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Sunstone's strategy earns praise

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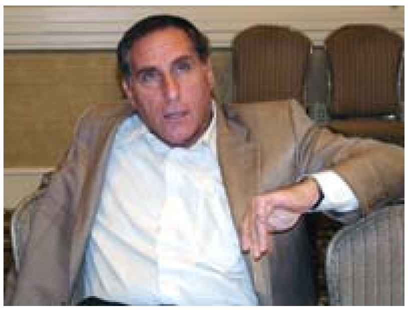

Bob Alter, Sunstone Hotel Investors c.e.o., said the company had converted to about half floating interest rates and half fixed rates when it went public.

PHOENIX—Sunstone Hotel Investors is one of the poster children for hotel companies making hay while the sun shines.

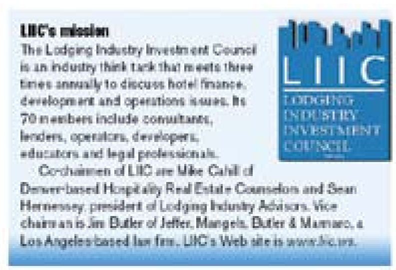
During this latest economic surge by the lodging industry, San Clemente, Calif.-based Sunstone returned to the public-company arena with an initial public offering in October 2004 and spent much of 2005 refinancing most of its debt and acquiring hotels.

It was the refinancing package that held the attention of members of the Lodging Industry Investment Council during a roundtable held in conjunction with The Lodging Conference in late September—about 40 percent of the two-hour session was spent dissecting the deals.

Bob Alter, c.e.o., said Sunstone had floating interest rates for 100 percent of its loans when the company was private, but had converted that to about 50 percent floating and 50 percent fixed rate by the time it went public.

"We did some 22 mutual loans," Alter said. "We thought we were going to do it with insurance companies and we wound up getting much better pricing from [commercial mortgage-backed securities]. We did something in the neighborhood of three-quarters of a billion dollars of financing and we're now 94 percent fixed, with an average length of about 10 [years] to 12 years with a fixed rate of the mid-fives.

"We didn't want to show a chart of all of our debt coming due in 2015, so we went in and did some sevens, some eights, some nines, some elevens. We have about $1.3 billion in debt, and about a $2.6 billion total enterprise value, of which 94 percent of it is fixed and it's all under 6 percent."


LIIC's mission
The Lodging Industry Investment Council is an industry think tank that meets three times annually to discuss hotel finance, development and operations issues. Its 70 members include consultants, lenders, operators, developers, educators and legal professionals.
Co-chairmen of LIIC are Mike Cahill of Denver-based Hospitality Real Estate Counselors and Sean Hennessey, president of Lodging Industry Advisors. Vice chairman is Jim Butler of Jeffer, Mangels, Butler & Marmaro, a Los Angeles-based law firm. LIIC's Web site is www.liic.org.

LIICs mission

That literally drew "oohs" from other roundtable participants, who had plenty of reaction to Sunstone's situation.


Christof Winkleman [left], first v.p., head of hotel finance group for Aareal Bank in Wiesbaden, Germany, and Gary Stougaard, executive v.p. and chief investment officer for Sunstone, participate in the LIIC roundtable.

"That pricing is a reflection of the equity in the market today," said Angelo Stambules, v.p. for GMAC Commercial Mortgage Corp. "The ability to make those structural changes to a securitization product will help the entire industry in the long term. From a lending perspective, it levels the playing field some. But it's those very, very large chunks that are getting done with those types of structural features. It's not two and three property owners who are getting that sort of coverage."

Bill Blackham, president and c.e.o. of Covington, Ky.-based Eagle Hospitality Properties Trust, said his company, which also went public during the last year, has had similar success in its refinancing program.

"The experience that's being described is not just for things that are $200 million," he said. "We also have in the past year brought our fixed-debt level into the 80s from less than 30 percent at the time of our initial public offering. In the last three transactions we did, we have an interest rate in or around 5.3 percent on the average. In fact, one of the deals is interest-only—no amortization."

Gary Stougaard, executive v.p. and chief investment officer for Sunstone, said the situation clearly is market driven.

"We wouldn't get 14 term sheets if it wasn't the market," he said.

"The issue is that the lending is fairly indiscriminate," said J. Mark Tobin, principal with Hospitality Real Estate Counselors. "Whereas there's an implied guarantee from certain sponsors that they would make up shortfalls temporary in nature, they would suck it up and say, 'Yeah, we've got a higher-leveraged return, that was good and now it's a different time we've got to ride this out.' Fair enough, but I think you'd agree that those 14 term sheets are coming in ... on lots of transactions, with good and bad sponsors, completely indiscriminate."

Blackham said the type of leverage and number of unencumbered assets does make the climate somewhat unique.

"It's kind of like the old implied guarantee of some of the agency debt, you know the United States government—the point is that with a lower level of leverage, until you get to a truly big meltdown, some of the pain and suffering associated with giving back is such that there is a comfort factor, maybe it's real and maybe it's perceived, but I'm sure that in the case of our execution, some of that was factored into the decision process of the underwriters," he said. "So there's value in that, if you will, that can be capitalized by a shrewd borrower."

Henry Vickers, principal with AEW Capital Management, said more value is coming into play with the reintroduction of foreign investors into the U.S. lodging market.

"In the developed world, U.S. interest rates are still among the highest, so international investors are looking at the U.S. and they see the cheap dollar," he said.

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