SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the Quarter Ended June 18, 1999 Commission File No. 0-25087

HOST MARRIOTT, L.P.
10400 Fernwood Road
Bethesda, Maryland 20817
(301) 380-9000

| | |
|---|---|
| Delaware | 52-2095412 |
| (State of Incorporation) | (I.R.S. Employer Identification Number) |

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, and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

| Class | Units outstanding at July 27, 1999 |
|---|---|
| Units of limited partnership interest | 292,854,286 |
| Units of Cumulative Redeemable Preferred limited partnership interest | 585,777 |

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HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions)

| | June 18, 1999 (unaudited) | December 31, 1998 |
| --- | --- | --- |
| **ASSETS** | | |
| Property and equipment, net | $7,214 | $7,201 |
| Notes and other receivables (including amounts due from affiliates of $131 million and $134 million, respectively) | 219 | 203 |
| Rent receivable | 86 | -- |
| Due from managers | -- | 19 |
| Investments in affiliates | 45 | 33 |
| Other assets | 414 | 370 |
| Cash and cash equivalents | 310 | 436 |
| | $8,288 | $8,262 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Debt | | |
| Senior notes | $2,546 | $2,246 |
| Mortgage debt | 2,230 | 2,438 |
| Convertible debt obligation to Host Marriott | 567 | 567 |
| Other | 456 | 447 |
| | 5,799 | 5,698 |
| Accounts payable and accrued expenses | 150 | 204 |
| Deferred income taxes | 96 | 97 |
| Other liabilities | 420 | 460 |
| Total liabilities | 6,465 | 6,459 |
| Minority interest | 144 | 147 |
| Limited Partnership interests of third parties at redemption value (representing 64.6 million units at June 18, 1999 and December 31, 1998) | 783 | 892 |
| Partners' Capital | | |
| General partner | 1 | 1 |
| Limited partner | 898 | 767 |
| Accumulated other comprehensive loss | (3) | (4) |
| Total shareholders' equity | 896 | 764 |
| | $8,288 | $8,262 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
Twelve weeks ended June 18, 1999 and June 19, 1998
(unaudited, in millions)

| | 1999 | 1998 |
|---|---|---|
| REVENUES | | |
| Rental income (Note 2)........ | $ 325 | $ -- |
| Hotel sales | | |
| Rooms........................ | -- | 511 |
| Food and beverage............ | -- | 222 |
| Other........................ | -- | 54 |
| Interest income.............. | 8 | 10 |
| Net gains on property transactions................. | 4 | 51 |
| Equity (loss) in earnings of affiliates................... | 1 | (2) |
| Other........................ | 3 | 3 |
| Total revenues.............. | 341 | 849 |
| EXPENSES | | |
| Depreciation................. | 67 | 60 |
| Property-level expenses....... | 62 | 60 |
| Hotel operating expenses | | |
| Rooms........................ | -- | 113 |
| Food and beverage............ | -- | 158 |
| Other department costs and deductions.................. | -- | 185 |
| Management fees (including Marriott International management fees of $55 million in 1998)............ | -- | 50 |
| Minority interest............ | 8 | 14 |
| Interest expense............. | 109 | 76 |
| Dividends on Host Marriott-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust whose sole assets are the convertible subordinated debentures due 2026 ("Convertible Preferred Securities")................ | -- | 8 |
| Corporate expenses........... | 8 | 9 |
| REIT Conversion expenses...... | -- | 6 |
| Other expenses............... | 5 | 5 |
| | 259 | 744 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES........... | 82 | 105 |
| Provision for income taxes...... | -- | (43) |
| INCOME FROM CONTINUING OPERATIONS..................... | 82 | 62 |
| INCOME FROM DISCONTINUED OPERATIONS, net of taxes....... | -- | 4 |
| INCOME BEFORE EXTRAORDINARY GAIN.......................... | 82 | 66 |
| Extraordinary item-gain on forgiveness of debt....... | 13 | -- |
| NET INCOME..................... | $ 95 | $ 66 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (cont.)
Twelve weeks ended June 18, 1999 and June 19, 1998
(unaudited)

| | | |
|---|---|---|
| BASIC EARNINGS PER UNIT: | | |
| CONTINUING OPERATIONS | $0.26 | $0.29 |
| Discontinued operations (net of income taxes) | -- | 0.02 |
| Extraordinary item-gain on forgiveness of debt | 0.06 | -- |
| BASIC EARNINGS PER UNIT: | $0.32 | $0.31 |
| DILUTED EARNINGS PER UNIT: | | |
| CONTINUING OPERATIONS | $0.27 | $0.26 |
| Discontinued operations (net of income taxes) | -- | 0.02 |
| Extraordinary item-gain on forgiveness of debt | 0.04 | -- |
| DILUTED EARNINGS PER UNIT | $0.31 | $0.28 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (cont.)
Twenty-four weeks ended June 18, 1999 and June 19, 1998
(unaudited, millions)

| | 1999 | 1998 |
|---|---|---|
| REVENUES | | |
| Rental income (Note 3) | $ 611 | $ -- |
| Hotel sales | | |
| Rooms | -- | 1,020 |
| Food and beverage | -- | 444 |
| Other | -- | 110 |
| Interest income | 16 | 24 |
| Net gains on property transactions | 16 | 52 |
| Equity (loss) in earnings of affiliates | 2 | (1) |
| Other | 3 | 5 |
| Total revenues | 648 | 1,654 |
| EXPENSES | | |
| Depreciation | 133 | 113 |
| Property-level expenses | 120 | 122 |
| Hotel operating expenses | | |
| Rooms | -- | 227 |
| Food and beverage | -- | 321 |
| Other department costs and deductions | -- | 374 |
| Management fees (including Marriott International management fees of $102 million in 1998) | -- | 108 |
| Minority interest | 13 | 30 |
| Interest expense | 217 | 152 |
| Dividends on Host Marriott-obligated mandatorily redeemable convertible preferred securities of a subsidiary trust whose sole assets are the convertible subordinated debentures due 2026 ("Convertible Preferred Securities") | -- | 17 |
| Corporate expenses | 16 | 21 |
| REIT conversion expenses | -- | 6 |
| Other expenses | 9 | 10 |
| | 508 | 1,501 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 140 | 153 |
| Provision for income taxes | -- | (63) |
| INCOME FROM CONTINUING OPERATIONS | 140 | 90 |
| INCOME FROM DISCONTINUED OPERATIONS, net of taxes | -- | 6 |
| INCOME BEFORE EXTRAORDINARY ITEM | 140 | 96 |
| Extraordinary item--gain on forgiveness of debt | 13 | -- |
| NET INCOME | $ 153 | $ 96 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (cont.)
Twenty-four weeks ended June 18, 1999 and June 19, 1998
(unaudited)

| | | |
|---|---|---|
| BASIC EARNINGS PER UNIT: | | |
| CONTINUING OPERATIONS.......................... | $0.46 | $0.42 |
| Discontinued operations (net of income taxes)... | -- | 0.03 |
| Extraordinary item-gain on forgiveness of debt.. | 0.06 | -- |
| BASIC EARNINGS PER UNIT:....................... | $0.52 | $0.45 |
| DILUTED EARNINGS PER UNIT: | | |
| CONTINUING OPERATIONS.......................... | $0.47 | $0.39 |
| Discontinued operations (net of income taxes)... | -- | 0.02 |
| Extraordinary item-gain on forgiveness of debt.. | 0.04 | -- |
| DILUTED EARNINGS PER UNIT...................... | $0.51 | $0.41 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
CONDENSED CONSOLIDATED STATEMENTS OF CASHFLOWS
Twenty-four weeks ended June 18, 1999 and June 19, 1998
(unaudited, in millions)

| | 1999 | 1998 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Income from continuing operations | $ 140 | $ 153 |
| Adjustments to reconcile to cash from continuing operations: | | |
| Depreciation and amortization | 135 | 114 |
| Income taxes | -- | 45 |
| Gain on sale of hotel properties | (16) | (51) |
| Equity in earnings of affiliates | (2) | 1 |
| Changes in operating accounts | (170) | (86) |
| Other | 24 | 27 |
| Cash from continuing operations | 111 | 203 |
| Cash from discontinued operations | -- | 3 |
| Cash from operations | 111 | 206 |
| INVESTING ACTIVITIES | | |
| Proceeds from sales of assets | 35 | 209 |
| Acquisitions | (4) | (358) |
| Capital expenditures: | | |
| Renewals and replacements | (86) | (77) |
| Development projects | (75) | (18) |
| Other investment | (16) | (14) |
| Purchases of short-term marketable securities | -- | (97) |
| Sales of short-term marketable securities | -- | 405 |
| Note receivable advances, net of collections | (17) | 4 |
| Affiliate collections, net | -- | 14 |
| Other | -- | (25) |
| Cash (used in) from investing activities from continuing operations | (163) | 43 |
| Cash used in investing activities from discontinued operations | -- | (2) |
| Cash (used in) from investing activities | (163) | 41 |
| FINANCING ACTIVITIES | | |
| Issuances of debt, net | 413 | 5 |
| Repurchase of units | (3) | -- |
| Distributions | (130) | -- |
| Scheduled principal repayments | (23) | (18) |
| Debt prepayments | (323) | (49) |
| Other | (8) | (31) |
| Cash used in financing activities from continuing operations | (74) | (93) |
| Cash used in financing activities from discontinued operations | -- | (150) |
| Cash used in financing activities | (74) | (243) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | $ (126) | $ 4 |
| Non-cash financing activities: | | |
| Assumption of mortgage debt for the acquisition of, or purchase of controlling interests in, certain hotel properties | $ -- | $ 164 |

See Notes to Condensed Consolidated Financial Statements

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. ORGANIZATION

Host Marriott Corporation ("Host Marriott"), operating through an umbrella partnership REIT structure, is the owner of hotel properties. Host Marriott operates as a self-managed and self-administered real estate investment trust ("REIT") and its operations are conducted through an operating partnership and its subsidiaries. As REITs are not currently permitted to derive revenues directly from the operation of hotels, Host Marriott leases substantially all of its hotels to subsidiaries of Crestline Capital Corporation ("Crestline" or the "Lessee") and certain other lessees.

In these condensed consolidated financial statements, the "Company" or "Host Marriott" refers to Host Marriott Corporation and its consolidated subsidiaries before, and Host Marriott, L.P. and its consolidated subsidiaries (the "Operating Partnership"), after Host Marriott Corporation's conversion to a REIT (the "REIT Conversion"). Host Marriott Corporation is presented as the predecessor to the Operating Partnership since the Operating Partnership and its subsidiaries received substantially all of the continuing operations, assets and liabilities of Host Marriott Corporation and its subsidiaries.

On December 15, 1998, shareholders of Host Marriott approved a plan to reorganize Host Marriott's business operations through the spin-off of Host Marriott's senior living business as part of Crestline and the contribution of Host Marriott's hotels and certain other assets and liabilities to a newly formed Delaware limited partnership, Host Marriott, L.P. Host Marriott merged into HMC Merger Corporation (the "Merger"), a newly formed Maryland corporation (renamed Host Marriott Corporation) which intends to qualify, effective January 1, 1999 as a REIT and is the sole general partner of the Operating Partnership. On December 29, 1998, Host Marriott completed the previously announced spin-off of Crestline through a taxable stock dividend to its shareholders. Each Host Marriott shareholder of record on December 28, 1998 received one share of Crestline for every ten shares of Host Marriott Corporation owned (the "Distribution"). In connection with the REIT Conversion, Host Marriott contributed its hotels and substantially all of its other assets and liabilities to the Operating Partnership and subsidiaries (the "Contribution") in exchange for units of partnership interest in the Operating Partnership. The Contribution was accounted for at Host Marriott's historical basis. As of June 18, 1999, Host Marriott owned approximately 78% of the Operating Partnership.

As a result of the Distribution, the Company's financial statements have been restated to present the senior living communities business results of operations and cash flows as discontinued operations. All historical financial statements presented have been restated to conform to this presentation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited condensed consolidated financial statements of the Company and its subsidiaries have been prepared without audit. Certain information and footnote disclosures normally included in financial statements presented in accordance with generally accepted accounting principles have been condensed or omitted. The Company believes the disclosures made are adequate to make the information presented not misleading. However, the unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 1998.

In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly the financial position of the Company as of June 18, 1999 and December 31, 1998, and the results of operations for the twelve and twenty-four weeks ended June 18, 1999 and June 19, 1998 and cash flows for the twenty-four weeks ended June 18, 1999 and June 19, 1998.

The statements of operations for the twelve and twenty-four weeks ended June 19, 1998 and the cash flows for the twenty-four weeks ended June 18, 1998 reflect the historical results of Host Marriott as discussed in Note 1. Interim results are not necessarily indicative of fiscal year performance because of the impact of seasonal and short-term variations.

The Company's leases have remaining terms ranging from 2 to 10 years, subject to earlier termination upon the occurrence of certain contingencies, as defined. The rent due under each lease is the greater of base rent or percentage rent, as defined. Percentage rent applicable to room, food and beverage and other types of hotel revenue varies by lease and is calculated by multiplying fixed percentages by the total amounts of such revenues over specified threshold amounts. Both the minimum rent and the revenue thresholds used in computing percentage rents are subject to annual adjustments based on increases in the United States Consumer Price Index and the Labor Index, as defined. Certain amounts of the percentage rent recognized are considered contingent until such time as the revenue recognized exceeds annual thresholds, which are determined individually by property. For the twelve and twenty-four weeks ended June 18, 1999, $138 million and $253 million of contingent rent is included in the statement of operations, respectively.

3. RENTAL REVENUE

The Company's 1999 revenue primarily represents the rental income from its leased hotels and is not comparable to 1998 hotel revenues which reflect gross sales generated by the properties. Also, in December 1998 the Company retroactively adopted Emerging Issues Task Force Issue No. 97-2, "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Management Entities and Certain Other Entities with Contractual Management Arrangements." The impact of the adoption of Issue 97-2 on the condensed consolidated financial statements for the twelve and twenty-four weeks ended June 19, 1998 was to increase both revenues and operating expenses by approximately $456 million and $922 million, respectively, with no impact on net income or earnings per share.

The comparison of the 1999 quarterly results with 1998 is also affected by a change in the reporting period for the Company's hotels not managed by Marriott International, which resulted in the 1998 year-to-date historical results adjusted to exclude December 1997 and include May 1998 and the 1998 second quarter adjusted to reflect March through May 1998. The 1999 results reflect comparable periods. The change in reporting was required as part of the REIT Conversion.

The table below represents hotel sales for all periods presented.

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| | (in millions) | | (in millions) | |
| Hotel Sales | | | | |
| Rooms | $ 672 | $ 511 | $1,272 | $1,020 |
| Food and beverage | 310 | 222 | 578 | 444 |
| Other | 72 | 54 | 135 | 110 |
| Total hotel sales | $1,054 | $ 787 | $1,985 | $1,574 |

4. EARNINGS PER UNIT

Basic earnings per unit is computed by dividing net income by the weighted average number of units. Diluted earnings per unit is computed by dividing net income as adjusted for potentially dilutive securities, by the weighted average number of units outstanding plus other potentially dilutive securities. Diluted earnings per unit was adjusted for the impact of the Convertible Preferred Securities as they were dilutive for all periods presented.

A reconciliation of the number of units utilized for the calculation of diluted earnings per unit follows:

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| | (in millions) | | (in millions) | |
| Weighted average number of units outstanding............................... | 292.5 | 216.1 | 292.0 | 215.9 |
| Assuming distribution of units to Host Marriott Corporation for Host Marriott Corporation common shares granted under the comprehensive stock plan, less shares assumed purchased at average market price........................... | 5.8 | 4.2 | 5.8 | 4.3 |
| Assuming distribution of common shares issuable for warrants, less Shares assumes purchased at average market price................................... | -- | 0.1 | -- | 0.1 |
| Assuming conversion of minority operating partnership units issuable............................. | 9.2 | -- | 9.2 | -- |
| Assuming conversion of Convertible debt to Host Marriott.................. | 35.8 | 35.8 | 35.8 | 35.8 |
| Units utilized for the calculation of diluted earnings per unit............. | 343.3 | 256.2 | 342.8 | 256.1 |

A reconciliation of net income to earnings used for the calculation of diluted earnings per unit follows:

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| | (in millions) | | (in millions) | |
| Net income............................... | $ 95 | $ 66 | $ 153 | $ 96 |
| Interest on debt obligation to Host Marriott, net of taxes.................. | 8 | 5 | 17 | 10 |
| Minority interest expense, assuming conversion of OP units.................. | 1 | -- | 3 | -- |
| Earnings used for the calculation of diluted earnings per unit............... | $ 104 | $ 71 | $ 173 | $ 106 |

5. DIVIDENDS AND DISTRIBUTIONS PAYABLE

On March 15, 1999 and June 15, 1999, the Board of Directors of Host Marriott declared cash dividends of $0.21 per share of Host Marriott Corporation common stock and corresponding distributions of $0.21 per unit of limited partnership interest ("OP Unit"). The first quarter dividend and distribution was paid on April 14, 1999 to shareholders and unitholders of record on March 31, 1999. The second quarter dividend and distribution was paid on July 14, 1999 to shareholders and unitholders of record on June 30, 1999.

The 1998 earnings per share has been restated to reflect the impact of the stock portion of a special dividend totaling 11.9 million shares of common stock issued in February, 1999 as a result of the REIT Conversion.

6. ACQUISITIONS AND PROPERTY EXPANSIONS

On December 30, 1998, the Company acquired a portfolio of twelve luxury hotels and other assets from the Blackstone Group, a Delaware limited partnership, and a series of funds controlled by affiliates of Blackstone

Real Estate Partners. The Company issued approximately 47.7 million OP Units and assumed debt and made cash payments of approximately $920 million and distributed 1.4 million of the shares of Crestline common stock to the Blackstone Real Estate Partners. Approximately 23.9 million OP Units were redeemable as of June 30, 1999.

The Company also completed a 210-room extension of the Philadelphia Marriott in April 1999 at a cost of approximately $37 million.

7. DISPOSITION

In February 1999, the Company sold the 479-room Minneapolis/Bloomington Marriott for $35 million and recorded a gain of $10 million, which was followed by the May 1999 sale of the 221-room Saddle Brook Marriott for $15 million resulting in a gain of $4 million.

8. DEBT ISSUANCES AND REFINANCING

In February 1999, the Company issued $300 million of 8 3/8% Series D senior notes due in 2006. The senior notes were used to refinance, or purchase, debt which had been acquired through the merger of certain partnerships or the purchase of hotel properties in connection with the REIT Conversion in December 1998.

The Company has offered to exchange Series D Senior notes for Series E Senior notes on a one-for-one basis. The terms of the Series E Senior notes and the Series D Senior notes will be substantially identical except that the Series E Senior notes will be freely transferable by the holders. The offer to exchange expires at 5:00 p.m. on August 25, 1999.

In April 1999, a subsidiary of the Company completed the refinancing of the $245 million mortgage on the New York Marriott Marquis, maturing June 2000. The Company was required to make a principal payment of $1.25 million on June 30, 1999. In connection with the refinancing, the Company renegotiated the management agreement and recognized an extraordinary gain of $13 million on the forgiveness of accrued incentive management fees by the manager. This mortgage was subsequently refinanced as part of the $665 million financing agreement discussed in note 11.

9. GEOGRAPHIC AND BUSINESS SEGMENT INFORMATION

The Company operates one business segment, hotel ownership. The Company's hotels are primarily operated under the Marriott or Ritz-Carlton brands. Substantially all of the Company's revenues are earned through leases with Crestline. With respect to 1998, the allocation of taxes is not evaluated at the segment level or reflected in the following information because the Company does not believe the information is material to the readers of the financial statements.

The Company's segmented revenues and income (loss) from continuing operations before income taxes are as follows (in millions):

| | Twelve Weeks Ended June 18, 1999 | | |
|---|---|---|---|
| | Hotels | Corporate & Other | Consolidated |
| Revenues............................. | $ 335 | $ 6 | $ 341 |
| Income (loss) from continuing operations before income taxes....... | 97 | (15) | 82 |

| | Twelve Weeks Ended June 19, 1998 | | |
|---|---|---|---|
| | Hotels | Corporate & Other | Consolidated |
| Revenues............................. | $ 797 | $ 52 | $ 849 |
| Income from continuing operations before income taxes................. | 82 | 23 | 105 |

| | Twenty-four Weeks Ended June 18, 1999 | | |
|---|---|---|---|
| | Hotels | Corporate & Other | Consolidated |
| Revenues............................. | $ 639 | $ 9 | $ 648 |
| Income (loss) from continuing operations before income taxes....... | 172 | (32) | 140 |

| | Twenty-four Weeks Ended June 19, 1998 | | |
|---|---|---|---|
| | Hotels | Corporate & Other | Consolidated |
| Revenues............................. | $1,598 | $ 56 | $1,654 |
| Income from continuing operations before income taxes................. | 153 | -- | 153 |

As of June 18, 1999, the Company's foreign operations consisted of four hotel properties located in Canada. There were no intercompany sales between the properties and the Company. The following table presents rental revenues in 1999 and hotel revenues in 1998 for each of the geographical areas in which the Company owns hotels (in millions):

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| United States.............. | $ 335 | $ 825 | $ 638 | $1,604 |
| International............. | 6 | 24 | 10 | 50 |
| Total.................... | $ 341 | $ 849 | $ 648 | $1,654 |

10. Comprehensive Income

The Company's other comprehensive income consists of foreign currency translation adjustments and changes in the value of the right to receive up to 1.4 million shares of Host Marriott Services Corporation's common stock or an equivalent cash value subsequent to the exercise of the options held by certain former and current employees of Marriott International at Host Marriott Service Corporation's option. For the twelve and twenty-four weeks ended June 18, 1999, comprehensive income totaled $97 million and $154 million, respectively. Comprehensive income was $67 million and $97 million for the twelve and twenty-four weeks ended June 18, 1998. As of June 18, 1999 and December 31, 1998 the Company's accumulated other comprehensive loss was approximately $3 million and $4 million, respectively.

11. Subsequent Events

In July 1999, the Company entered into a financing agreement pursuant to which it borrowed $665 million due 2009 at a fixed rate 7.47 percent. The New York Marriott Marquis as well as seven other hotels serve as collateral. The proceeds from this financing were used to refinance existing mortgage indebtedness maturing at various times through 2000.

In July 1999, the Company sold 4.0 million shares of 10% Class A cumulative redeemable preferred stock with a $0.01 par value. Holders of the stock are entitled to receive cumulative cash dividends at a rate of 10% per annum of the $25.00 per share liquidation preference. Dividends are payable quarterly in arrears commencing October 15, 1999. After August 3, 2004 the Company has the option to redeem the Class A preferred stock for $25.00 per share, plus accrued and unpaid dividends to the date of redemption. The Class A preferred stock ranks senior to the common stock, and the authorized Series A Junior Participating preferred stock. The Class A preferred stockholders generally have no voting rights.

In June 1999, the Company acquired by merger Timewell Group, L.P. and Timeport, L.P. which each own limited partnership interests in the partnership that owns the New York Marriott Marquis. As part of the merger, the general partners of Timewell Group, L.P. and Timeport, L.P. received 345,559 and 240,218 cumulative redeemable preferred OP Units, respectively. The preferred OP Units are convertible into OP Units on a one-for-one basis, subject to certain adjustments, at any time beginning one year after the merger at the option of the holders. At any time beginning two years after the merger, the Company can redeem the preferred OP units for OP Units or cash.

In June 1999, the Company refinanced the debt on the San Diego Marriott Hotel and Marina. The mortgage is for $195 million for a term of 10 years at a rate of 8.45%. In addition, the Company issued $23 million of mortgage debt on the Philadelphia Marriott in July 1999 at an interest rate of approximately 8.6%, maturing 2009.

12. SUMMARIZED LEASE POOL FINANCIAL STATEMENTS

As discussed in Note 2, as of June 18, 1999, almost all the properties of the Company and its subsidiaries were leased to Crestline Capital Corporation and managed by Marriott International, Inc. In conjunction with these leases, Crestline and certain of its subsidiaries entered into limited guarantees of the lease obligations of each lessee. The full-service hotel leases are grouped into four lease pools, with Crestline's guarantee limited to the greater of 10% of the aggregate rent payable for the preceding year or 10% of the aggregate rent payable under all leases in the respective pool. Additionally, the lessee's obligation under each lease agreement is guaranteed by all other lessees in the respective lease pool. As a result, the Company believes that the operating results of each full-service lease pool may be material to the Company's financial statements. Financial information of certain pools related to the sublease agreements for limited service properties are not presented, as the Company believes they are not material to the Company's financial statements. Financial information of Crestline may be found in its quarterly and annual filings with the Securities and Exchange Commission. Further information regarding these leases and Crestline's limited guarantees may be found in the Company's annual report on Form 10-K for the fiscal year ended December 31, 1998. The results of operations for the twelve and twenty-four weeks ended June 18, 1999 and summarized balance sheet data as of June 18, 1999 of the lease pools in which the Company's hotels are organized are as follows (in millions):

| | Twelve Weeks Ended June 18, 1999 | | | | |
|---|---|---|---|---|---|
| | Pool 1 | Pool 2 | Pool 3 | Pool 4 | Combined |
| Hotel Sales | | | | | |
| Rooms | $144 | $157 | $141 | $145 | $ 587 |
| Food and beverage | 68 | 76 | 67 | 81 | 292 |
| Other | 16 | 16 | 19 | 19 | 70 |
| Total hotel sales | 228 | 249 | 227 | 245 | 949 |
| Operating Costs and Expenses | | | | | |
| Rooms | 33 | 36 | 34 | 31 | 134 |
| Food and beverage | 51 | 55 | 47 | 56 | 209 |
| Other | 57 | 55 | 57 | 55 | 224 |
| Management fees | 11 | 16 | 10 | 17 | 54 |
| Lease expense | 72 | 83 | 76 | 83 | 314 |
| Total operating expenses | 224 | 245 | 224 | 242 | 935 |
| Operating Profit | 4 | 4 | 3 | 3 | 14 |
| Corporate and Interest Expenses | -- | (1) | -- | -- | (1) |
| Income before taxes | 4 | 3 | 3 | 3 | 13 |
| Income taxes | (2) | (1) | (1) | -- | (4) |
| Net Income | $ 2 | $ 2 | $ 2 | $ 3 | $ 9 |

| | Twenty-four Weeks Ended June 18, 1999 | | | | |
|---|---|---|---|---|---|
| | Pool 1 | Pool 2 | Pool 3 | Pool 4 | Combined |
| Hotel Sales | | | | | |
| Rooms | $273 | $294 | $268 | $273 | $1,108 |
| Food and beverage | 127 | 137 | 128 | 153 | 545 |
| Other | 30 | 29 | 38 | 34 | 131 |
| Total hotel sales | 430 | 460 | 434 | 460 | 1,784 |
| Operating Costs and Expenses | | | | | |
| Rooms | 64 | 68 | 63 | 58 | 253 |
| Food and beverage | 97 | 102 | 91 | 104 | 394 |
| Other | 110 | 107 | 107 | 103 | 427 |
| Management fees | 20 | 30 | 21 | 33 | 104 |
| Lease expense | 133 | 147 | 146 | 157 | 583 |
| Total operating expenses | 424 | 454 | 428 | 455 | 1,761 |
| Operating Profit | 6 | 6 | 6 | 5 | 23 |
| Corporate and Interest Expenses | (1) | (1) | (1) | (1) | (4) |
| Income before taxes | 5 | 5 | 5 | 4 | 19 |
| Income taxes | (2) | (2) | (2) | (1) | (7) |
| Net Income | $ 3 | $ 3 | $ 3 | $ 3 | $ 12 |

| | As of June 18, 1999 | | | | |
|---|---|---|---|---|---|
| | Pool 1 | Pool 2 | Pool 3 | Pool 4 | Combined |
| Assets.................... | $ 49 | $ 43 | $ 46 | $ 46 | $ 184 |

| | | | | | |
|---|---|---|---|---|---|
| Liabilities................ | 46 | 40 | 43 | 43 | 172 |
| Equity..................... | 3 | 3 | 3 | 3 | 12 |

13. SUPPLEMENTAL GUARANTOR AND NON-GUARANTOR SUBSIDIARY INFORMATION

All subsidiaries of the operating partnership guarantee the Company's senior notes except those among the twenty full service hotels listed below and HMH HPT Residence Inn, LLC and HMH HPT Courtyard, LLC, the lessees of the Residence Inn and Courtyard properties, respectively. The separate financial statements of each guaranteeing subsidiary (each, a "Guarantor Subsidiary") are not presented because management has concluded that such financial statements are not material to investors. The guarantee of each Guarantor Subsidiary is full and unconditional and joint and several and each Guarantor Subsidiary is a wholly owned subsidiary of the Company. The non-guarantor subsidiaries (the "Non-Guarantor Subsidiaries") own the following full-service hotels: the Albany Marriott; Atlanta Marriott Marquis; Grand Hyatt, Atlanta; Harbor Beach Marriott Resort; Hartford Marriott; Hyatt Regency, Cambridge; Hyatt Regency, Reston; Manhattan Beach Marriott; Minneapolis Southwest Marriott; New York Marriott Marquis; Ontario Airport Marriott; Pittsburgh City Center Marriott; The Ritz-Carlton, Amelia Island; San Diego Marriott Hotel and Marina; San Diego Mission Valley Marriott; Swissotel, Atlanta; Swissotel, Boston; Swissotel, Chicago; The Drake (Swissotel) New York; and the Oklahoma City Waterford Marriott.

The following condensed combined consolidating information sets forth the financial position as of June 18, 1999 and December 31, 1998 and results of operations for the twelve weeks and twenty-four weeks ended June 18, 1999 and June 19, 1998, respectively, and cash flows for the twenty-four weeks ended June 18, 1999 and June 19, 1998 of the parent, Guarantor Subsidiaries and the Non-Guarantor Subsidiaries.

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Supplemental Condensed Combined Consolidating Balance Sheets
(in millions)

June 18, 1999

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Property and equipment, net............ | $1,223 | $3,784 | $2,207 | $ -- | $7,214 |
| Investments in affiliate............... | 1,366 | -- | -- | (1,321) | 45 |
| Notes and other receivables............ | 817 | 54 | 19 | (671) | 219 |
| Other assets........................... | 144 | 194 | 189 | (27) | 500 |
| Cash and cash equivalents.............. | 157 | 122 | 31 | -- | 310 |
| Total assets........................ | $3,707 | $4,154 | $2,446 | $(2,019) | $8,288 |
| Debt................................... | $1,598 | $2,860 | $1,128 | $ (354) | $5,232 |
| Convertible debt obligations to Host Marriott............................. | 567 | -- | -- | -- | 567 |
| Deferred income taxes.................. | 50 | 39 | 7 | -- | 96 |
| Other liabilities...................... | 72 | 581 | 240 | (323) | 570 |
| Total liabilities................... | 2,287 | 3,480 | 1,375 | (677) | 6,465 |
| Minority interests..................... | 15 | 56 | 73 | -- | 144 |
| Limited partner interest of third parties at redemption value | 783 | -- | -- | -- | 783 |
| Owner's capital | 622 | 618 | 998 | (1,342) | 896 |
| Total liabilities and owner's capital | $3,707 | $4,154 | $2,446 | $(2,019) | $8,288 |

December 31, 1998

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Property and equipment, net............ | $1,172 | $3,796 | $2,233 | $ -- | $7,201 |
| Investments in affiliate............... | 1,038 | -- | -- | (1,005) | 33 |
| Notes and other receivables............ | 782 | 52 | 19 | (650) | 203 |
| Other assets........................... | 259 | 145 | 141 | (156) | 389 |
| Cash and cash equivalents.............. | 330 | 91 | 15 | -- | 436 |
| Total assets........................ | $3,581 | $4,084 | $2,408 | $(1,811) | $8,262 |
| Debt................................... | $1,438 | $2,837 | $1,183 | $ (327) | $5,131 |
| Convertible debt obligation to Host Marriott............................. | 567 | -- | -- | -- | 567 |
| Deferred income taxes.................. | 51 | 39 | 7 | -- | 97 |
| Other liabilities...................... | 97 | 600 | 252 | (285) | 664 |
| Total liabilities................... | 2,153 | 3,476 | 1,442 | (612) | 6,459 |
| Minority interests..................... | 15 | 56 | 76 | -- | 147 |
| Limited partner interest of third parties at redemption value | 892 | -- | -- | -- | 892 |
| Owner's capital | 521 | 552 | 890 | (1,199) | 764 |
| Total liabilities and owner's | $3,581 | $4,084 | $2,408 | $(1,811) | $8,262 |

| | | | | | |
|---|---|---|---|---|---|
| capital | ====== | ====== | ====== | ======= | ====== |

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Supplemental Condensed Combined Statements of Operations
(in millions)

Twelve Weeks Ended June 18, 1999

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| REVENUES | $ 76 | $173 | $105 | $(13) | $ 341 |
| Depreciation | (15) | (35) | (17) | -- | (67) |
| Property-level expenses | (11) | (23) | (28) | -- | (62) |
| Hotel operating expenses | -- | -- | -- | -- | -- |
| Minority interest | (17) | (4) | (2) | 15 | (8) |
| Interest expense | (27) | (55) | (25) | (2) | (109) |
| Dividends on convertible preferred securities | -- | -- | -- | -- | -- |
| Corporate expenses | (2) | (5) | (1) | -- | (8) |
| Other expenses | (3) | (1) | (1) | -- | (5) |
| Income from continuing operation | 1 | 50 | 31 | -- | 82 |
| Income before extraordinary gain | 1 | 50 | 31 | -- | 82 |
| Extraordinary item-gain on forgiveness of debt | -- | -- | 13 | -- | 13 |
| NET INCOME | $ 1 | $ 50 | $ 44 | $ -- | $ 95 |

Twelve Weeks Ended June 19, 1998

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| REVENUES | $ 309 | $ 473 | $ 56 | $11 | $ 849 |
| Depreciation | (25) | (30) | (5) | -- | (60) |
| Property-level expenses | (30) | (43) | 13 | -- | (60) |
| Hotel operating expenses | (192) | (279) | (35) | -- | (506) |
| Minority interest | (15) | 7 | 2 | (8) | (14) |
| Interest expense | (2) | (48) | (23) | (3) | (76) |
| Dividends on convertible preferred securities | (8) | -- | -- | -- | (8) |
| Corporate expenses | (2) | (5) | (2) | - | (9) |
| REIT Conversion expenses | (6) | -- | -- | -- | (6) |
| Other expenses | (4) | (1) | -- | -- | (5) |
| Income from continuing operations before taxes | 25 | 74 | 6 | -- | 105 |
| Provision for income taxes | (10) | (31) | (2) | -- | (43) |
| Income from continuing operations | 15 | 43 | 4 | -- | 62 |
| Income from discontinued operations | 4 | -- | -- | -- | 4 |
| NET INCOME | $ 19 | $ 43 | $ 4 | $ -- | $ 66 |

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Supplemental Condensed Combined Statements of Operations
(in millions)

Twenty-four Weeks Ended June 18, 1999

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| REVENUES | $138 | $ 334 | $191 | $(15) | $ 648 |
| Depreciation | (28) | (70) | (35) | -- | (133) |
| Property-level expenses | (21) | (45) | (54) | -- | (120) |
| Hotel operating expenses | -- | -- | -- | -- | -- |
| Minority interest | (18) | (7) | (3) | 15 | (13) |
| Interest expense | (68) | (103) | (46) | -- | (217) |
| Dividends on convertible preferred securities | -- | -- | -- | -- | -- |
| Corporate expenses | (3) | (9) | (4) | -- | (16) |
| Other expenses | (7) | (1) | (1) | -- | (9) |
| Income before extraordinary gain | (7) | 99 | 48 | -- | 140 |
| Extraordinary item-gain on forgiveness of debt | -- | -- | 13 | -- | 13 |
| NET INCOME (LOSS) | $ (7) | $ 99 | $ 61 | $ -- | $ 153 |

Twenty-four Weeks Ended June 19, 1998

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| REVENUES | $ 558 | $ 851 | $ 250 | $5 | $ 1,654 |
| Depreciation | (39) | (57) | (17) | -- | (113) |
| Property-level expenses | (41) | (63) | (18) | -- | (122) |
| Hotel operating expenses | (344) | (530) | (156) | -- | (1,030) |
| Minority interest | (27) | (6) | (2) | 5 | (30) |
| Interest expense | (21) | (94) | (37) | -- | (152) |
| Dividends on convertible preferred securities | (17) | -- | -- | -- | (17) |
| Corporate expenses | (5) | (11) | (5) | - | (21) |
| REIT Conversion expenses | (6) | -- | -- | -- | (6) |
| Other expenses | (9) | (1) | -- | -- | (10) |
| Income from continuing operations before taxes | 49 | 89 | 15 | -- | 153 |
| Provision for income taxes | (20) | (37) | (6) | -- | (63) |
| Income from continuing operations | 29 | 52 | 9 | -- | 90 |
| Income from discontinued operations | 6 | -- | -- | -- | 6 |
| NET INCOME | $ 35 | $ 52 | $ 11 | $ -- | $ 96 |

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Supplemental Condensed Combined Statements of Cash Flows
(in millions)

Twenty-four Weeks Ended June 18, 1999

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
|---|---|---|---|---|
| OPERATING ACTIVITIES | | | | |
| Cash (used in) from operations.......... | $ (5) | $ 116 | $ -- | $ 111 |
| INVESTING ACTIVITIES | | | | |
| Cash received from sales of assets...... | 1 | 34 | -- | 35 |
| Capital expenditures.................... | (49) | (107) | (21) | (177) |
| Acquisitions............................ | -- | -- | (4) | (4) |
| Other................................... | (17) | -- | -- | (17) |
| Cash used in investing activities....... | (65) | (73) | (25) | (163) |
| FINANCING ACTIVITIES | | | | |
| Repayment of debt....................... | (25) | (256) | (65) | (346) |
| Issuances of debt....................... | (2) | 256 | 159 | 413 |
| Transfers to/from Parent................ | 65 | (12) | (53) | -- |
| Distributions........................... | (130) | -- | -- | (130) |
| Repurchase of units..................... | (3) | -- | -- | (3) |
| Other................................... | (8) | -- | -- | (8) |
| Cash (used in) from financing activities | (103) | (12) | 41 | (74) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | $ (173) | $ 31 | $ 16 | $ (126) |

HOST MARRIOTT, L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Twenty-four Weeks Ended June 19, 1998

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
|---|---|---|---|---|
| OPERATING ACTIVITIES | | | | |
| Cash from continuing operations......... | $ 43 | $ 144 | $ 16 | $ 203 |
| Cash from discontinued operations....... | 3 | -- | -- | 3 |
| Cash from operations................... | 46 | 144 | 16 | 206 |
| INVESTING ACTIVITIES | | | | |
| Cash received from sales of assets...... | 209 | -- | -- | 209 |
| Capital expenditures................... | (28) | (62) | (19) | (109) |
| Acquisitions........................... | (229) | (15) | (114) | (358) |
| Sales of short-term marketable securities, net....................... | 308 | -- | -- | 308 |
| Other.................................. | (7) | -- | -- | (7) |
| Cash from (used in) investing activities from continuing operations | 253 | (77) | (133) | 43 |
| Cash used in investing activities from discontinued Operations | (2) | -- | -- | (2) |
| Cash from (used in) investing activities | 251 | (77) | (133) | 41 |
| FINANCING ACTIVITIES | | | | |
| Repayment of debt | (55) | (10) | (2) | (67) |
| Issuances of debt | 5 | -- | -- | 5 |
| Transfers to/from Parent | (52) | (51) | 103 | -- |
| Other | (31) | -- | -- | (31) |
| Cash (used in) from financing activities from continuing operations | (133) | (61) | 101 | (93) |
| Cash used in financing activities from discontinued operations | (150) | -- | -- | (150) |
| Cash (used in) from financing activities | (283) | (61) | 101 | (243) |
| INCREASE IN CASH AND CASH EQUIVALENTS | $ 14 | $ 6 | $ (16) | $ 4 |

## Forward-looking Statements

Certain matters discussed herein are forward-looking statements. Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology, such as "believes," "expects," "may," "will," "should," "estimates," or "anticipates," or the negative thereof or other variations thereof or comparable terminology. All forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual transactions, results, performance or achievements to be materially different from any future transactions, results, performance or achievements expressed or implied by such forward-looking statements. Although we believe the expectations reflected in such forward-looking statements are based upon reasonable assumptions, we can give no assurance that our expectations will be attained or that any deviations will not be material. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances.

## Results of Operations

Revenues. Our historical revenues have primarily represented gross property-level sales from hotels, net gains on property transactions, interest income and equity in earnings of affiliates. As of January 1, 1999, we lease substantially all of our hotels to subsidiaries of Crestline Capital Corporation. As a result of these leases, we no longer record property-level revenues and expenses, rather we recognize rental income on the leases. Thus, 1999 revenues and expenses are not comparable with prior periods. Note 3 to the financial statements presents a table comparing gross hotel sales for all periods presented to facilitate an investor's understanding of the operation of our properties. The comparison of the 1999 quarterly results with 1998 is also affected by a change in the reporting period for our hotels not managed by Marriott International, which resulted in the 1998 year-to-date historical results adjusted to exclude December 1997 and include May 1998 and the 1998 second quarter adjusted to reflect March through May 1998. The 1999 results reflect comparable periods. The change in reporting was required as part of the REIT conversion.

Year-to-date results for 1999 were driven by the addition of 36 properties in 1998. The increase in hotel sales reflects growth in room revenues generated per available room or REVPAR. For comparable properties, REVPAR increased 3.7% to $120.85 for the second quarter of 1999. Year-to-date REVPAR increased 4% to $120.67. On a comparable basis, average room rates increased approximately 2% and 3% for the second quarter and year-to-date, respectively, while average occupancy increased one percent for both periods.

Interest income decreased as the result of a lower level of cash and marketable securities held during the first half of 1999 compared to the first half of 1998.

The net gain on property transactions for 1999 primarily resulted from the $10 million gain on the sale of the 479-room Minneapolis/Bloomington Marriott for approximately $35 million and the $4 million gain on the sale of the 221-room Saddle Brook Marriott for approximately $15 million.

Expenses. As discussed above, hotel revenues and hotel operating costs are not comparable with the prior year. The lessee pays certain property-level costs including management fees and we receive a rent payment, which is net of those costs. Property-level costs which are comparable, including depreciation, property taxes, insurance, ground and equipment rent increased 8% to $129 million for the second quarter

1999 versus the second quarter 1998 and increased $18 million or 8% to $253 million year-to-date, primarily reflecting the depreciation from the 36 properties acquired during 1998.

Minority Interest. Minority interest expense decreased $6 million to $8 million for the second quarter of 1999 and decreased $17 million to $13 million year-to-date, primarily reflecting the impact of the consolidation of partnerships which occurred in connection with the REIT conversion.

Interest Expense. Interest expense increased 43% to $109 million in the second quarter of 1999 and increased 43% to $217 million year-to-date, primarily due to the issuance of senior notes, establishment of a new credit facility, interest expense on the convertible debt obligation to Host Marriott and additional mortgage debt on properties acquired in 1998.

Dividends on Convertible Preferred Securities. The dividends on Convertible Preferred Securities reflect the dividends accrued for the first half of fiscal year 1998 on the $550 million in 6 3/4% Convertible Preferred Securities. The Convertible Preferred Securities are held by the REIT. The dividends paid by the REIT are supported by the $567 million debt obligation to Host Marriott on the balance sheet. The Operating Partnership incurs interest expense on the debt obligation, and, therefore, no dividends are included in the current period statement of operations.

Corporate Expenses. Corporate expenses decreased $1 million to $8 million for the second quarter of 1999 and decreased $5 million to $16 million year-to-date, resulting primarily from the timing of certain project costs not incurred in 1999 and lower compensation costs.

Income from Discontinued Operations. Income from discontinued operations represents the senior living communities business' results of operations for the second quarter of 1998 and year-to-date as restated for the spin-off of Crestline.

Extraordinary Gain. In connection with the refinancing of the mortgage and the renegotiation of the management agreement on the New York Marriott Marquis, we recognized an extraordinary gain of $13 million on the forgiveness of debt for accrued incentive management fees by the manager.

Net Income. Our net income increased $29 million for the second quarter of 1999 to $95 million and increased $57 million to $153 million for year-to-date 1999.

## FFO and EBITDA

We consider Funds From Operations or FFO as defined by the National Association of Real Estate Investment Trusts and our consolidated earnings before interest expense, income taxes, depreciation, amortization and other non-cash items or EBITDA to be indicative measures of our operating performance due to the significance of our long-lived assets and because such data is considered useful by the investment community to better understand our results, and can be used to measure our ability to service debt, fund capital expenditures and expand our business. However, such information should not be considered as an alternative to net income, operating profit, cash from operations, or any other operating or liquidity performance measure prescribed by generally accepted accounting principles. Cash expenditures for various long-term assets, interest expense (for EBITDA purposes only) and income taxes have been, and will be incurred which are not reflected in the EBITDA and FFO presentation.

Management believes that FFO is a meaningful disclosure that will help the investment community to better understand our financial performance, including enabling its shareholders and analysts to more easily compare our performance to other Real Estate Investment Trusts. FFO increased $37 million, or 32%, to $152 million in the second quarter of 1999 over the second quarter of 1998. However, FFO as presented may not be comparable to amounts calculated by other companies. For periods prior to 1999, the FFO disclosed represents comparative FFO (FFO plus deferred tax expense). The following is a reconciliation of income from continuing operations to FFO (in millions):

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| Income from continuing operations | $ 82 | $ 62 | $ 147 | $ 90 |
| Depreciation and amortization | 67 | 62 | 135 | 114 |
| Other real estate activities | (5) | (51) | (16) | (52) |
| Partnership adjustments | 8 | (2) | 3 | (7) |
| REIT conversion expenses | -- | 6 | -- | 6 |
| Deferred taxes | -- | 29 | -- | 39 |
| Discontinued operations | -- | 9 | -- | 16 |
| Funds From Operations | $ 152 | $ 115 | $ 269 | $ 206 |

EBITDA increased $47 million, or 23%, to $255 million in the second quarter of 1999 and $70 million, or 17%, to $481 million year-to-date. Hotel EBITDA increased $41 million, or 19%, to $263 million in the second quarter of 1999 and $67 million or 16% to $493 million year-to-date, reflecting comparable hotel EBITDA growth, as well as incremental EBITDA from 1998 acquisitions offset by amounts representing hotel sales which are retained by Crestline.

The following is a reconciliation of EBITDA to income from continuing operations (in millions):

| | Twelve Weeks Ended | | Twenty-four Weeks Ended | |
|---|---|---|---|---|
| | June 18, 1999 | June 19, 1998 | June 18, 1999 | June 19, 1998 |
| EBITDA | $ 255 | $ 208 | $ 481 | $ 411 |
| Interest expense | (109) | (76) | (217) | (152) |
| Dividends on Convertible Preferred Securities | -- | (8) | -- | (17) |
| Depreciation and amortization | (67) | (62) | (135) | (114) |
| Minority interest expense | (8) | (14) | (13) | (30) |
| Income taxes | -- | (43) | -- | (63) |
| Other non-cash charges, net | 11 | 57 | 24 | 55 |
| Income from continuing operations | $ 82 | $ 62 | $ 140 | $ 90 |

Our interest coverage, defined as EBITDA divided by cash interest expense, was 2.7 times for the 1999 second quarter, 3.0 times for the 1998 second quarter and 2.5 times for full year 1998. The ratio of earnings to fixed charges was 1.7 to 1.0 for the second quarter of 1999 and 2.0 to 1.0 for the second quarter of 1998.

Cash Flows and Financial Condition

We reported a decrease in cash and cash equivalents of $126 million during the twenty-four weeks ended June 18, 1999. Cash from continuing operations was $111 million through the second quarter of 1999 and $203 million through the second quarter of 1998. The $92 million decrease in cash from continuing operations resulted principally from an increase in rent receivable resulting from the timing of the receipt of cash payments. There was no cash activity related to discontinued operations for the second quarter of 1999; however, cash from discontinued operations totaled $3 million through the second quarter of 1998.

Cash used in investing activities from continuing operations was $163 million through the second quarter of 1999. Cash from investing activities from continuing operations was $43 million through the second quarter of 1998. Cash used in investing activities through the second quarter of 1999 includes capital expenditures of $177 million, mostly related to renewals and replacements on existing properties and development projects. In addition, we generated $35 million of cash from the net sale of assets, primarily the Minneapolis/Bloomington property. There was no cash related to investing activities from discontinued operations through the second quarter 1999; however, cash used in investing activities from discontinued operations totaled $2 million year-to-date 1998. Property and equipment balances include $145 million and $78 million for construction in progress as of June 18, 1999 and December 31, 1998, respectively. The current balance primarily relates to properties in Tampa, Orlando, Memphis and various other expansion and development projects.

Cash used in financing activities from continuing operations was $74 million through the second quarter of 1999 and $93 million through the second quarter of 1998. Cash used in financing activities for 1999 includes $323 million in prepayment of debt, offset by $413 million in debt issuances for 1999. Both financing activities were related to our February 1999 issuance of $300 million of 8-3/8% Series D Senior notes due in 2006 and the refinancing of the New York Marriott Marquis.

The Series D Senior notes were used to refinance, or purchase, debt which had been assumed through the merger of certain partnerships or the purchase of hotel properties in connection with the REIT conversion in December 1998. In August 1999, we intend to exchange Series D Senior notes for Series E Senior notes on a one-for-one basis. The terms of the Series E Senior notes and the Series D Senior notes will be substantially identical except that the Series E Senior notes are freely transferable by the holders.

In April 1999, a subsidiary completed the refinancing of the $245 million mortgage on the New York Marriott Marquis, maturing June 2000. We subsequently refinanced this mortgage as part of the $665 financing agreement completed in the third quarter of 1999.

Cash used in financing activities also reflects $69 million in dividend payments for a special dividend declared in December 1998 and paid in February 1999. In addition, on March 15, 1999 and June 15, 1999, the Board of Directors declared regular cash distributions of $0.21 per OP unit. The first quarter distribution was paid on April 14, 1999. The second quarter distribution was paid on July 14, 1999 to unitholders and is not reflected in the cash flow statement.

There was no cash related to financing activities from discontinued operations through the second quarter of 1999; however, cash used in financing activities from discontinued operations totaled $150 million through the second quarter of 1998.

In July 1999, the Company sold 4.0 million shares of 10% Class A Cumulative Redeemable Preferred Stock with a $0.01 par value. Holders of the stock are entitled to receive cumulative cash dividends at a rate of 10% per annum of the $25.00 per share liquidation preference. Dividends are payable quarterly in arrears on October 15, 1999. After August 3, 2004 we have the option to redeem the Class A preferred stock for $25.00 per share, plus accrued and unpaid dividends to the date of redemption. The Class A preferred stock ranks prior to the common stock and the authorized Series A Junior Participating preferred stock. The Class A preferred stockholders generally have no voting rights.

We also entered into a financing agreement for $665 million due 2009 at a fixed rate of 7.47%. The proceeds from this financing were used to refinance existing mortgage indebtedness maturing at various times through 2000.

In June 1999, we acquired by merger Timewell Group, L.P. and Timeport, L.P., which each own limited partnership interests in the partnership that owns the New York Marriott Marquis. As part of the merger, the general partners of Timewell Group, L.P. and Timeport, L.P. received 345,559 and 240,218 cumulative redeemable preferred OP Units, respectively. The preferred OP Units are convertible into OP Units on a one-for-one basis, subject to certain adjustments, at any time beginning one year after the merger at the option of the holders. At any time, beginning two years after the merger, we can redeem the preferred OP units for OP Units or cash.

Also in June 1999, we refinanced the debt on the San Diego Marriott Hotel and Marina. The mortgage is for $195 million for a term of 10 years at a rate of 8.45%. In addition, we completed a 210-room extension of the Philadelphia Marriott in April 1999 at a cost of approximately $37 million. The mortgage on the Philadelphia Marriott was refinanced in July 1999 for $23 million at an interest rate of approximately 8.6%, maturing in 2009.

On December 30, 1998, we acquired a portfolio of twelve luxury hotels and other assets from the Blackstone Group, a Delaware limited partnership, and a series of funds controlled by affiliates of Blackstone Real Estate Partners. We issued approximately 47.7 million OP Units and assumed debt and made cash payments of approximately $920 million and distributed 1.4 million of the shares of Crestline common stock to the Blackstone Real Estate Partners. Approximately 23.9 million OP Units were redeemable as of June 30, 1999.

## Year 2000 Issue

Year 2000 issues have arisen because many existing computer programs and chip-based embedded technology systems use only the last two digits to refer to a year, and therefore do not properly recognize a year that begins with "20" instead of the familiar "19". If not corrected, many computer applications could fail or create erroneous results. The following disclosure provides information regarding the current status of our Year 2000 compliance program.

We have adopted the compliance program because we recognize the importance of minimizing the number and seriousness of any disruptions that may occur as a result of the Year 2000 issue. Our compliance program includes an assessment of our hardware and software computer systems and embedded systems, as well as an assessment of the Year 2000 issues relating to third parties with which we have a material relationship or whose systems are material to the operations of our hotel properties. Our efforts to ensure that our computer systems are Year 2000 compliant have been segregated into two separate phases: in-house systems and third-party systems. Following the REIT conversion, Crestline, as the lessee of most of our hotels, will deal directly with Year 2000 matters material to the operation of the hotels, and Crestline has agreed to adopt and implement the program outlined below with respect to third-party systems for all hotels for which it is lessee.

In-House Systems. Since the distribution of Marriott International on October 8, 1993, we have invested in the implementation and maintenance of accounting and reporting systems and equipment that are intended to enable us to provide adequately for our information and reporting needs and which are also Year 2000 compliant. Substantially all of our in-house systems have already been certified as Year 2000 compliant through testing and other mechanisms and we have not delayed any systems projects due to the Year 2000 issue. We engaged a third party to review our Year 2000 in-house readiness and found no problems with any mission critical systems. Management believes that future costs associated with Year 2000 issues for our in-house systems will be insignificant and therefore not impact our business, financial condition and results of operations. We have not developed, and do not plan to develop, a separate contingency plan for our in-house systems due to their current Year 2000 compliance. We do, however, have the normal disaster recovery procedures in place should we have a systems failure.

Third-Party Systems. We rely upon operational and financial systems provided by third parties, primarily the managers and operators of our hotel properties, to provide the appropriate property-specific operating systems, including reservation, phone, elevator, security, HVAC and other systems, and to provide us with financial information. Based on discussion with the third parties that are critical to our business, including the managers and operators of our hotels, we believe that these parties are in the process of studying their systems and the systems of their respective vendors and service providers and, in many cases, have begun to implement changes, to ensure that they are Year 2000 compliant. We continue to receive verbal and written assurances that these third parties are, or will be, Year 2000 compliant on time. To the extent these changes impact property-level systems, we may be required to fund capital expenditures for upgraded equipment and software. We do not expect these charges to be material, but we are committed to making these investments as required. To the extent that these changes relate to a third party manager's centralized systems, including reservations, accounting, purchasing, inventory, personnel and other systems, management agreements generally provide for these costs to be charged to our properties subject to annual limitations, which costs will be borne by Crestline under the leases. We expect that the third party managers will incur Year 2000 costs in lieu of costs for their centralized systems related to system projects that otherwise would have been pursued and, therefore, the overall level of centralized systems charges allocated to the properties will not materially increase as a result of the Year 2000 compliance effort. We believe that this deferral of certain system projects will not have a material impact on our future results of operations, although it may delay certain productivity enhancements at our properties. We and Crestline will continue to monitor the efforts of these third parties to become Year 2000 compliant and will take appropriate steps to address any non-compliance issues. We believe that, in the event of material Year 2000 non-compliance, we will have the right to seek recourse against the manager under our third party management agreements. The management agreements, however, generally do not specifically address the Year 2000 compliance issue. Therefore, the amount of any recovery in the event of Year 2000 non-compliance at a property, if any, is not determinable at this time, and only a portion of such recovery would accrue to us through increased lease rental payments from Crestline.

We and Crestline will work with the third parties to ensure that appropriate contingency plans will be developed to address the most reasonably likely worst case Year 2000 scenarios, which may not have been identified fully. In particular, we and Crestline have had extensive discussions regarding the Year 2000 problem with Marriott International, the manager of a substantial majority of our hotel properties. Due to the significance of Marriott International to our business, a detailed description of Marriott International's state of readiness follows.

Marriott International has adopted an eight-step process toward Year 2000 readiness, consisting of the following: (i) Awareness: fostering understanding of, and commitment to, the problem and its potential risks; (ii) Inventory: identifying and locating systems and technology components that may be affected; (iii) Assessment: reviewing these components for Year 2000 compliance, and assessing the scope of Year 2000 issues; (iv) Planning: defining the technical solutions and labor and work plans necessary for each affected system; (v) Remediation/Replacement: completing the programming to renovate or replace the problem software or hardware; (vi) Testing and Compliance Validation: conducting testing, followed by independent validation by a separate internal verification team; (vii) Implementation: placing the corrected systems and technology back into the business environment; and (viii) Quality Assurance: utilizing an internal audit team to review significant projects for adherence to quality standards and program methodology.

Marriott International has grouped its systems and technology into three categories for purposes of Year 2000 compliance: (i) information resource applications and technology (IT Applications)--enterprise-wide systems supported by Marriott International's centralized information technology organization ("IR"); (ii) Business-initiated Systems ("BIS")--systems that have been initiated by an individual business unit, and that are not supported by Marriott International's IR organization; and (iii) Building Systems--non-IT equipment at properties that use embedded computer chips, such as elevators, automated room key systems and HVAC equipment. Marriott International is prioritizing its efforts based on how severe an effect noncompliance would have on customer service, core business processes or revenues, and whether there are viable, non-automated fallback procedures (System Criticality).

Marriott International measures the completion of each phase based on documentation and quantified results weighted for System Criticality. As of June 18, 1999, the Awareness, Inventory, Assessment, and Planning phases were complete for IT Applications, BIS, and Building Systems. For IT Applications, the Remediation/Replacement and Testing phases were 95 percent complete. Compliance Validation had been completed for approximately 85 percent of key systems, with most of the remaining work in its final stage. For BIS and Building Systems, Remediation/Replacement is substantially complete with a target date of September 1999. For BIS, Testing and Compliance Validation is in progress. Testing is over 95% complete for Building Systems for which approximately five percent require further remediation/replacement and re-testing, and Compliance Validation is in progress. Implementation and Quality Assurance is 80 percent complete for IT Applications. For BIS, Implementation is substantially complete while Quality Assurance is in progress. Both Implementation and Quality Assurance are in progress for Building Systems.

Year 2000 compliance communications with Marriott International's significant third party suppliers, vendors and business partners, including its franchisees are ongoing. Marriott International's efforts are focused on the connections most critical to customer service, core business processes and revenues, including those third parties that support the most critical enterprise-wide IT Applications, franchisees generating the most revenues, suppliers of the most widely used Building Systems and BIS, the top 100 suppliers, by dollar volume, of non-IT products and services, and financial institutions providing the most critical payment processing functions. Responses have been received from a majority of the firms in this group. A majority of these respondents have either given assurances of timely Year 2000 compliance or have identified the necessary actions to be taken by them or Marriott International to achieve timely Year 2000 compliance for their products. Where Marriott International has not received satisfactory responses it is addressing the potential risks of failure through its contingency planning process.

Marriott International has established a common approach for testing and addressing Year 2000 compliance issues for its managed and franchised properties. This includes guidance for operated properties, and a Year 2000 "Toolkit" for franchisees containing relevant Year 2000 compliance information. Marriott International is also utilizing a Year 2000 best-practices sharing system. Marriott International is monitoring the progress of the managed and franchised properties towards Year 2000 compliance.

Risks. There can be no assurances that Year 2000 remediation by us or third parties will be properly and timely completed, and failure to do so could have a material adverse effect on us, our business and our financial condition. We cannot predict the actual effects to us of the Year 2000 problem, which depends on numerous uncertainties such as: whether significant third parties properly and timely address the Year 2000 issue and whether broad-based or systemic economic failures may occur. Moreover, we are reliant upon Crestline to interface with third parties in addressing the Year 2000 issue at the hotels leased by Crestline. We are also unable to predict the severity and duration of any such failures, which could include disruptions in passenger transportation or transportation systems generally, loss of utility and/or telecommunications services, the loss or disruption of hotel reservations made on centralized reservation systems and errors or failures in financial transactions or payment processing systems such as credit cards. Due to the general uncertainty inherent in the Year 2000 problem and our dependence on third parties, including Crestline following the REIT Conversion, we are unable to determine at this time whether the consequences of Year 2000 failures will have a material impact on us. Our Year 2000 compliance program and Crestline's adoption thereof are expected to significantly reduce the level of uncertainty about the Year 2000 problem and management believes that the possibility of significant interruptions of normal operations should be reduced.

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have certain derivative and other financial instruments that are sensitive to changes in interest rates, including interest rate swap agreements and debt obligations. The interest recognized on the debt obligations and interest rate swap instruments is based on various LIBOR terms, which were 4.9% and 5.8%, respectively, at June 18, 1999 and 5.1% and 5% at December 31, 1998, respectively. The interest rates, fair values and future maturities associated with these financial instruments have not changed materially from the amounts reported in our annual report on Form 10-K except for the refinancing and termination discussed below.

We repaid a $40 million variable rate mortgage with proceeds from the $300 million senior notes offering discussed in Note 8 to the financial statements during the first quarter of 1999. We terminated the associated swap agreement incurring a termination fee of approximately $1 million.

In July 1999, we completed the refinancing of approximately $790 million of outstanding variable rate mortgage debt and terminated the related interest rate swap agreements. See Note 11 to the condensed consolidated financial statements. As a result of the termination of the interest rate swap agreements we no longer have derivatives outstanding. As of July 27, 1999, our remaining variable debt consists of the credit facility and the mortgage debt on the Ritz-Carlton Amelia Island property.

# PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

The Company is from time to time the subject of, or involved in, judicial proceedings. Management believes that any liability or loss resulting from such matters will not have a material adverse effect on the financial position or results of operations of the Company.

## Item 4. Submission of Matters to a Vote of Security Holders

None.

## Item 5. Other Information

None.

## Item 6. Exhibits and Reports on Form 8-K

a. Exhibits:

None.

b. Reports on Form 8-K:

None.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOST MARRIOTT, L.P.

BY: HOST MARRIOTT CORPORATION
Its General Partner

| | |
|---|---|
| July 27, 1999 | /s/ Donald D. Olinger |
| - ------------- | -------------------------- |
| Date | Donald D. Olinger<br>Senior Vice President and<br>Corporate Controller<br>(Chief Accounting Officer) |

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE HOST MARRIOTT, L.P. CONDENSED CONSOLIDATED INTERIM BALANCE SHEET AND CONDENSED CONSOLIDATED INTERIM STATEMENT OF OPERATIONS AS OF AND FOR THE PERIOD ENDED JUNE 18, 1999 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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