinued operations and segregated in the consolidated statements of operations for all periods presented. On October 7, 2005, SHR

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

sold the Marriott Schaumburg located in Chicago, Illinois for net sales proceeds aggregating $21,458,000. On October 27, 2005, SHR sold the Embassy Suites Lake Buena Vista located in Orlando, Florida for net sales proceeds aggregating $54,809,000. On May 7, 2006, the Company entered into an agreement to sell the Marriott Rancho Las Palmas Resort for approximately $56,000,000. The property was sold in July 2006 (see note 16). The assets and liabilities of these hotels have been classified as held for sale for all periods presented. Significant components of assets held for sale and liabilities of assets held for sale at June 30, 2006 consist of property and equipment, mortgages and other debt payable and accounts payable and accrued expenses. The following is a summary of income (loss) from discontinued operations for the three and six months ended June 30, 2006 and 2005 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Hotel operating revenues	$ 8,997	$ 16,464	$ 19,247	$ 34,751
Operating costs and expenses	7,142	13,514	25,427	27,111
Depreciation and amortization		1,610	772	3,200
Total operating costs and expenses	7,142	15,124	26,199	30,311
Operating income (loss)	1,855	1,340	(6,952)	4,440
Interest expense	(174)	(824)	(418)	(1,591)
Interest income	16	22	45	35
Other expenses, net		(25)		(32)
Income tax (expense) benefit	(200)		3,700	
Loss on sale of assets	(35)		(22)	
Minority interests	(24)	(121)	224	(676)
Income (loss) from discontinued operations	$ 1,438	$ 392	$ (3,423)	$ 2,176

5. INVESTMENT IN JOINT VENTURES

Investment in the InterContinental Prague

The Company owns a 35% interest in and acts as asset manager for a joint venture that owns the InterContinental Prague. At June 30, 2006 and December 31, 2005, SHR s investment in the hotel totaled $15,173,000 and $12,886,000, respectively. SHR accounts for the investment using the equity method of accounting. SHR s equity in earnings of the joint venture amounted to $316,000 and $1,156,000 for the three months ended June 30, 2006 and 2005, respectively and $180,000 and $1,558,000 for the six months ended June 30, 2006 and 2005, respectively. SHR s equity in earnings of the InterContinental Prague includes the Company s 35% joint venture interest, excludes asset management fees earned and includes certain costs, which SHR agreed to pay in full.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The following are the summary statements of operations of SHC Prague InterContinental B.V., which, through its affiliated subsidiaries, owns and operates the InterContinental Prague hotel, for the three and six months ended June 30, 2006 and 2005 (in thousands):

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Total revenues	$ 11,002	$ 10,070	$ 17,547	$ 16,691
Expenses:				
Property and other costs	5,870	5,311	10,439	9,886
Depreciation and amortization	1,371	1,530	2,889	3,137
Interest expense - affiliates	11	33	32	65
Interest expense bank loan	1,058	1,006	2,050	2,029
Other income, net	1,597	(1,602)	1,098	(3,189)
Income tax expense	444	599	692	747
Total expenses	10,351	6,877	17,200	12,675
Net income	$ 651	$ 3,193	$ 347	$ 4,016

The following are the summary balance sheets of SHC Prague InterContinental B.V. as of June 30, 2006 and December 31, 2005 (in thousands):

	June 30, 2006	December 31, 2005
Property and equipment, net	$ 97,279	$ 90,438
Goodwill	33,442	30,334
Cash and other assets	26,581	21,907
Total assets	$ 157,302	$ 142,679
Bank debt	$ 87,397	$ 82,440
Notes payable to affiliates	1,542	1,542
Deferred tax liability	15,163	14,243
Other liabilities	8,636	6,680
Total liabilities	112,738	104,905
Minority interests	1,786	1,631
Total shareholders equity	42,778	36,143
Total liabilities and shareholders equity	$ 157,302	$ 142,679

Investment in the Hotel del Coronado

On January 9, 2006, subsidiaries of SHR closed the acquisition of a 45% joint venture ownership interest in SHC KSL Partners, LP (Hotel Venture), the existing owner of the Hotel del Coronado in San Diego, California, and in HdC North Beach Development, LLLP (North Beach

Venture), the owner of an adjacent land parcel under development, for a pro rata share of an aggregate agreed-upon market value of $745,000,000. The Company, through its subsidiaries, paid $71,342,000 (including $21,250,000 of escrow deposits paid in 2005) to fund its investment in the joint venture, which was funded with borrowings under the Company s bank credit facility, and the joint venture refinanced the property with $610,000,000 of proceeds from the mortgage and mezzanine financings discussed below as well as borrowings of $10,500,000 on the bank credit facility. SHR earns fees under an asset management agreement with the joint venture. SHR receives fees amounting to 1% of the ventures revenues and 2% of the ventures development costs. In addition, SHR earns financing fees of 0.325% of any debt principal placed on behalf of the Hotel Venture as well as certain incentive fees as provided by the asset management agreements. SHR recognizes income of 55% of these fees,

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

representing the percentage of the venture not owned by SHR. These fees amounted to $262,000 and $1,588,000 for the three and six months ended June 30, 2006, respectively, and are included in other income, net on the consolidated statements of operations. The Company accounts for the Ventures using the equity method of accounting.

In connection with the acquisition, the entities entered into partnership agreements, which contain provisions regarding allocations of net income and loss to the partners and the distribution of cash to the partners. These allocations are based on the partners pro-rata ownership interests in the Hotel Venture and North Beach Venture.

On January 9, 2006, the Hotel Venture entered into mortgage and mezzanine loans with German American Capital Corporation (GACC), as lender. The principal amount of the loans is $610,000,000 and they accrue interest at LIBOR plus a blended spread of 2.08% per annum (7.28% at June 30, 2006). In addition, the Hotel Venture entered into a $20,000,000 revolving credit facility with GACC that bears interest at LIBOR plus 2.50% per annum (7.70% at June 30, 2006). At June 30, 2006, there was $500,000 outstanding on the revolving credit facility. The mortgage loan is secured by a mortgage on the Hotel del Coronado and the mezzanine loans and revolving credit facility are secured by a pledge of the equity interest held by the borrowers in their subsidiaries.

On January 9, 2006, as required by the loan agreements described above, the Hotel Venture purchased interest rate caps with a LIBOR strike price of 5.00% from January 9, 2006 to January 15, 2008 and 5.50% from January 15, 2008 to January 15, 2009. These caps expire on January 15, 2009. The interest rate caps were purchased with notional amounts covering the entire $630,000,000 of the mortgage and mezzanine loans (including the bank credit facility).

Concurrently with the purchase of the interest rate caps described above, SH Funding entered into an agreement to sell a cap with a strike price of 5.00%. This cap expires on January 15, 2009. The interest rate cap was sold with a notional amount of $9,000,000.

Further, on January 9, 2006, the North Beach Venture entered into a $59,000,000 construction loan with GMAC Commercial Mortgage Corporation to be used in connection with the construction of a 78-room beachfront, luxury condominium-hotel development on the North Beach Venture land parcel. The construction loan bears interest at LIBOR plus 2.50% per annum (7.61% at June 30, 2006). At June 30, 2006, there was $13,037,000 outstanding on the construction loan.

At June 30, 2006, SHR s investment in the Hotel and North Beach Ventures totaled $71,119,000. SHR s equity in income (losses) of the Ventures amounted to $5,000 and $(1,436,000) for the three and six months ended June 30, 2006, respectively. This amount includes the Company s 45% joint venture interest after elimination of asset management fees.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The following is the summary combined statements of operations of the Hotel and North Beach Ventures, which, through their affiliated subsidiaries, own and operate the Hotel del Coronado and North Beach Venture development, for the three months ended June 30, 2006 and for the period from January 9, 2006 to June 30, 2006 (in thousands):

	Three Months Ended June 30, 2006	For the Period From January 9, 2006 to June 30, 2006
Total revenues	$ 33,904	$ 61,106
Expenses:		
Property and other costs	20,084	38,079
Depreciation and amortization	2,570	5,456
Interest expense	11,191	20,973
Other expense, net	280	546
Deferred income tax expense	150	150
Total expenses	34,275	65,204
Net loss	$ (371)	$ (4,098)

The following is the summary combined balance sheet of the Hotel and the North Beach Ventures as of June 30, 2006 (in thousands):

Property and equipment, net	$ 332,545
Intangible assets, net	49,443
Goodwill	23,401
Deferred financing costs, net	7,555
Cash and other assets	30,522
Total assets	$ 443,466
Mortgage and other debt	$ 610,500
Construction loan	13,037
Other liabilities	24,481
Total liabilities	648,018
Total partners deficit	(204,552)
Total liabilities and partners deficit	$ 443,466

Investment in Four Seasons Residence Club Punta Mita

The Company owns a 31% interest in and acts 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 on the property adjacent to the Company s Four Seasons Punta Mita Resort hotel that is sold in fractional ownership interests. At June 30, 2006 and December 31, 2005, SHR s investment amounted to $2,956,000 and $2,647,000, respectively. SHR s equity in earnings of the joint venture amounted to $351,000 and $309,000 for the three and six months ended June 30, 2006, respectively.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

6. INDEBTEDNESS

Bank Credit Facility:

On November 9, 2005, SH Funding entered into a bank credit agreement with a group of lenders led by Wachovia Capital Markets, LLC and Deutsche Bank Securities Inc. This agreement replaced the previous bank credit facility agreement that was entered into on June 29, 2004. The agreement provides for a $125,000,000 revolving loan and expires November 9, 2009, subject to a one-year extension at the borrower s option. On May 30, 2006, SHR amended the agreement to increase the revolving loan to $150,000,000. The borrowing base of $150,000,000 is based on a minimum of seven qualified properties (as defined in the agreement). SHR guaranteed the loan and pledged its interest in SH Funding as collateral for this loan. Certain subsidiaries of SH Funding also guaranteed the loan and SH Funding s interest in certain subsidiaries have been pledged as collateral for this loan. Interest is payable monthly at LIBOR plus a spread of 1.50% to 2.75% (1.50% as of June 30, 2006) depending on a leverage test. Additionally, there is an unused commitment fee of 0.30% per annum of the unused revolver balance if the average daily-unused amount is less than $62,500,000 or 0.20% per annum of the unused revolver balance if the average daily-unused amount is greater than $62,500,000. Under the agreement, dividend payments may not exceed 90% of funds from operations, subject to dividend payments to preserve our REIT status. The agreement also requires maintenance of certain other financial covenants, all of which SH Funding and SHR were in compliance with at June 30, 2006. At June 30, 2006 and December 31, 2005, $0 and $26,000,000, respectively, was outstanding under this facility and the weighted-average interest rate for the six months ended June 30, 2006 was 6.21%.

Mortgages and Other Debt Payable:

Mortgages and other debt are summarized as follows, excluding amounts included in liabilities of assets held for sale (in thousands):

	June 30, 2006	December 31, 2005
Commercial Mortgage-Backed Securities and Mezzanine Debt	$ 699,413	$ 626,462
Other Debt		6,918
	$ 699,413	$ 633,380

Commercial Mortgage-Backed Securities (CMBS) and Mezzanine Debt

On November 9, 2005, subsidiaries of SHR (the Borrowers) completed a $350,000,000 Floating Rate CMBS financing with GACC. Initial funding of $220,000,000 was received on November 9, 2005 and a secondary draw of $90,000,000 was received on June 29, 2006. Additional draws up to $40,000,000 are available prior to November 9, 2006 (one year subsequent to closing). Proceeds from the original funding, together with available cash, were used to retire the floating rate loan that was entered into on June 29, 2004 and amended on August 24, 2004 as described below. The new notes are secured by mortgages on eight hotel properties owned by the Borrowers (carrying amount of $606,643,000 at June 30, 2006). The notes mature on November 9, 2007, subject to three one-year extensions at the Borrower s option. Interest is payable monthly at the 30-day LIBOR plus 0.85%, until maturity, at which time the principal and any unpaid interest are payable. The interest rate at June 30, 2006 was 6.05%.

On November 9, 2005, as required by the loan agreement described above, the Borrowers purchased an interest rate cap with a LIBOR strike price of 8.50%. This cap expires on November 15, 2007. The interest rate cap was purchased with a notional amount covering the entire $350,000,000 of the CMBS loan.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

On April 1, 2005, the joint ventures (the Ventures) that own the InterContinental Chicago and Miami hotels completed three mortgage loan financings with GACC, which were used to acquire the two properties. Aggregate proceeds from these financings amounted to $202,000,000, consisting of CMBS totaling $149,000,000 and mezzanine loans totaling $53,000,000. The CMBS loans are secured by mortgages on the two hotels (carrying amount of $282,542,000 at June 30, 2006) owned by the Ventures and the mezzanine loans are secured by the Ventures equity interests in the two hotels. The CMBS and mezzanine loans mature on April 9, 2007, subject to three one-year extensions at the Ventures option. Interest is payable monthly at the 30-day LIBOR plus a blended interest rate of 1.75%, until maturity, at which time the principal and any unpaid interest are payable. The interest rate at June 30, 2006 was 6.95%.

On April 1, 2005, as required by the loan agreements described above, the Ventures purchased interest rate caps with LIBOR strike prices ranging from 5.48% to 7.42%. These caps expire on April 15, 2007. The interest rate caps were purchased with notional amounts covering the entire $202,000,000 of the CMBS and mezzanine loans.

Concurrently with the purchase of the interest rate caps described above, SH Funding entered into an agreement to sell caps with strike prices ranging from 5.48% to 7.42%. These caps expire on April 15, 2007. The interest rate caps were sold with notional amounts of $202,000,000.

Unlike the Company s swaps described below, the caps owned by SHR as of June 30, 2006 have not been designated as hedges and therefore, the mark to market of the caps is recorded in earnings (see note 9).

On June 15, 2006, the Company executed a $75,000,000 corporate interest rate swap agreement. This agreement effectively fixes the interest rate on a portion of the corporate floating rate debt. The swap was accomplished through a seven-year swap of LIBOR into a fixed rate of 5.501%.

On May 26, 2006, the Company traded $100,000,000 in corporate interest rate swap agreements. The agreements, with an effective date of August 15, 2006, will effectively fix the interest rate on a portion of future corporate floating rate debt. The aggregate $100,000,000 in swaps was accomplished through seven-year swaps of LIBOR into a fixed rate of 5.416%.

On June 9, 2006, the Company traded an additional $100,000,000 in corporate interest rate swap agreements. The agreements, with an effective date of August 15, 2006, will effectively fix the interest rate on a portion of future corporate floating rate debt. The aggregate $100,000,000 in swaps was accomplished through five-year swaps of LIBOR into a fixed rate of 5.344%.

During the year ended December 31, 2005, the Company executed $200,000,000 in corporate interest rate swap agreements. The agreements effectively fix the interest rate on a portion of the corporate floating rate debt. The aggregate $200,000,000 in swaps was accomplished through five-year swaps of LIBOR into a fixed rate of 4.42% for a combined notional amount of $75,000,000, seven-year swaps of LIBOR into a fixed rate of 4.59% for a combined notional amount of $75,000,000 and seven-year swaps of LIBOR into a fixed rate of 4.12% for a combined notional amount of $50,000,000.

During the year ended December 31, 2004, certain subsidiaries (the Subsidiaries) completed two mortgage loan financings with GACC (the fixed rate loan) and a group of lenders led by LaSalle Bank National Association acting as trustee (the floating rate loan). Aggregate proceeds from these financings amounted to $408,500,000, consisting of a fixed rate loan totaling $208,500,000 and a floating rate loan totaling $200,000,000.

The fixed rate loan is secured by mortgages on three hotels (carrying amount of $270,393,000 at June 30, 2006) owned by the Subsidiaries. The loan matures July 1, 2011 and bears interest at a fixed blended interest rate of 5.43%. Interest and principal are payable monthly on a thirty-year amortization schedule. The unamortized principal balance at June 30, 2006 was $202,978,000.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

On August 24, 2004, the Subsidiaries entered into an Amended and Restated Indenture for the issuance of $275,000,000 of floating rate notes of the Subsidiaries. This new indenture amended and restated the floating rate loan described above, which originally provided for the issuance of $200,000,000 in notes secured by a mortgage on eight of the Subsidiaries hotel properties. The new notes were secured by mortgages on nine hotel properties owned by the Subsidiaries, including the eight properties from the prior loan transaction and the Ritz-Carlton Half Moon Bay, which was acquired on August 24, 2004. The notes had a maturity date of September 9, 2006, subject to three one-year extensions at the Subsidiaries option. Interest was payable monthly at the 30-day LIBOR plus 1.41%, until maturity, at which time the principal and any unpaid interest were payable.

As required by the floating rate loan agreement, the Subsidiaries purchased an interest rate cap with a LIBOR strike price of 5.00%. This cap had an expiration date of July 15, 2006. Originally, an interest rate cap was purchased with a notional amount covering the entire $200,000,000 of the floating rate notes, but the Subsidiaries sold an offsetting cap due to the execution of a swap agreement for a notional amount of $96,000,000 with Credit Suisse First Boston. The fixed rate under this swap agreement is 3.62%. This agreement was effective June 29, 2004 and has an expiration date of June 29, 2007.

As required by the August 24, 2004 Amended and Restated Indenture described above, the Subsidiaries purchased an additional interest rate cap with a LIBOR strike price of 5.00%. This cap had an expiration date of September 15, 2006 and was purchased with a notional amount covering the additional $75,000,000 of principal.

On October 7, 2005 and October 27, 2005, $17,250,000 and $18,865,000 of the floating rate loan that was entered into on June 29, 2004 and amended on August 24, 2004 was repaid as a result of proceeds received from the sales of the Marriott Schaumburg and the Embassy Suites Lake Buena Vista, respectively. The remaining principal balance of $238,885,000 was repaid on November 9, 2005 using the proceeds of the mortgage loan financing described above. In connection with the repayment, SHR sold the related caps and wrote off the unamortized deferred financing costs applicable to issuing this debt.

Both the fixed and floating loan agreements require various cash reserve accounts. At June 30, 2006 and December 31, 2005, these cash reserves aggregate $9,249,000 and $11,196,000, respectively, and are included in restricted cash and cash equivalents in the accompanying consolidated balance sheets.

Other Debt

A subsidiary of SHR had a loan payable to an affiliate of one of SHR s hotel managers. Loan proceeds were used to acquire certain furniture, fixtures and equipment (FF&E). Through June 29, 2004, interest accrued at 7% per annum. On June 29, 2004, the loan agreement was amended to reflect a new interest rate of LIBOR plus 3.0%. The principal balance outstanding at December 31, 2005 was $6,918,000. This loan was paid off in full during the first quarter of 2006.

The following table summarizes the aggregate maturities (including extension options) for all mortgages and other debt payable as of June 30, 2006, excluding amounts included in liabilities of assets held for sale (in thousands):

Years ended December 31,	**Amounts**
2006 (remainder)	$ 1,201
2007	3,067
2008	3,209
2009	3,421
2010	500,049
Thereafter	188,466
Total	$ 699,413

20

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Interest Expense:

Total interest expense for the three and six months ended June 30, 2006 includes a reduction of $1,811,000 and $3,487,000, respectively, related to capitalized interest. Total interest expense also includes amortization of deferred financing costs of $412,000 and $822,000 for the three months ended June 30, 2006 and 2005, respectively and $820,000 and $1,543,000 for the six months ended June 30, 2006 and 2005, respectively.

7. MINORITY INTERESTS

There are two components to SHR s minority interests. First, the Company reflects minority interests related to the InterContinental Chicago and Miami hotels on the balance sheet for the 15% portion of the properties consolidated by SHR, but not owned by the Company. The original minority interest balance of $11,616,000 was established based on the historical book value of the assets at the time of the transaction. Net earnings from these properties attributable to minority interests amounted to $593,000 and $789,000 for the three and six months ended June 30, 2006, respectively, which is reflected as minority interest expense in consolidated hotel joint ventures in the statements of operations. Included in distributions payable in the accompanying June 30, 2006 balance sheet is $1,481,000 payable to minority interests related to the InterContinental Chicago and Miami hotels. Second, minority interest in SH Funding on the consolidated balance sheets is calculated by dividing the number of units held by the minority interests by the sum of SHR s units and the units held by the minority interests, all calculated based on the units outstanding at the end of the period. Net income and other comprehensive income are allocated to minority interests in SH Funding based on their weighted average ownership percentages during the period. The ownership percentage is calculated by dividing the number of units held by the minority interests by the sum of SHR s units and the units held by the minority interests, all calculated based on the weighted average days outstanding.

8. EQUITY AND DISTRIBUTION ACTIVITY

Common Shares:

The following table presents the changes in the issued and outstanding common shares since December 31, 2005 (excluding 1,088,729 and 8,366,091 units of SH Funding outstanding at June 30, 2006 and December 31 2005, respectively, which are exchangeable for common shares on a one-for-one basis, or the cash equivalent thereof, subject to certain restrictions and at the Company s option; and 377,011 and 296,859 restricted stock units at June 30, 2006 and December 31, 2005, respectively see note 10) (in thousands):

Outstanding at December 31, 2005	43,878
Common stock issued	24,100
Operating partnership units redeemed for common shares	7,277
Restricted stock units redeemed for common shares	27
Outstanding at June 30, 2006	75,282

Common Stock Offerings:

On May 24, 2006, a public offering of common stock was completed at a price of $20.50 per share. The shares consisted of 16,100,000 shares of common stock sold by the Company (including the over-allotment option issuance). After discounts, commissions and estimated expenses, the Company raised net proceeds of approximately $318,280,000. These proceeds were used to repay existing indebtedness under the bank credit facility, to partially fund the acquisition of the Westin St. Francis and the Ritz-Carlton Laguna Niguel and for general corporate purposes.

21

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

On January 30, 2006, a public offering of common stock was completed at a price of $20.00 per share. The shares consisted of 8,000,000 primary shares of common stock sold by the Company (including the over-allotment option issuance) and 12,731,640 secondary shares of common stock sold by stockholders affiliated or associated with Prudential Financial, Inc. and Whitehall Street Real Estate Limited Partnerships VII and IX, affiliates of Goldman, Sachs & Co. Goldman Sachs & Co. received approximately $1,996,000 of discounts and commissions related to this transaction. After discounts, commissions and estimated expenses, the Company raised net proceeds of approximately $151,900,000. These proceeds were used to repay existing indebtedness under the bank credit facility, to partially fund the acquisition of the Four Seasons Washington D.C. and for general corporate purposes.

Redemption of Units of Non-Managing Member Limited Liability Company Interests in SH Funding:

The Company offered all holders of units of non-managing member limited liability company interests in SH Funding an opportunity to redeem their interests on January 20, 2006 by its waiver of the transfer restrictions in the limited liability company agreement of SH Funding. On January 20, 2006, holders of 7,229,590 limited liability interests in SH Funding redeemed their interests in exchange for an equal number of shares of the Company s common stock. Subsequent to January 20, 2006, holders of an additional 47,772 limited liability interests in SH Funding redeemed their interest in exchange for an equal number of shares of the Company s common stock. After these exchanges, SHR s ownership share of SH Funding increased to approximately 99%.

Distributions to Shareholders and Unitholders:

Declaration Date	Distribution Per Share/Unit	Shareholders/Unitholders of Record Date	Date Paid	Amount Paid
December 13, 2005	$ 0.22	December 31, 2005	January 20, 2006	$ 11,531,000
March 15, 2006	$ 0.23	March 31, 2006	April 20, 2006	$ 13,927,000
June 9, 2006	$ 0.23	June 30, 2006	July 10, 2006	$ 17,634,000

Preferred Stock:

On May 17, 2006, SHR completed a public offering of 5,750,000 shares of 8.25% Series C Cumulative Redeemable Preferred Stock, par value $0.01 per share (liquidation preference $25.00 per share). After discounts, commissions and estimated expenses, the Company raised net proceeds of approximately $138,472,000. These proceeds were used to repay existing indebtedness under our credit facility, to partially fund the acquisition of the Westin St. Francis and the Ritz-Carlton Laguna Niguel and for general corporate purposes.

The Series C Preferred Stock has a perpetual life and is not redeemable before May 17, 2011. Beginning May 17, 2011, SHR may redeem Series C Preferred Stock at $25.00 per share plus accrued distributions. Distributions on the Series C Preferred Stock will be cumulative from the date of issuance and are payable quarterly, starting June 30, 2006.

On January 31, 2006, SHR completed a public offering of 4,600,000 shares of 8.25% Series B Cumulative Redeemable Preferred Stock, par value $0.01 per share (liquidation preference $25.00 per share). After discounts, commissions and expenses, the Company raised net proceeds of approximately $110,878,000. These proceeds were used to repay existing indebtedness under the Company s credit facility, to partially fund the acquisition of the Four Seasons Washington D.C. and for general corporate purposes.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The Series B Preferred Stock has a perpetual life and is not redeemable before January 31, 2011. Beginning January 31, 2011, SHR may redeem Series B Preferred Stock at $25.00 per share plus accrued distributions. Distributions on the Series B Preferred Stock will be cumulative from the date of issuance and are payable quarterly, starting March 31, 2006.

Declaration Date	Distribution Per Share	Shareholders of Record Date	Date Paid	Amount Paid
Distributions to Preferred Shareholders Series A				
March 2, 2006	$ 0.53125	March 15, 2006	March 31, 2006	$ 2,125,000
June 9, 2006	$ 0.53125	June 20, 2006	June 30, 2006	$ 2,125,000
Distributions to Preferred Shareholders Series B				
March 2, 2006	$ 0.34375	March 15, 2006	March 31, 2006	$ 1,581,000
June 9, 2006	$ 0.51563	June 20, 2006	June 30, 2006	$ 2,372,000
Distributions to Preferred Shareholders Series C				
June 9, 2006	$ 0.24635	June 20, 2006	June 30, 2006	$ 1,417,000

9. DERIVATIVES

SHR enters into derivative financial instruments with high credit quality counterparties and diversifies its positions among such counterparties in order to reduce its exposure to credit losses. To date SHR has not experienced any credit losses on derivatives.

SHR manages its interest rate risk by varying its exposure to fixed and variable rates while attempting to minimize its interest costs. SHR manages its fixed interest rate and variable interest rate risk through the use of interest rate caps and swaps. The caps limit SHR s exposure on its variable rate debt that would result from an increase in interest rates. The Company s lenders, as stipulated in the respective loan agreements, generally require such caps. SHR uses interest rate swaps to effectively convert portions of its variable rate debt to fixed rate debt. Certain of the Company s derivatives are designated as cash flow hedges and to the extent effective, changes in the fair value of these instruments are recorded in accumulated other comprehensive income. To the extent these instruments are not designated as hedges or are ineffective as hedges, changes in the fair value of these instruments are recorded in interest expense or other income, net, as appropriate. Upon extinguishment of debt, income effects of cash flow hedges are reclassified from accumulated other comprehensive income to interest expense, net, loss on early extinguishment of debt, or income from discontinued operations as appropriate. The Company recognizes all derivatives as either assets or liabilities on the balance sheet, classifies those instruments as either other assets or in accounts payable and accrued expenses and measures those instruments at fair value.

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

The market values of the Company s interest rate caps and swaps were as follows (in thousands):

	June 30, 2006	December 31, 2005
Interest rate caps	$ (113)	$ 1
Interest rate swaps	12,774	5,015

10. RESTRICTED STOCK UNITS AND OTHER EMPLOYEE MATTERS

SHR issues restricted stock units (RSUs) to certain employees, officers and directors under its 2004 incentive plan (the Plan). RSUs represent awards of shares of the Company s common stock that vest ratably over four years or as otherwise approved by the Compensation Committee of the Board of Directors, provided the participant continues as an employee or director. Unvested RSUs will be forfeited upon termination. RSUs are essentially the same as restricted stock except that instead of actual shares, RSUs represent a promise to distribute shares at some future date.

Participants holding RSUs will have no voting rights until such time as the underlying shares are issued. Dividends will accrue on all RSUs, and will either be reinvested in additional RSUs or paid in cash. At June 30, 2006, a total of 720,683 RSUs were outstanding with an aggregate value at issuance of $12,742,000. At June 30, 2006, a total of 377,011 RSUs were vested. The Company recorded compensation expense of $868,000 and $555,000 related to these RSUs (net of forfeitures) for the three months ended June 30, 2006 and 2005, respectively and $1,700,000 and $987,000 for the six months ended June 30, 2006 and 2005, respectively. As of June 30, 2006, there was $4,903,000 of total unrecognized compensation costs related to nonvested RSUs granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.5 years. Effective January 1, 2006, the Company adopted SFAS No. 123R (revised 2004), Share-Based Payment. In accordance with the provisions of this standard, the Company s unrecognized compensation costs have been included in additional paid-in-capital in the accompanying consolidated balance sheet as of June 30, 2006.

The Company has a defined contribution plan that covers employees meeting eligibility requirements. The Company will match 50% of the first 6% of compensation that an employee elects to defer and this amount vests at 33.33% per year of service. Contributions by the Company were $36,000 and $20,000 for the three months ended June 30, 2006 and 2005, respectively and $107,000 and $73,000 for the six months ended June 30, 2006 and 2005, respectively. The Company modified its defined contribution plan to, among other things, provide for 100% matching of the first 6% of compensation that an employee elects to defer beginning July 1, 2006. These matching contributions will immediately vest. Any discretionary matching contributions will continue to vest at 33.33% per year of service.

11. RELATED PARTY TRANSACTIONS

The Company has an asset management agreement with SHC LLC, under which the Company manages the day-to-day business of SHC LLC and its hotels for an initial annual fee of $5,000,000, payable monthly in arrears. The term of the agreement is for five years, commenced on June 29, 2004 and will renew unless prior written notice is given. In addition, SHC LLC has the right to terminate the agreement if certain events occur. SHC LLC sold three properties in 2005 and two properties in the six months ended June 30, 2006. As a result of the disposition of these properties, the asset management fee was reduced by approximately $2,823,000 annually. For the three months ended June 30, 2006 and 2005, SHR recognized approximately $610,000 and $1,250,000, respectively of income related to its asset management agreement with SHC LLC, which is included in other income, net. For the six months ended June 30, 2006 and 2005, SHR recognized approximately $1,326,000 and $2,500,000, respectively of income related to its asset management agreement with SHC LLC, which is included in other income, net.

12. COMMITMENTS AND CONTINGENCIES

Environmental Matters:

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

Table of Contents

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

Litigation:

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

13. GEOGRAPHIC AND BUSINESS SEGMENT INFORMATION

SHR operates in one reportable business segment, hotel ownership. As of June 30, 2006, SHR s foreign operations consisted of two Mexican hotel properties, the LaSolana Hotel and Villas Development Sites, a 31% interest in a Mexican joint venture, a 35% interest in a European joint venture and leasehold interests in each of a French and a German hotel property.

The following table presents revenues and assets for the geographical areas in which SHR operates (excluding the unconsolidated joint ventures) (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues (excluding amounts related to discontinued operations):				
United States	$ 138,969	$ 101,538	$ 245,821	$ 175,631
International	21,305	19,898	45,226	41,054
Total	$ 160,274	$ 121,436	$ 291,047	$ 216,685

	As of June 30, 2006	As of December 31, 2005
Long-lived Assets (excluding assets held for sale):		
United States	$ 1,616,549	$ 1,039,269
International	164,783	112,071
Total	$ 1,781,332	$ 1,151,340

14. HYATT REGENCY NEW ORLEANS

In August 2005, Hurricane Katrina caused substantial damage to the Hyatt Regency New Orleans property. The hurricane damage also caused significant interruption to the business, and the hotel has effectively ceased operations.

The Company has comprehensive insurance coverage (both property damage and business interruption) for this loss providing for an aggregate $350,000,000 of coverage, subject to a deductible of approximately $11,000,000. The Company s damage assessment teams, working with the insurance provider adjusters, are inspecting the property and implementing a restoration plan. The recovery effort is expected to include replacing portions of the building, landscaping and furniture. The net book value of the property damage is currently estimated to be at least $32,685,000; however, the Company is still assessing the impact of the hurricane on the hotel, and the actual net book value write-off could vary from this estimate. Changes to this estimate will be recorded in the periods in which they are determined. A $3,000,000 increase in the property damage was recorded during the first quarter of 2006. As of June 30, 2006, the Company has recorded a net fixed asset write-off and a corresponding insurance claim receivable for this $32,685,000 net book value amount because the Company believes that it is probable that the insurance recovery, net of deductibles on a replacement cost basis, will exceed the net book value of the damaged portion of the assets.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

While the Company expects the insurance proceeds will be sufficient to cover most of the replacement cost of the restoration of the hotel, certain deductibles and limitations will apply. No determination has been made as to the total amount or timing of those insurance payments and those insurance payments may not be sufficient to cover the costs of the entire restoration. To the extent that insurance proceeds, which are on a replacement cost basis, ultimately exceed the net book value of the damaged property, a gain will be recorded in the period when all contingencies related to the insurance claim have been resolved.

The Company has hired consultants to assess business interruption claims who are currently negotiating with the insurance carrier regarding coverage for these income losses sustained. To the extent the Company is entitled to recover incurred expenses under the insurance policies, the Company recognizes a receivable when it can be demonstrated that it is probable that such insurance recovery will be realized, and such insurance recovery will then be reflected as a component of operating income. Any gain or profit component resulting from business interruption insurance for lost income will not be recognized until the relevant payments have been received and all contingencies related to the insurance recoveries are resolved. This income recognition criteria will likely result in business interruption insurance recoveries being recorded in a period subsequent to the period that we experience lost income from the affected property, resulting in fluctuations in the Company s net income that may reduce the comparability of reported quarterly and annual results for some periods into the future.

Through June 30, 2006, the Company has recorded $42,702,000 in insurance recoveries receivable related to property damage and business interruption. The Company has collected $30,000,000 in insurance proceeds through June 30, 2006, including $10,000,000 collected in 2005. Of the $42,702,000 total receivable recorded, $32,685,000 represents the recovery of the net book value of fixed assets written off because of the damage, as discussed above. The remaining $10,017,000 represents a probable recovery of expenses incurred through June 30, 2006. The cost recoveries are recorded on the expense line item to which they relate, and therefore there is no net impact to any expense line item or the Company s results. Since the property has ceased significant operations, the Company discontinued depreciating property and equipment starting in September 2005. In addition, the Company has capitalized interest expense amounting to $1,277,000 and $2,545,000 for the three and six months ended June 30, 2006, respectively, and will continue to capitalize interest on the property s debt as long as the property is undergoing active reconstruction activities to return to normal operations.

The following is a summary of hurricane-related activity recorded (in thousands):

Fixed assets net book value write down	$ 32,685
Recovery of costs incurred	10,017
Proceeds received as of June 30, 2006	(30,000)
Insurance recoveries receivable as of June 30, 2006	$ 12,702

15. TERMINATION OF MANAGEMENT AGREEMENT

During the first quarter of 2006, the Company reached an agreement with Marriott Hotel Services, Inc. (MHS), the manager of its Marriott Rancho Las Palmas Resort, to terminate the hotel management contract with MHS on or before December 29, 2006. Under the agreement, the Company was required to pay MHS an initial termination fee of $5,000,000 upon termination, and an additional termination fee of $5,000,000 in 2009, provided that the additional termination fee will not be required if the Company has entered into a qualifying hotel management contract with MHS, or an affiliate, by December 31, 2008. The Company also agreed to reimburse MHS for certain severance and relocation costs for MHS employees at the resort. For the six months ended June 30, 2006, the Company recorded a charge of $9,695,000 for the present value of the termination fees and estimated severance and relocation costs. The charges are included in discontinued operations in the accompanying consolidated statement of operations for the six months ended June 30, 2006.

STRATEGIC HOTELS & RESORTS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

16. SUBSEQUENT EVENTS

On July 6, 2006, the Company entered into a mortgage loan with Metropolitan Life Insurance Company. The principal amount of the loan was $220,000,000 which accrues interest at LIBOR plus 0.70%. The loan is secured by, among other things, the Westin St. Francis hotel. Proceeds from the loan were used to partially fund the acquisition of the Ritz-Carlton Laguna Niguel.

On July 7, 2006, the Company purchased the Ritz-Carlton Laguna Niguel from SHC LLC for $330,000,000 plus assumed debt of $8,550,000. The acquisition was financed using cash on hand which included proceeds raised through the Company s recent public offerings of preferred and common stock (see note 8) and mortgage debt proceeds described below. An escrow deposit of $16,500,000 was paid in the second quarter of 2006 related to this acquisition and is included in other assets in the accompanying consolidated balance sheet as of June 30, 2006. As a result of the purchase, the Company s annual asset management fee from SHC LLC was reduced by approximately $1,474,000 to approximately $703,000.

On July 14, 2006, SHR sold the Marriott Rancho Las Palmas Resort for $56,000,000. Sales proceeds, net of closing costs, exceeded the property s carrying value by approximately $15,600,000. Upon disposition, the Company paid MHS the initial termination fee of $5,000,000 (see note 15).

On July 28, 2006, the Company entered into an agreement to acquire the Marriott London Grosvenor Square hotel for a purchase price of £103,000,000 ($192,000,000). The acquisition, which is expected to close in the third quarter of 2006, remains subject to customary closing conditions. The acquisition is expected to be financed using mortgage debt and borrowings on the bank credit facility.

On August 3, 2006, the Company purchased a 65.0% interest in the entity that owns the InterContinental Hotel in Prague, Czech Republic, for $68,800,000. The purchase brings the company s interest in the entity that owns the property to 100%. Including the assumption of $56,500,000 in debt, the company s total investment to acquire the 65% interest is $125,300,000. The acquisition was financed using borrowings under the bank credit facility.

Table of Contents

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

Note on 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 Form 10-Q 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, as amended (the Exchange Act).

Words or phrases such as anticipates, believes, estimates, expects, intends, may, plans, potential, predicts, projects, should, 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.

Some important factors that could cause actual results or outcomes for us to differ materially from these forward-looking statements are discussed in the cautionary statements contained in Exhibit 99.1 to this Form 10-Q, which are incorporated herein by reference. In assessing forward-looking statements contained herein, readers are urged to read carefully all cautionary statements contained in this Form 10-Q.

Overview

Strategic Hotels & Resorts, Inc., which we refer to herein as SHR or the Company, formerly known as Strategic Hotel Capital, Inc., was incorporated in January 2004 to own and asset manage upper upscale and luxury hotels in North America and Europe. Our founder and accounting predecessor, Strategic Hotel Capital, L.L.C., or SHC LLC, was founded in 1997 by Laurence Geller, our President and Chief Executive Officer, Whitehall (an affiliate of Goldman, Sachs & Co.), and others. We made an election to be taxed, beginning with our 2004 tax year, as a REIT under the Internal Revenue Code. On June 29, 2004, we completed our initial public offering (IPO) of common stock. Prior to the IPO, 21 hotel interests were owned by SHC LLC. Concurrent with and as part of the transactions relating to the IPO, a reverse spin-off distribution to shareholders separated SHC LLC into two companies, a new, privately-held SHC LLC, with interests, at that time, in seven hotels (the Distributed Properties), and Strategic Hotels & Resorts, Inc., a public entity with interests, at that time, in 14 hotels. See Item 1. Unaudited Condensed Consolidated Financial Statements Note 1. General for the hotel interests owned by us.

We operate as a self-administered and self-managed REIT, which means that we are managed by our board of directors and executive officers. A REIT is a legal entity that holds real estate interests and, through payments of dividends to stockholders, is permitted to reduce or avoid federal income taxes at the corporate level. For us to continue to qualify as a REIT, we cannot operate hotels; instead we employ internationally known hotel management companies to operate our hotels for us under management contracts. We conduct our operations through our direct and indirect subsidiaries including our operating partnership, Strategic Hotel Funding, L.L.C. (SH Funding), which currently holds substantially all of our assets. We are the sole managing member of our operating partnership and hold approximately 99% of its membership units as of June 30, 2006. We manage all business aspects of our operating partnership, including the sale and purchase of hotels, the investment in these hotels and the financing of our operating partnership and its assets.

Throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations section, references to we , our and us are references to SHC LLC and its consolidated subsidiaries before the IPO and SHR, SH Funding and their subsidiaries after the IPO.

When presenting the dollar equivalent amount for any amounts expressed in a foreign currency, the dollar equivalent amount has been computed based on the exchange rate on the date of the transaction or the exchange rate prevailing on June 30, 2006 as applicable, unless otherwise noted.

Factors Affecting Our Results of Operations

Acquisition and Sale of Interests in Hotel Properties. We sold two properties in 2005 and in July 2006 we sold the Marriott Rancho Las Palmas, which we held for sale as of June 30, 2006. The results of operations for these properties have been classified as discontinued operations in the statements of operations for the three and six months ended June 30, 2006 and 2005.

On April 1, 2005, we purchased 85% controlling interests in the InterContinental hotels in Chicago and Miami for an agreed aggregate value of approximately $301.0 million and established a new basis of approximately $297.0 million. Our total initial investment was $285.4 million. On September 1, 2005, we purchased the Fairmont Chicago for approximately $158.0 million. On January 9, 2006 we acquired a 45% managing joint venture ownership interest in the Hotel del Coronado for our pro rata share of an agreed upon market value of $745.0 million. On March 1, 2006, we purchased the Four Seasons Washington D.C. hotel for approximately $169.7 million. On June 1, 2006, we purchased the Westin St. Francis hotel for approximately $440.0 million.

We define our total portfolio as properties that are owned or leased by us, and their operations are included in our consolidated operating results. We present certain information about our hotel operating results and statistics on a comparable hotel basis. We define our Comparable REIT Assets as those (a) that are owned or leased by us, and their operations are included in our consolidated operating results, and (b) for which we reported comparable operating results throughout the reporting periods being presented. Accordingly, our comparable hotels for purposes of the comparison of the three and six months ended June 30, 2006 and 2005 do not include the Hyatt New Orleans which was taken out of service in September 2005, the Fairmont Chicago which we purchased in September 2005, the Four Seasons Washington D.C. which we purchased in March 2006, the Westin St. Francis which we purchased in June 2006, the Prague InterContinental and the Hotel del Coronado which we account for under the equity method, and all sold properties that are included in discontinued operations. Our comparable hotels for purposes of the comparison of the six months ended June 30, 2006 and 2005 also do not include the InterContinental Chicago and Miami hotels, which we purchased 85% controlling interests in April 2005.

We present these Comparable REIT Asset results because we believe that doing so provides management and the reader with useful information for evaluating the period-to-period performance of our hotels and facilitates comparisons with other hotel REITs and hotel owners. In particular, these measures assist management and the reader in distinguishing whether increases or decreases in revenues and/or expenses are due to operations of the Comparable REIT Assets or from the remainder of the portfolio.

Table of Contents

Revenues. Substantially all of our revenue is derived from the operation of our hotels. Specifically, our revenue consists of (in thousands):

	For the Six Months Ended June 30,							
	Total Portfolio				Comparable REIT Assets			
	2006	2005	2006 % of Total Revenues	2005 % of Total Revenues	2006	2005	2006 % of Total Revenues	2005 % of Total Revenues
Revenues:								
Rooms	$ 159,419	$ 115,793	54.8%	53.5%	$ 87,111	$ 78,760	51.2%	50.5%
Food and beverage	96,468	70,935	33.1%	32.7%	55,442	50,681	32.6%	32.5%
Other hotel operating revenues	27,391	21,978	9.4%	10.1%	19,690	18,644	11.6%	11.9%
	283,278	208,706	97.3%	96.3%	162,243	148,085	95.4%	94.9%
Lease revenue	7,769	7,979	2.7%	3.7%	7,769	7,979	4.6%	5.1%
Total revenues	$ 291,047	$ 216,685	100.0%	100.0%	$ 170,012	$ 156,064	100.0%	100.0%

Rooms revenue. Occupancy and average daily rate are the major drivers of rooms revenue.

Food and beverage revenue. Occupancy and local social catering are the major drivers of food and beverage revenue.

Other hotel operating revenue. Other hotel operating revenue consists of ancillary revenue such as telephone, parking, golf course, spa, entertainment and other guest services and is also driven by occupancy.

Lease revenue. We earn lease revenue from the Hamburg Marriott and the Paris Marriott Champs Elysées (Paris Marriott). Lease revenue for the Hamburg Marriott consists of a fixed annual rental paid in monthly installments plus a percentage of profits in excess of the base rent. As a result of a sublease arrangement at the Paris Marriott whereby we lease our interest in the hotel to a third party, we record lease revenue in our consolidated statements of operations.

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

- average daily occupancy,

- average daily rate, or ADR,

- net revenue per available room, or RevPAR, which is the product of ADR and average daily occupancy, but does not capture food and beverage revenues or other hotel operations revenue such as telephone, parking and other guest services, and

- total revenue per available room, or Total RevPAR, which includes RevPAR and food and beverage and other hotel revenues per available room.

Fluctuations in revenues, which tend to correlate with changes in the U.S. gross domestic product, are driven largely by general economic and local market conditions as well as general health and safety concerns, which in turn affect levels of business and leisure travel. Guest demographics also affect our revenues. For example, a greater percentage of transient guests, which includes corporate and premium business travelers who generally pay the highest average room rates, will generate higher room revenues. However, a greater percentage of certain group guests which do not include the highest corporate premium but do consume larger relative amounts of food and beverage and other services may contribute to a higher total revenue. In addition to economic conditions, supply is another important factor that can affect revenues. Room rates and occupancy tend to fall when supply increases unless the supply growth is offset

Table of Contents

by an equal or greater increase in demand. One reason why we target upper upscale and luxury hotels in select urban and resort markets, including major business centers and leisure destinations, is because they tend to be in locations that have greater supply constraints such as lack of available land, high development costs, long development and entitlement lead times and brand trade area restrictions that prevent the addition of a certain brand or brands in close proximity. Nevertheless, our hotels are not completely insulated from competitive pressures and our hotel operators will lower room rates to compete more aggressively for guests in periods when occupancy declines. Our ADR increased 16.6% to $223.25 during the six months ended June 30, 2006 from $191.49 during the six months ended June 30, 2005. With respect to the Comparable REIT Assets, ADR increased by 9.2% to $228.43 for the six months ended June 30, 2006 from $209.10 for the six months ended June 30, 2005.

Operating Costs and Expenses. Our operating costs and expenses consist of the costs to provide hotel services, including (in thousands):

	For the Six Months Ended June 30,							
	Total Portfolio				Comparable REIT Assets			
	2006	2005	2006 % of Total Operating Costs and Expenses	2005 % of Total Operating Costs and Expenses	2006	2005	2006 % of Total Operating Costs and Expenses	2005 % of Total Operating Costs and Expenses
Operating Costs and Expenses:								
Rooms	$ 37,970	$ 26,488	15.1%	14.1%	$ 18,397	$ 17,015	13.4%	13.0%
Food and beverage	66,142	48,502	26.2%	25.7%	38,430	35,828	28.1%	27.3%
Other departmental expenses	72,353	54,428	28.7%	28.9%	43,563	41,526	31.8%	31.7%
Management fees	9,093	8,340	3.6%	4.4%	5,609	5,683	4.1%	4.3%
Other hotel expenses	18,281	12,636	7.2%	6.7%	8,832	9,137	6.5%	7.0%
	203,839	150,394	80.8%	79.8%	114,831	109,189	83.9%	83.3%
Lease expense	6,619	6,991	2.6%	3.7%	6,619	6,991	4.8%	5.3%
Depreciation and amortization	29,228	21,612	11.6%	11.5%	15,364	15,007	11.3%	11.4%
Corporate expenses	12,589	9,407	5.0%	5.0%				
Total operating costs and expenses	$ 252,275	$ 188,404	100.0%	100.0%	$ 136,814	$ 131,187	100.0%	100.0%

Rooms expense. Like rooms revenue, occupancy is a major driver of rooms expense, which has a significant correlation with rooms revenue.

Food and beverage expense. Like food and beverage revenue, occupancy and local social catering are the major drivers of food and beverage expense, which has a significant correlation with food and beverage revenue.

Other departmental expenses. Other departmental expenses consist of general and administrative, marketing, repairs and maintenance, utilities and expenses related to earning ancillary revenue.

Management fees. We pay base and incentive management fees to our hotel operators. Base management fees are computed as a percentage of revenue and correlate to revenues. Incentive management fees are incurred when operating profits exceed levels prescribed in our management agreements.

Other hotel expenses. Other hotel expenses consist primarily of insurance costs and property taxes.

Table of Contents

Lease expense. We recorded a sale and leaseback of the Paris Marriott and Hamburg Marriott and record lease expense on our statements of operations.

Corporate expenses. Corporate expenses include our corporate level expenses such as payroll and related costs, restricted stock units plan expense, professional fees, travel expenses and office rent.

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

Recent Trends and Events

Recent Trends. In the second quarter of 2006, the overall economy and the travel industry continued to gain momentum from the recovery that began in 2004 and accelerated in 2005. The improved demand continues to be driven by the business traveler and the strength of the leisure market. For example, with respect to the Comparable REIT Assets, RevPAR increased 10.7% to $172.02 for the six months ended June 30, 2006 from $155.39 for the six months ended June 30, 2005.

Recent Events. In addition to the recent trends described above, we expect that the following events will cause our future results of operations to differ from our historical performance:

Hyatt Regency New Orleans. In August 2005, Hurricane Katrina caused substantial damage to the Hyatt Regency New Orleans property. The hurricane damage also caused significant interruption to the business, and the hotel has effectively ceased operations.

We have comprehensive insurance coverage (both property damage and business interruption) for this loss providing for an aggregate $350.0 million of coverage, subject to a deductible of approximately $11.0 million. The recovery effort is expected to include replacing portions of the building, landscaping and furniture. The net book value of the property damage is currently estimated to be at least $32.7 million; however, we are still assessing the impact of the hurricane on the hotel, and the actual net book value write-off could vary from this estimate.

While we expect the insurance proceeds will be sufficient to cover most of the replacement cost of the restoration of the hotel, certain deductibles and limitations will apply. No determination has been made as to the total amount or timing of those insurance payments, and those insurance payments may not be sufficient to cover the costs of the entire restoration.

To the extent we are entitled to recover incurred expenses under the insurance policies, we recognize a receivable when it can be demonstrated that it is probable that such insurance recovery will be realized, and such insurance recovery will then be reflected as a component of operating income. Any gain or profit component resulting from business interruption insurance for lost income will not be recognized until the relevant payments have been received and all contingencies related to the insurance recoveries are resolved. This income recognition criteria will likely result in business interruption insurance recoveries being recorded in a period subsequent to the period that we experience lost income from the affected property, resulting in fluctuations in our net income that may reduce the comparability of reported quarterly and annual results for some periods into the future.

Through June 30, 2006, we have recorded $42.7 million in insurance recoveries receivable related to property damage and business interruption recoveries. We have collected $30.0 million in insurance proceeds through June 30, 2006, including $10.0 million collected in 2005. Of the $42.7 million total receivable recorded, $32.7 million represents the recovery of the net book value of fixed assets written off because of the damage, as discussed above. The remaining $10.0 million represents a probable recovery of expenses incurred through June 30, 2006.

Table of Contents

Common Stock Offering. During the first quarter of 2006, we completed a public offering of common stock at a price of $20.00 per share. The shares consisted of 8,000,000 primary shares of common stock sold by us and 12,731,640 secondary shares of common stock sold by stockholders affiliated or associated with Prudential Financial, Inc. and Whitehall Street Real Estate Limited Partnerships VII and IX. After discounts, commissions and estimated expenses, we raised net proceeds of approximately $151.9 million. These proceeds were used to repay existing indebtedness under our credit facility, to partially fund the acquisition of the Four Seasons Washington D.C. and for general corporate purposes.

On May 24, 2006, we completed a public offering of 16,100,000 shares of common stock at a price of $20.50 per share. After discounts, commissions and estimated expenses, we raised net proceeds of approximately $318.3 million. These proceeds were used to repay existing indebtedness under our credit facility, to partially fund the acquisitions of the Westin St. Francis and Ritz-Carlton Laguna Niguel and for general corporate purposes.

Preferred Stock Offering. On January 31, 2006, we completed a public offering of 4,600,000 shares of 8.25% Series B Cumulative Redeemable Preferred Stock, par value $0.01 per share (liquidation preference $25.00 per share). After discounts, commissions and estimated expenses, we raised net proceeds of approximately $110.9 million. These proceeds were used to repay existing indebtedness under our credit facility, to partially fund the acquisition of the Four Seasons Washington D.C. and for general corporate purposes.

On May 17, 2006, we completed a public offering of 5,750,000 shares of 8.25% Series C Cumulative Redeemable Preferred Stock, par value $0.01 per share (liquidation preference $25.00 per share). After discounts, commissions and estimated expenses, we raised net proceeds of approximately $138.5 million. These proceeds were used to repay existing indebtedness under our credit facility, to partially fund the acquisitions of the Westin St. Francis and Ritz-Carlton Laguna Niguel and for general corporate purposes.

Hotel Acquisitions. In the fourth quarter of 2005, we signed letters of intent to purchase the LaSolana Hotel and Villa project adjacent to our existing Four Seasons Punta Mita Resort for a purchase price of approximately $30.9 million (including net working capital) plus the assumption of an agreement, which was executed in the first quarter of 2006, to pay installments totaling $13.5 million over the next four years. The purchase includes a fee simple interest in 20.5 acres of land with plans to develop approximately 70 hillside hotel suites, spa, restaurant, pool and retail (Hotel Site) and the right to develop 55 for-sale residences on 27 acres of land (Villa Site). The acquisition consisted of purchasing existing promissory notes totaling $17.9 million (including accrued interest) as well as the equity interests of $13.0 million (including acquisition costs). In 2005, we purchased the promissory notes and made a refundable deposit of $1.0 million on the equity investment. On March 8, 2006, we acquired the remaining equity interests to take full ownership and control of the development sites. Upon purchase of the remaining equity interests, title to the Hotel Site transferred to us and the previously acquired promissory notes were converted to equity. Initially, we assumed an agreement to purchase the Villa Site for which consideration was expected to be paid in fixed installments (estimated at $13.5 million) over a four-year period. In addition to these installments, additional payments were required (based on a formula in the agreement) upon sale of villa units. However, there have been ongoing negotiations with respect to the nature and timing of the fixed and variable payments. Those negotiations, resulted in termination of the previous agreement. The new agreement requires a single payment of $18.0 million, expected to be paid in the third quarter of 2006, with no future obligation to pay any variable amounts upon sale of the villas.

On January 9, 2006, our subsidiaries closed the acquisition of a 45% joint venture ownership interest in SHC KSL Partners, LP (Hotel Venture), the existing owner of the Hotel del Coronado in San Diego, California, and in HdC North Beach Development, LLLP (North Beach Venture), the owner of an adjacent land parcel under development, for our pro rata share of an aggregate agreed-upon market value of $745.0 million. The 679-room Hotel del Coronado is a National Historic Landmark located on 28 acres of beachfront. The property s amenities include eight restaurants, retailing outlets, two beachfront pools, and 135,000 square feet of combined indoor and outdoor function space. We own the hotel in partnership with KKR and KSL Resorts. An affiliate of KSL continues to manage the property. Our capital commitment is limited to our equity investment equal to approximately $71.3 million. We funded our equity investment in the Hotel del Coronado joint venture through borrowings under our revolving credit facility. The joint venture has obtained $610.0 million of commercial mortgage-backed securities and mezzanine debt financing and a $20.0 million revolving credit facility, concurrent with our acquisition, which are secured by, among other things, a mortgage on the Hotel del Coronado. We earn fees under an asset management agreement with the joint venture. We receive fees amounting to 1% of the ventures revenues and 2% of the ventures development costs. In addition, we earn financing fees of 0.325% of any debt principal placed on behalf of the Hotel Venture as well as certain incentive fees as provided by the asset management agreements. We recognize income of 55% of these fees, representing the percentage of the venture not owned by us. We account for the Hotel Venture and North Beach Venture using the equity method of accounting.

On March 1, 2006, we purchased the Four Seasons Washington D.C. hotel for approximately $169.7 million. We used proceeds from our common stock and preferred stock offerings described above to acquire this property.

On June 1, 2006, we purchased the Westin St. Francis San Francisco hotel for approximately $438.8 million. We used proceeds from our common and preferred stock offerings described above to acquire this property. On July 6, 2006, a subsidiary of SHR entered into a mortgage loan with Metropolitan Life Insurance Company. The principal amount of the loan was $220.0 million and accrues interest at LIBOR plus 0.70%. The loan is secured by, among other things, the Westin St. Francis hotel. Proceeds from the loan were used to partially fund the acquisition of the Ritz-Carlton Laguna Niguel.

On July 7, 2006, we purchased the Ritz-Carlton Laguna Niguel from SHC LLC for approximately $330.0 million and agreed to assume up to $8.6 million in debt. We used proceeds from our common and preferred stock offerings described above to acquire this property as well as proceeds from a mortgage debt financing secured by the Westin St. Francis.

On June 30, 2006 we entered into an agreement to purchase the Fairmont Scottsdale Princess hotel for approximately $345.0 million and an adjacent development land parcel for $15.0 million. The acquisition is expected to be financed using mortgage debt and borrowings on the bank credit facility and is anticipated to close in September 2006.

On July 28, 2006, we entered into an agreement to acquire the Marriott London Grosvenor Square hotel for a purchase price of £103.0 million ($192.0 million). The acquisition, which is expected to close in the third quarter of 2006, remains subject to customary closing conditions. The acquisition is expected to be financed using mortgage debt and borrowings on the bank credit facility.

On August 3, 2006, we purchased a 65.0% interest in the entity that owns the InterContinental Hotel in Prague, Czech Republic, for $68.8 million. The purchase brings our interest in the entity that owns the property to 100%. Including the assumption of $56.5 million in debt, our total investment to acquire the 65% interest is $125.3 million. The acquisition was financed using borrowings under the bank credit facility.

Sales of Hotels. On July 14, 2006, we sold the Marriott Rancho Las Palmas Resort for approximately $56.0 million. The expected gain on sale is approximately $15.6 million (including estimated closing costs).

Termination of Management Agreement. During the first quarter of 2006, we reached an agreement with Marriott Hotel Services, Inc. (MHS), the manager of its Marriott Rancho Las Palmas Resort, to terminate the hotel management contract with MHS on or before December 29, 2006. Under the agreement, we are required to pay MHS an initial termination fee of $5.0 million upon termination, which was paid in July 2006, and an additional termination fee of $5.0 million in 2009, provided that the additional termination fee will not be required if we have entered into a qualifying hotel management contract with MHS, or an affiliate, by December 31, 2008. We also agreed to reimburse MHS for certain severance and relocation costs for MHS employees at the resort. We recorded a charge of $9.7 million for the present value of the termination fees and estimated severance and relocation costs. This charge is included in income (loss) from discontinued operations in the accompanying consolidated statement of operations for the six months ended June 30, 2006.

Redemption of Units of Non-Managing Member Limited Liability Company Interests in SH Funding. We offered all holders of units of non-managing member limited liability company interests in SH Funding an opportunity to redeem their interests on January 20, 2006 by our waiver of the transfer restrictions in the limited liability company agreement of SH Funding. On January 20, 2006, holders of 7,229,590 limited liability interests in SH Funding redeemed their interests in exchange for an equal number of shares of our common stock. As of June 30, 2006, holders of an additional 47,772 limited liability interests in SH Funding had redeemed their interests in exchange for an equal number of shares of our common stock. After these exchanges, our ownership share of SH Funding increased to approximately 99%.

Operating Results

Comparison of Three Months Ended June 30, 2006 to Three Months Ended June 30, 2005

The following table presents our total portfolio and Comparable REIT Assets, as defined on page 29, operating results for the three months ended June 30, 2006 and 2005, including the amount and percentage change in these results between the two periods. Our total portfolio represents the results of operations included in the consolidated statements of operations (in thousands, except operating data).

	Total Portfolio				Comparable REIT Assets			
	2006	2005	Change ($)	Change (%)	2006	2005	Change ($)	Change (%)
Revenues:								
Rooms	$ 87,700	$ 65,094	$ 22,606	34.7%	$ 62,350	$ 56,436	$ 5,914	10.5%
Food and beverage	53,613	40,414	13,199	32.7%	39,029	35,985	3,044	8.5%
Other hotel operating revenue	14,993	12,020	2,973	24.7%	11,045	10,807	238	2.2%
	156,306	117,528	38,778	33.0%	112,424	103,228	9,196	8.9%
Lease revenue	3,968	3,908	60	1.5%	3,968	3,908	60	1.5%
Total revenues	160,274	121,436	38,838	32.0%	116,392	107,136	9,256	8.6%
Operating Costs and Expenses:								
Hotel operating expenses	111,503	85,222	26,281	30.8%	78,141	74,978	3,163	4.2%
Lease expense	3,395	3,418	(23)	(0.7)%	3,395	3,418	(23)	(0.7)%
Depreciation and amortization	15,487	12,615	2,872	22.8%	11,355	11,084	271	2.4%
Corporate expenses	6,916	4,650	2,266	48.7%				
Total operating costs and expenses	137,301	105,905	31,396	29.6%	92,891	89,480	3,411	3.8%
Operating income	22,973	15,531	7,442	47.9%	$ 23,501	$ 17,656	$ 5,845	33.1%
Interest expense, net	(6,458)	(9,450)	2,992	(31.7)%				
Equity in earnings of joint ventures	672	1,156	(484)	(41.9)%				
Other income, net	1,064	1,723	(659)	(38.2)%				
Income before income taxes, minority interests and discontinued operations	18,251	8,960	9,291	103.7%				
Income tax expense	(1,207)	(1,440)	233	(16.2)%				
Minority interests	(860)	(1,780)	920	(51.7)%				
Income from continuing operations	16,184	5,740	10,444	182.0%				
Income from discontinued operations, net of tax and minority interests	1,438	392	1,046	266.8%				
Net income	$ 17,622	$ 6,132	$ 11,490	187.4%				
Reconciliation of Comparable REIT Assets Operating Income to Operating Income:								
Comparable REIT Asset operating income					$ 23,501	$ 17,656	$ 5,845	33.1%
Corporate expenses					(6,916)	(4,650)	(2,266)	48.7%
Corporate depreciation and amortization					(48)	(37)	(11)	29.7%
Non-Comparable REIT Asset operating income					6,436	2,562	3,874	151.2%
Operating Income					$ 22,973	$ 15,531	$ 7,442	47.9