04-May-2021

Sunstone Hotel Investors, Inc. (SHO)

Q1 2021 Earnings Call

CORPORATE PARTICIPANTS

Aaron Reyes
Senior Vice President-Corporate Finance & Treasurer, Sunstone Hotel Investors, Inc.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

Bryan Albert Giglia
Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.

Marc A. Hoffman
Executive Vice President & Co-Chief Operating Officer, Sunstone Hotel Investors, Inc.

Chris Ostapovicz
Senior Vice President & Co-Chief Operating Officer, Sunstone Hotel Investors, Inc.

OTHER PARTICIPANTS

Rich Allen Hightower
Analyst, Evercore ISI

Dany Asad
Analyst, BofA Securities, Inc.

David Katz
Analyst, Jefferies LLC

Smedes Rose
Analyst, Citigroup Global Markets, Inc.

Anthony F. Powell
Analyst, Barclays Capital, Inc.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Michael J. Bellisario
Analyst, Robert W. Baird & Co., Inc.

Lukas Hartwich
Analyst, Green Street Advisors

Stephen Grambling
Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen and thank you for standing by. Welcome to the Sunstone Hotel Investors First Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. I would like to remind everyone that today – this conference is being recorded today, May 4, 2021, at 12:00 PM Eastern Time.

I will now turn the presentation over to Mr. Aaron Reyes, Senior Vice President and Treasurer. Please go ahead, sir.

Aaron Reyes

Senior Vice President-Corporate Finance & Treasurer, Sunstone Hotel Investors, Inc.

Thank you, operator and good morning everyone. By now, you should have all received a copy of our first quarter earnings release and supplemental, which were made available yesterday. If you do not yet have a copy, you can access them on our website.

Before we begin, I would like to remind everyone that this call contains forward-looking statements that are subject to risks and uncertainties, including those described in our prospectuses, 10-Qs, 10-Ks, and other filings with the SEC, which could cause actual results to differ materially from those projected. We caution you to consider these factors in evaluating our forward-looking statements. We also note that this call may contain non-GAAP financial information, including adjusted EBITDAre, adjusted FFO and property-level adjusted EBITDAre. We are providing that information as a supplement to information prepared in accordance with generally accepted accounting principles.

With us on the call today are John Arabia, President and Chief Executive Officer; Bryan Giglia, Chief Financial Officer; Chris Ostapovicz and Marc Hoffman, Co-Chief Operating Officers and Robert Springer, Chief Investment Officer. After our remarks, we will be available to answer your questions.

With that, I'd like to turn the call over to John. Please go ahead.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

Thank you, Aaron. Hello, everyone, and thank you for joining our call today. I'm happy to report that our recent operating results exceeded our expectations, and there's clear evidence that we are rapidly approaching better days. While we continue to face challenges across our portfolio and current results are nowhere near their potential, we continue to see sustained improvements in leisure, group and commercial demand.

As has been widely discussed, the leisure segment has demonstrated the most robust demand to date, however, the nascent recovery in business transient and group demand witnessed in the fourth quarter of 2020 continues to gain steam and, if our forward-looking data is correct, business and group demand should produce far more meaningful benefits as the year matures. Based on the recent acceleration in bookings across all business segments, we continue to believe that the lodging recovery has begun. Our portfolio is currently sustaining cash flow positive operating levels, and we expect the return to quarterly corporate profitability in the second half of the year.

Today, I'll provide a recap of our first quarter results along with comments on recent operating and booking trends. I will then discuss our recent acquisition of Montage Healdsburg, a spectacular newly-built luxury resort in Sonoma County, along with the potential for additional acquisitions of Long-Term Relevant Real Estate. Finally, I'll talk about our Chief Operating Officer transition. Bryan will later provide more details on our liquidity, earnings and dividends.

So let's talk about our first quarter operating results. When we last spoke on our year end call in February, we stated that we expected the seasonally slower first quarter of 2021 to be very similar to the fourth quarter of 2020, and then for operating fundamentals to accelerate starting in the second quarter.

Fortunately our forecasts proved to be conservative and the first quarter materially exceeded our expectations comparable 17 Hotel portfolio revenues were $47 million and RevPAR was $42.19 which represent declines of 73% and 70%, respectively compared to the first quarter of last year. Our portfolio RevPAR of just over $42 increased 66% from the $25 achieved in the fourth quarter and increased a 137% over the $18 achieved in the third quarter. The sequential improvement in RevPAR was a function of increased leisure demand as we reopened our higher-rated leisure hotels, increased group demand particularly from government sources and a modest lift in business transient volume.

Despite occupancy still lagging compared to pre-pandemic levels four of our hotels including Oceans Edge, Chicago Embassy Suites, Hyatt Chicago and Wailea Beach Resort achieved higher room rates in this past quarter than was the case in the first quarter of 2019. This is important because it shows that the industry has learned from its past mistakes and when possible our hotels have pushed rates despite lower occupancy levels. For example, just because Wailea is running below its pre-pandemic occupancy levels, it does not mean that we need to discount our rooms. For once, we're actually doing the opposite in certain situations which should prove to be beneficial when occupancy returns to 2019 levels.

For the first quarter, leisure remained the dominant source of business for many of our hotels. Our resort destinations continue to significantly outperform our city center properties, particularly on the weekends and over Spring Break. As our higher-rated hotels continue to ramp up, our portfolio experienced a 24% increase in transient rate in the first quarter compared to the fourth quarter of last year.

Oceans Edge in Key West was nearly flat in occupancy compared to the first quarter of last year, but this year's ADR increased by 15% and RevPAR increased 13%. The performance is led by strong transient demand particularly in the higher-rated premium segment. With many area attractions still closed, more guests are electing to utilize on property food and beverage outlets. Oceans Edge saw a 13% increase in food and beverage spend per occupied room in the first quarter as compared to pre-pandemic levels. Similarly, Wailea Beach Resort, which benefited from additional airlift and relaxed restrictions during the quarter was able to drive rate despite occupancies below 2019 levels. During the first quarter as occupancy grew from the high teens to the mid-60s, we focused on maintaining premium pricing as opposed to dropping rates in hopes of inducing demand.

As a result, the hotel commanded a 7% higher rate than was the case in the first quarter of 2019. Similar to what we saw in Key West, food and beverage outlet spend per occupied room in Wailea increased nearly 70% as compared to the first quarter of 2019. We continue to believe that our outstanding hotel product and the desire by travelers to vacation in Maui will allow us to maintain our high rates, while building occupancy, as more people feel comfortable traveling. We are excited about the resort's potential going into the summer months with very high occupancy already on the books.

Now let's take a look at our quarterly group performance. Group business increased to approximately 51,000 room nights in the first quarter of 2021 up from 32,000 room nights in the fourth quarter of last year. Group business continues to be comprised primarily of government-related groups, all of which tend to be short-term in nature, but work well in the current environment as they don't require long-term commitments for our space. Similar to last quarter, we saw instances of traditional groups holding their meetings as planned. For example, during the first quarter, we had some corporate and medical groups hold their events at our resort properties, including Wailea Beach Resort, Oceans Edge and Renaissance Orlando. We expect to see a steady acceleration of traditional group meetings, including citywide, corporate and association meetings in the second quarter and the remainder of the year.

During the first quarter, property-level expenses declined by 59% compared to the first quarter 2020. Despite such a material decline in cost, the low occupancy environment resulted in a property-level adjusted EBITDA loss of $15 million in the first quarter. We had expected our seasonally slow first quarter to produce a more significant loss than the $18 million loss we generated in the fourth quarter and were pleasantly surprised by the strength in both leisure and group demand. Despite a property-level EBITDA loss in the first quarter, in March, for the first month since the pandemic began, we effectively broke even at the hotel EBITDA level.

This is an important milestone. Given the rate and occupancy levels we see developing in the second quarter, we expect to reach property-level profitability earlier in the quarter than we previously expected. Looking towards the remainder of the year, booking trends for all segments continue to accelerate. This is evident in our continued sequential monthly RevPAR improvement in April. Through the first 28 days of April our 16 hotels were open for the entire month excluding Montage Healdsburg, generated RevPAR of $80. This figure represents a $15 increase from the hotels open in March, which itself was a nearly $19 increase from February. Well transient trends remained strong, we now have increased confidence in the improving group and business demand trends, which we believe have just begun and should continue to strengthen into the second half of this year. Given the current trajectory, we feel more confident now than we did a quarter ago.

As we look at the group business in the second quarter, more cities are easing meeting restrictions allowing more groups to confirm their intent to hold their events and more attendees aiming to make the trip. For example, after California announced the lifting of certain meeting restrictions, the Hilton Bayfront confirmed an in-house medical related group meeting for June. The Renaissance Orlando has had several in-house group and local social events confirm their events starting as early as April and accelerating into May. This gives us additional confidence that non-government related group business will begin to increase in the second quarter.

As travel restrictions and social distancing requirements ease, group activity should accelerate in the mid-to-late summer, as meeting planners have become more confident about holding their events in the third and fourth quarters. Based on these assumptions, we expect our group contribution will perform materially better in the second half of 2021 and specifically in the fourth quarter. The current pace of future group bookings also points to recovery. Following the relaxation of stay-at-home orders, we saw a meaningful increase in booking and group-related lead volume. Since the beginning of the first quarter through April, we booked 236,000 group room nights for all future months. While a portion of these bookings relate to specific event-driven business, the remaining balance still represents an acceleration from previous months and demonstrates pent-up demand to hold meetings as conditions permit.

Production for the portfolio has steadily improved each quarter since the beginning of the pandemic. Hilton San Diego Bayfront produced significantly more room nights in the first quarter of 2021 than in the same period of 2019 and Renaissance Long Beach had its best first quarter production since 2017. In addition to the more optimistic outlook for group business, transient trends are steadily improving since the vaccine distribution began. While our net transient reservations are still short of normal levels, bookings continue to accelerate. Our trailing six-week booking trends compared to the same time in 2019 are down roughly 25% to 35%, which marks a material improvement from the 80% to 90% declines we saw at the first of the year.

The booking window, which had shrunk to just a few days at the start of the pandemic, is extending with reservations starting to pick up 30 days out. Our resort and leisure destination hotels are seeing the earliest reservations with reservations stretching out through the summer and even into the holiday season. For example at Wailea, we currently have more transient rooms on the books for each month from June through December than we did at the same time in 2019 with average rates that also exceed 2019 levels. While we still have a ways to go to get back to normal operating levels the trend is heading in the right direction.

Moving to transactions we're excited to add Montage Healdsburg to our portfolio. The 130 room newly constructed luxurious resort opened in December 2020. Located in one of the most sought after and highest-rated leisure destinations in the US, this resort is a perfect example of Long-Term Relevant Real Estate. With its strategic acquisition, we've increased our concentration of Long-Term Relevant Real Estate, improved the overall quality of our portfolio and entered a market that is difficult to assemble, developable land to build competitive luxury resorts. The acquisition was financed with a combination of cash on hand and $66 million of directly issued preferred equity that has an initial yield tied to the performance of the resort. The preferred equity aligns us and the seller and motivates the seller to finish the residencies, which we'll be able to participate in the resort's rental program and will add further ancillary business demand including food and beverage and spa revenue.

We expect the resort to generate a 6% to 7% stabilized yield on our investment after the property wraps up and it increases our overall leisure exposure to approximately 30%. The acquisition of Montage Healdsburg is consistent with our long-stated strategy of acquiring early in the cycle, adding high quality LTRR to the portfolio and maintaining our balance sheet strength. With a strong balance sheet and a growing deal pipeline, we expect Montage Healdsburg to be the first of several acquisitions of LTRR to be completed in the early stages of this new operating cycle. As we continue to add to the portfolio in the near term, we will look to sell the remaining non-LTRR assets to finance future acquisitions.

To sum things up. We believe that the worst is behind us and we are now in a period of recovery. The vast majority of our portfolio is operating and we are seeing trends that give us increased optimism and confidence that we are on the path to return to corporate quarterly profitability in the second half of 2021. And finally, the addition of Montage Healdsburg adds a high quality, leisure-oriented LTRR asset to the portfolio, while deploying a portion of our available cash.

Before I turn the call over to Bryan, I'd like to address a bittersweet moment for me and for the company. After 15 years of service, our Chief Operating Officer, Marc Hoffman, will be retiring in just a few short weeks. It has been a pleasure to work with Marc and his contributions to the company can be seen throughout our portfolio. His foresight and vision to transform the plain and mundane into exceptional, can be seen at Boston Park Plaza, Wailea Beach Resort and most recently at the Bidwell Portland.

On behalf of the Sunstone team, I want to thank Marc for his contributions to the company. I also want to thank Marc for taking an active role in identifying his successor. Chris Ostapovicz, our new Chief Operating Officer, has been at the company two months and is already proving why he is the right choice for the job. Chris has big shoes to fill, but I'm confident that he is up to the task and will serve our shareholders well.

With that I'll turn it over to Bryan. Bryan, please go ahead.

Bryan Albert Giglia

Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.

Thank you, John, and good morning everyone. As of the end of the quarter, we had approximately $365 million of total cash and cash equivalents, including $45 million of restricted cash and undrawn $500 million revolving credit facility. Adjusting for the acquisition of the Montage Healdsburg, our pro forma cash balance at the end of the quarter would have been approximately $167 million. After deploying a portion of our excess liquidity our balance sheet remains strong and positions us well to grow the company through the acquisition of Long-Term Relevant Real Estate as the industry recovers while maintaining a best-in-class balance sheet. We continue to focus on managing our costs and minimizing hotel expenses while maintaining our properties in good condition and opportunistically investing in projects that would have resulted in material displacement.

Working with our operators, we have seen operating expense reductions ranging from 60% to 75% since the start of the pandemic, with the most recent quarter at nearly 60%. Our current expectation is that in total our portfolio will sustain cash flow positive operating levels in the second quarter and we will achieve positive quarterly corporate EBITDA in the second half of the year. March and April results provide us with more confidence in achieving this trajectory.

Shifting to the first quarter financial results, the full details of which are provided in our earnings release and our supplemental. First quarter results reflect a strengthening operating environment driven by leisure and some select group business. First quarter adjusted EBITDA was a loss of $15 million and first quarter adjusted FFO per diluted share was a loss of $0.13. These results far surpassed our previous expectations.

Now turning to dividends we have suspended our common dividend until we return to taxable income which may or may not occur in 2021. Separately, our board has approved the routine quarterly distributions for all of our outstanding series of preferred securities.

And with that we can now open the calls of questions. Operator please go ahead.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from Rich Hightower.

Rich Allen Hightower
Analyst, Evercore ISI

Q

Hey good morning out there guys.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Hey Rich, how you are you doing?

Rich Allen Hightower
Analyst, Evercore ISI

Q

Good, good, good. If Marc Hoffman is listening in I just want to say Marc always profited from any conversation that you are a part of, I've learned a lot over the years and I really appreciate your evident enthusiasm for the work you did. So I just wanted to put that on the record. But maybe to shift...

Marc A. Hoffman
Executive Vice President & Co-Chief Operating Officer, Sunstone Hotel Investors, Inc.

A

Thank you, Rich, it's much appreciated.

Rich Allen Hightower
Analyst, Evercore ISI

Q

Oh good, you're on the line. Great. Awesome. So to shift to the Montage deal for a second, guys, maybe just walk us through the financial structuring and maybe some of the incentives around Ohana taking the preferred as partial consideration in the manner outlined? And then also sort of a second part to that, how much of the eventual 6% to 7% stabilized yield is dependent on income from the residences versus sort of the main hotel, if you don't mind?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Yeah. Let me start off with the financing. So roughly 75% of the transaction was financed with cash on hand using a notable portion of our excess liquidity that we've been holding up. We still have excess capacity past this. There's about $200 million that went to the cash portion of the transaction. The other part of the transaction, I actually think was an elegant solution to deal with different aspects of the transaction was a preferred equity issued directly to Ohana, the seller. That preferred, which is a 100% callable at our election, there's no five-year lockout, which is typical for preferred so completely at our election, bears an interest rate that is tied to the yield of the hotel. Obviously, this is a hotel that just opened up and would expect to ramp, including the delivery of the Montage Healdsburg Residences, which will have the option to be put into the rental program, which would become call it 8% to 10%, the total earnings of the hotel, but will just add another dimension of the resort.

As a reminder, we will not own the residences, Ohana will continue own those lots and develop those residences, but they're an important part the long-term earnings power of the asset. So to me, Rich, we were able to hedge out a portion of the operations, 25% of the operations of the hotel in the short-term but we would love nothing more than that to become an incredibly expensive piece of preferred paper because that means that the hotel is doing exceptionally well. And at that point, we are 100% free at our option to finance at $66 million with a lower coupon security or cash on hand or what have you.

Rich Allen Hightower
Analyst, Evercore ISI

Q

Okay, great. That's helpful. Yeah, that's great. And then second question here. Just looking at the very strong rate performance in several of the resorts that you mentioned Wailea, Oceans Edge and so forth. How much of that would you attribute to the mix of the hotel whether it was the room mix, the customer mix, probably one and the same I would imagine and how would you expect that to trend as we kind of move along and the hotels open up more fully as we get through the year here?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Yeah I think it has less to do with mix, quite honestly, Rich and quite honestly, I think it has to do with the amount of pent-up demand for properties like that and experiences like that. People want to get out of their homes, they have canceled numerous vacations. Wealth has increased oddly enough through this entire pandemic and people are looking for experiences such as Hawaii, Wailea, Oceans Edge, Key West, et cetera. So I would say, it's predominantly that and as demand has come back. We started off Wailea in occupancies in the teens and I think I remember seeing on one of our conference calls start booking now because we are going to quickly get to a sold out point and that is coming true.

And when you take a look at our bookings for this summer, our bookings are well ahead of a normal pace at a far higher rate. I would encourage all of you to take a look at, for example, our availability in Wailea for June there are very, very few dates left to check in and they are all at extraordinarily high rates. Demand is there and we expect other parts of our business to start seeing that snapback in demand as well. It is taking longer for commercial and for group, but I firmly believe that in through conversations with meeting planners, et cetera, there is a lot of pent-up demand for hotel and travel.

Rich Allen Hightower
Analyst, Evercore ISI

Q

All right. Great, thank you.

Operator: [Operator Instructions] Your next question is from Dany Asad.

Dany Asad
Analyst, BofA Securities, Inc.

Q

Hey, good morning everybody, actually I have a little bit of a follow-up question on to Rich's original question, but it more of, like a flow through question right. So during the stage of this recovery, we know there's like an element of bringing costs back into your operating structure. But this time around you have assets like the Montage, Wailea, Oceans Edge they're all probably going to be generating pretty significant ancillary or non-room revenues and you have guests spending more time on property. So John, when you look at this early cycle recovery versus let's say, the last one, how do we think about any upside that Sunstone can have here from a flow through standpoint?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Several things in there, Dany. And by the way, hello. Several things in there. First and foremost, we have qn opportunity, we probably never thought we had to effectively zero base these budgets and add back incremental services and people as occupancy ramps up. It is not a one size fits all approach. I would tell you that those hotels that we're running at lower occupancies, we are very focused on expenses, adding back slowly, et cetera. Those hotels such as Wailea that's currently running, call it a $500, $600, $700 rate. Oceans Edge that's running in some days, running at $400, $500, $600 rate have certain expectations from guests that we are balancing and meeting. And so those hotels that we see the business coming back, we are quickly adding back those services because it's the right business decision for the long-term. So I would say that it's a mix.

Now the real question is which you brought up is what do long-term? And how much have we learned from this experience to increase our margins going forward? I can turn it over to Chris Ostapovicz, who I know Chris and Marc have both been in direct lines of conversation now for months and months and working with our operators to talk about what the operations look like in the future. Chris?

Chris Ostapovicz
Senior Vice President & Co-Chief Operating Officer, Sunstone Hotel Investors, Inc.
A

Thanks John and nice to hear your voice Dany. I think in the big picture standpoint, our operators have figured out how to operate our hotels much more efficiently. Whether it's managers that are taking on more responsibilities within the hotel, if they only manage one department before now they're very comfortable managing two or three. And then when we look at adding back services as John mentioned, we're doing it when it makes sense whether it's at Wailea or whether it's at Oceans Edge. If the guests are looking for those services, we're adding it back when it makes sense for us and the customer, whether it's food and beverage, whether it's valet parking.

And right now as we add those back, we expect them to be incremental. Where in the past maybe they weren't incremental to us. In addition to that some of the big management companies have really taken the opportunity to engage with us, understanding more of the ownership perspective and recognize that at the end of the day they're spending our money in the recent perspective they pulled back a lot of programs and now there is a dialogue as they add them back. Similar to adding services at the property level, adding services back whether it's brand standards, expectations and that the key thing is that there appears to be a lot more flexibility going forward and what makes sense for each of the assets versus just an across the board implementation.

Dany Asad
Analyst, BofA Securities, Inc.
Q

Got it. Thank you very much.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Thanks Dany.

Operator: All right and your next question comes from David Katz.

David Katz
Analyst, Jefferies LLC
Q

Hi, afternoon everyone.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Hey, David.

David Katz
Analyst, Jefferies LLC
Q

Hey. John I got stuck on one line, I don't want to say stuck because that sounds negative, but one line from the release jumped out at me, which is we would expect Montage to be the first of several acquisitions completed over the early stage of this new operating cycle. Would you mind just elaborating a bit more on what you were all thinking when you put that in there?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Yeah, sure David. Fairly straightforward, we have said repeatedly that we're unlikely to be acquisitive or less likely to be acquisitive later on in an operating cycle. We've had numerous conversations about that and what we've done is built up capacity. We didn't know how the cycle would end and one only knows that we weren't anticipating a pandemic but here, we are nonetheless. We feel more confident early on in an operating cycle, so we put capital to work to use a good portion of our excess capacity and actually to increase our normalized leverage levels, all consistent with what we've been saying for the past basically decade.

And so we would anticipate to be more acquisitive here in these early days of this cycle. We have been working on acquisitions, Robert and the team have been working on acquisitions for eight months, nine months shortly after we just got our footing in the pandemic even though things were still rough we set our eyes on growing the company. And so we've been having a lot of conversations with folks and hopefully we are successful in acquiring not just any hotel, but Long-Term Relevant Real Estate. And doing so successfully because we think that those assets will not only stand the test of time, but deliver superior returns. I would also tell you it should not be lost on people that those companies with the better balance sheets are those companies striking first, and those companies that I believe will be more acquisitive through this cycle than others. So...

David Katz
Analyst, Jefferies LLC
Q

Okay. Congrats on the deal. It's a beautiful hotel. Good luck.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.
A

Thanks, David.

Operator: All right. And your next question is from Smedes Rose.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.
Q

Hi. Thanks. I was just wondering you mentioned you're seeing some acceleration in the group bookings outlook. Are you guys getting any sense from the corporate side that there's any pullback on business spending or corporations getting used to having not had a travel budget really for the last year or so and wanting to kind of impair that going forward? Or is that not something that's really coming up in your conversations?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

No, not coming up in our conversations, yet. The first question really has been can we have the meeting, and people are getting far more comfortable that those meetings are happening. Some are happening in the second quarter, several are happening in the third quarter, and a lot are happening in the fourth quarter as people get more comfortable. Obviously, the dynamics could change over time, but that's what we're seeing in conversations with the meeting planners. Oddly enough, we've actually seen a fair number of groups actually increased their book and keep their spend.

So far we have not seen lots of instances where people are coming and materially cutting their expenditures. And in fact at one of our large hotels, we just booked a significant book of business over the past two days for early 2022 and the food and beverage component was spectacular. So I continue to believe that there is pent-up demand for group, and it won't come in a straight line, but I'm feeling good about.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And could you also just maybe touch on anything you're seeing on the labor side in terms of the ability to bring people back or are having to pay more to get people to come back or anything you're seeing there?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Sure. Good question, Smedes. We are having some challenges filling open positions at several of our hotels including our most notably in some of the resorts that have rebounded so quickly. I think there's a few reasons, one, through this pandemic, there are several folks still have children at home that are taking classes remotely and that's making it difficult to get back to work. But we believe that the largest factor at play is the government benefits including extended unemployment that are a great safety net, but at the end of the day, unfortunately are a disincentive to work. That said our operators are finding ways to get the job done and as Chris mentioned earlier, finding ways to do it more efficiently, which has created some savings. I would expect this challenge to remain in place at several of our hotels, largely through Labor Day. It is our thought that once the extended unemployment benefits expire and kids can go back to school in person that a good portion of these problems should mitigate.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you.

Operator: And your next question comes from Anthony Powell.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Hi, good morning. I'm sorry, if you went over this already, but just could you go over how much actual capacity you have under your credit facility agreement to buy hotels with current liquidity, your appetite to do ATMs or other equity offerings to fund further deals this year? And just your overall financing outlook for these transactions you hope to achieve over the next couple of years?

Bryan Albert Giglia

Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.

A

Good morning, Anthony. We've talked about this several times, but while we did not build the balance sheet geared for a global pandemic, we did build the balance sheet that was built to withstand a significant cyclical downturn. And so, if you go back and look at our 2019 earnings and if you were to say that we would achieve 50% of our 2019 earnings that would put our leverage at about 4 times. At 75%, we would be about 3 times. These are lower leverage levels than many of our peers were at prior to the pandemic. So what this means is we have significant capacity. We have room in the balance sheet as EBITDA comes back to have the option to decide how to fund future acquisitions. Whether it be through asset sales, we have $165 million of cash remaining on the balance sheet, we have the credit facility that's undrawn at this time, so we have a lot of different options. As John said, the overall plan was always to increase leverage early in the cycle, and then moderate it down to where we have always had our peak of cycle targets and so, we expect to continue to do that. That doesn't mean that every deal will be debt funded, but it will be a mix of debt of equity at the right time and right price, and then also asset sales that we can use to fund acquisitions in the future. And so, it'll be a combination of those, but the bottom line is that we still retain significant cash on the balance sheet and, more importantly, we retain significant capacity in the balance sheet.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Right. But just to be clear, do you need to be out of the amendment to actually have the capacity? Or can you access some of the stuff now? I'm just trying to make sure I understand the timing of everything.

Bryan Albert Giglia

Chief Financial Officer & Executive Vice President, Sunstone Hotel Investors, Inc.

A

We can use several of those levers now. And then, based on our expectations and our projections, it will be in the latter part of this year where we expect to be able to exit all of the covenant restrictions at that time.

Anthony F. Powell

Analyst, Barclays Capital, Inc.

Q

Yeah. Great. Thank you.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks, Anthony.

Operator: Your next question comes from Chris Woronka.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys. Thanks for taking the questions. Maybe we can talk a little bit more about acquisitions more broadly. It seems as if yourselves and maybe some of your peers have an idea to maybe make a little bit more of a bet on leisure or resort markets in this next up-cycle. So the question is, is that correct and at what point does an urban opportunity come along, I mean are you willing to even consider those? Or are there just certain bets on markets or states or segments that you really don't want to make?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Montage Healdsburg is obviously a leisure-oriented, luxury resort, but also has a smaller group component. I would not take that acquisition as we are solely focused on resort acquisitions. We will continue to look at resort acquisitions but we are a long-term owner. Robert and the team have underwritten urban hotels, group hotels, et cetera, and we will continue to. Right now resort is favored, but that too at some point will change. And I think in the not so distant future, we will see a recovery in group and transient. So we have taken a look at all types of hotels, but we are not moving away at all from the desire or the direction of owning Long-Term Relevant Real Estate.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Okay that's helpful. And John, you mentioned earlier that you're seeing a lot more price discipline right now even though occupancy levels are way below 2019 levels in some of your hotels? What do you think's driving that? Is that just a function of different people in different places that the operators or is it a computer kind of learning or how do you explain it?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

I think more disciplined around the topic. Look, even in some of those markets where occupancy is unbelievably low, we've held firm and said we're unlikely to spur incremental demand by just dropping rates further. Now keep that in the perspective, we have several hotels that yes have dropped rates, but not as much as we thought would have been the case, given the very low occupancies. In other areas where we see strength in demand, we are being incredibly aggressive in pushing rates where we can. And thus far, we are not seeing pushback from the consumer. In fact, the consumer continues to come, which I think is more evidence of the pent-up demand to travel that I think is going to be robust for quite some time.

Chris Woronka
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Very helpful. Thanks, John.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks, Chris.

Operator: Your next question comes from Michael Bellisario.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Hey, Michael.

Michael J. Bellisario

Analyst, Robert W. Baird & Co., Inc.

Q

Good morning, guys. Hey, John. One question, two parts with respect to Montage. One, can you provide some of your underlying assumptions that you guys made to get to that 6% to 7% yield thinking ADR, occupancy, margins, what are you assuming there? And then also on the supply front, what has it been like historically in Sonoma County, if you could quantify it and then what does the pipeline look like, if you look out over the next three to five years?

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Sure. All right. So underlying assumptions, won't give you everything, but effectively the ADR that we are assuming are ADR levels that are already captured and have been captured for years in that market. It is one of the highest ADR markets in the luxury set in the country. And some of those hotels that we believe we will go head-to-head with have consistently generated ADRs of $1,100-plus a night. A very, very strong transient, very strong weekend, very strong seasonally and into the fall, into crush, et cetera. And also with the number of events that are held in the overall wine region, Napa and Sonoma drive pretty significant business. The margins on this type of hotel I would say just in general are typically in the mid-20s to 30% EBITDA margin level. There is a lot of food and beverage, there's a lot of other income that moves through a hotel like this.

So those are the general parameters, but I want to make one point abundantly clear that we are not assuming anything that isn't already being done in that market. And given the sense of place, given the Montage name, given the quality of the asset we feel very comfortable about hitting that over a stabilized basis.

To your question about supply, unfortunately, there was a tragedy in the Napa area of Calistoga Ranch being burned down in the Glass Fire and Meadowood primarily leisure and group hotel, but a formidable group hotel being partially burned down in the Glass Fire. That has taken out a decent part of supply. Part of that supply, we have heard that Meadowood will eventually come back but it's unclear about Calistoga. And it's being replaced right now by Montage, and soon to be completed Four Seasons Napa. So I think the market has the ability to absorb those rooms. Quite honestly, on weekends and in special weeks, I wish we had a much larger hotel because the amount of turn away demand that we have at Montage Healdsburg is significant. And so we feel very good about it, Michael.

Michael J. Bellisario

Analyst, Robert W. Baird & Co., Inc.

Q

Very helpful. Thanks, John.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thank you.

Operator: Your next question comes from Lukas Hartwich.

Lukas Hartwich
Analyst, Green Street Advisors

Q

Thanks. Good morning.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Hey, Lukas.

Lukas Hartwich
Analyst, Green Street Advisors

Q

Hey. So when it comes to LTRR acquisitions, obviously, there's a limited opportunity set and there's a ton of competition for those assets. Would you ever consider investing outside the US? Clearly, there's a lot of hotels that I think would hit that target in terms of type of hotel, but it's obviously outside the US? So I'm just curious how you guys think about that?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Never say never but pretty comfortable saying not now and probably not soon. Given the tax implications, then becoming experts on different markets, given some of the challenges in asset managing those assets from afar. So, I would say not on our radar screen right now, Lukas. Plus, I think that there are plenty of target opportunities here that we continue to either underwrite or keep our eye on. Keep in mind that the relationship with Ohana has been developed over the past 10 years. We've been talking to them about this asset for several years and it finally came together over the past eight months to nine months. Sometimes these things take a very long time to nurture the relationship and get it done. So we'll continue to do that and I think there are a lot of opportunities for us. And I do believe that it is a very highly sought after asset class, which again is one of the reasons we like it. As you've seen in this downturn, asset values for LTRR do not dip as much as commodity hotels. I think they not only keep their asset value, but increase their asset value more than a commodity hotel. And there will always be a buyer for that asset.

Lukas Hartwich
Analyst, Green Street Advisors

Q

Thank you.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks, Lukas.

Operator: And your next question comes from Stephen Grambling.

Stephen Grambling
Analyst, Goldman Sachs & Co. LLC

Q

Hey good morning. As you look at the urban markets perhaps can you just give us a little more color on what you're thinking about business transients' recovery? And maybe the interplay between group and leisure in urban markets?

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Sure. The urban markets have been slower to come back is I think been widely known. Boston has been slow, Chicago is slow, San Francisco is slow. But we are starting to see a nascent recovery in business transient in those markets. We are seeing as we talked about in our prepared remarks the transient reservations every single week since the start of the year have basically increased and continued to increase. And so that gives us confidence that business is starting to come back. Now what I think is a big wild card that I'm actually pretty bullish on is many corporations are starting to talk about going back to the office as soon as Memorial Day and as late as Labor Day. And we have heard that many corporations are allowing people to travel as soon as they get back to the office. We've heard that anecdotally from numerous corporations. If that is the case and given the booking window on that business, I think there is a very good chance that we start seeing a pretty rapid increase in business transient or commercial travel starting this summer and then accelerate meaningfully after Labor Day. We shall see.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

That's helpful and I guess as you think about pricing just as a quick follow up. If business transient ends up plateauing maybe not quite where you were pre-pandemic, does the pricing behavior change where you'd anticipate that some of those properties could try to backfill the softer business transient, with the strength in group and with the strength in leisure?

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Backfilling. Good question. Some of our larger city center hotels do have the ability because they actually have a fair amount of meeting space. Take a look at Embarcadero for example. That's one where I think the hotel is actually very well set up to backfill with other types of demand whether it's in-house group, leisure on the weekends sitting right next to the Ferry Terminal building, et cetera. So, yeah, I can see that. I think it's probably on a case-by-case basis. Yeah, I can see that.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

That's helpful thanks so much.

John V. Arabia

President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thank you.

Operator: And your next question comes from Floris van Dijkum.

Floris van Dijkum

Hey guys thanks for taking my question. I hate to do this you to guys but I'm going to ask you another question on your Montage acquisition. I guess that's the danger when you only have 17 assets, one of them can dominate. John, what would you say to the to the comments that you're basically making a beta bet on resorts?

And at what price or what kind of EBITDA level would you say that you have to surpass to say this has been a home run, is it is it north of $20 million – and north of $25 million you are sort of assuming a $17.5 million both of EBITDA on a stabilized yield, do you think this has the potential to get up to those levels?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Yes. All right. I think if we achieve a six, seven yield on an asset like this, I think buyers in today's interest rate environment, quality environment, et cetera, I think an asset like this could be priced at a sub-5 probably, in the mid 4s cap rate. If we get to that level of earnings, which I think is doable. I think this hotel is a home run, plain and simple. Price per key starts becoming irrelevant, it really comes down to EBITDA production. I take a look at the same thing that we have in Wailea. Wailea, people thought we overpaid for. I think that assets probably worth $1.1 million, $1.2 million-plus the key because it is so productive. And t again, there will always be a buyer for them. Now did we have our struggles during COVID? Sure. But that hotel is ramping so quickly because people want to be there. It is a spectacular experience. And those are the types of assets that we're going to go after. So yes, I'm very confident in this acquisition, and I think we can achieve those numbers.

Floris van Dijkum

Thanks. And maybe, one follow-up in terms of you had two leaseholds remaining, and one of it being the Hilton, I think, Bayfront. And is it the fact that, it was leasehold and presumably, I would have thought that that hotel would have had positive EBITDA given there it's a resort hotel and it's in a drive-to-market, but it actually showed marginally negative EBITDA for the month. Is that partly because of the lease payments that you have to make there? And what are your thoughts about potential buying those out or disposing of that I think, the Magnificent Mile the other leasehold in your portfolio?

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

So the Hilton Bayfront is 1,190-room spectacular group hotel, and our phenomenal team on property there has done a great job of running that hotel as a 700 to 900 room transient hotel on the weekends and picking up that business, despite the fact that the hotel really was not built for that type of business. So the profitability of that hotel is going to absolutely take off when groups come back and when catering comes back because that is what that hotel was built to do. We have stemmed our losses there because of that transient business, but I would not define that as a transient resort. The lease payment does make a higher hurdle to the EBITDA line, but we're confident and Chris, Marc, myself the asset managers were all down and in fact we're doing a lot of work to the hotel now as the building is slow. But we are highly focused on returning that hotel to significant profitability and we believe, we will do so later on in the year and into next year as group comes back.

Floris van Dijkum

Thanks John.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

A

Thanks Floris.

Operator: And now I would like to turn the call over to John Arabia for closing remarks.

John V. Arabia
President, Chief Executive Officer & Director, Sunstone Hotel Investors, Inc.

Well thank you everybody for your interest very much appreciate. We are all here in the office if there are any follow-up calls. Have a wonderful day and a great summer, take care.

Operator: And this concludes today's conference call. Thank you for your participation, you may now disconnect.