

Sunstone Hotel Investors, Inc.
Form 10-K
February 17, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2010

OR

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

For the transition period from _____ to _____

Commission file number 001-32319

Sunstone Hotel Investors, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	20-1296886 (I.R.S. Employer Identification Number)
120 Vantis, Suite 350 Aliso Viejo, California (Address of Principal Executive Offices)	92656 (Zip Code)

Registrant's telephone number, including area code: **(949) 330-4000**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	New York Stock Exchange
Series A Cumulative Redeemable Preferred Stock, \$0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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, as amended (the Exchange Act), during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or

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for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing sale price of the registrant's common stock on June 30, 2010 as reported on the New York Stock Exchange (NYSE) was approximately \$957.1 million. The registrant had no non-voting common equity outstanding on such date. This amount excludes 2,143,252 shares of the registrant's common stock held by the executive officers and directors. Exclusion of such shares should not be construed to indicate that any such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the registrant or that such person is controlled by or under common control with the registrant.

The number of shares of the registrant's common stock outstanding as of February 11, 2011 was 117,553,469.

Documents Incorporated by Reference

Part III of this Report incorporates by reference information from the definitive Proxy Statement for the registrant's 2011 Annual Meeting of Stockholders.

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SUNSTONE HOTEL INVESTORS, INC.

ANNUAL REPORT ON

FORM 10-K

For the Year Ended December 31, 2010

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SIGNATURES

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The Company means Sunstone Hotel Investors, Inc., a Maryland corporation, and one or more of its subsidiaries, including Sunstone Hotel Partnership, LLC, or the Operating Partnership, and Sunstone Hotel TRS Lessee, Inc., or the TRS Lessee, and, as the context may require, Sunstone Hotel Investors only or the Operating Partnership only.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report, together with other statements and information publicly disseminated by the Company, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe the Company's future plans, strategies and expectations, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond the Company's control and which could materially affect actual results, performances or achievements. Factors that may cause actual results to differ materially from current expectations include, but are not limited to the risk factors discussed in this Annual Report on Form 10-K. Accordingly, there is no assurance that the Company's expectations will be realized. Except as otherwise required by the federal securities laws, the Company disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Item 1. Business

Our Company

We were incorporated in Maryland on June 28, 2004. We are a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code. As of December 31, 2010, we owned 31 hotels (the 31 hotels). The 31 hotels are comprised of 11,722 rooms, located in 13 states and in Washington, D.C. We also own a 38% equity interest in a joint venture that owns one hotel, and we own other non-hotel investments.

Our primary business is to acquire, own, asset manage and renovate full-service hotels in the United States. As part of our ongoing portfolio management strategy, we may also sell hotels from time to time. Our hotels are operated under leading brand names, such as Marriott, Fairmont, Hilton, Hyatt and Starwood. Our portfolio primarily consists of upper upscale and upscale full-service hotels. We also own luxury and upper midscale hotels. The classifications luxury, upper upscale, upscale and upper midscale are defined by Smith Travel Research, an independent provider of lodging industry statistical data. Smith Travel Research classifies hotel chains into the following segments: luxury; upper upscale; upscale; upper midscale; midscale; economy; and independent.

Our hotels are operated by third party managers pursuant to management agreements with our TRS Lessee or its subsidiaries. As of December 31, 2010, a subsidiary of Interstate Hotels & Resorts, Inc. (IHR), managed 13 of the 31 hotels. Additionally, subsidiaries of Marriott International, Inc. or Marriott Services, Inc. (collectively Marriott) managed 12 of the 31 hotels, and Davidson Hotel Company (Davidson), a

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subsidiary of Denihan Hospitality Group (Denihan), Fairmont Hotels & Resorts (U.S.) (Fairmont), Hilton Worldwide (Hilton), Hyatt Corporation (Hyatt) and Sage Hospitality Resources (Sage), each managed one of the 31 hotels. We have attempted to align the interests of our managers with our own by structuring our management agreements to allow our managers to earn incentive management fees upon the attainment of certain profit thresholds.

Competitive Strengths

We believe the following competitive strengths distinguish us from other owners of lodging properties:

- **Access to Capital.** As a publicly traded REIT, we benefit from greater access to a variety of forms of capital as compared to non-public investment vehicles.
- **Strong Cash Position.** As of December 31, 2010, we had \$278.0 million in cash and cash equivalents. We intend to utilize a portion of our higher than historical cash balance to fund the acquisition of additional hotels and capital investments in our portfolio.
- **Flexible Capital Structure.** We believe our capital structure provides us with appropriate financial flexibility to execute our strategy. As of December 31, 2010, our indebtedness bore fixed interest at a weighted average rate of 5.5%, and had a weighted average term to maturity of 6.9 years. All of our debt is in the form of senior unsecured notes or single asset non-recourse loans rather than cross-collateralized multi-property pools. We believe this structure is appropriate for the operating characteristics of our business as it isolates risk and provides flexibility for various portfolio management initiatives, including the sale of individual hotels subject to the existing debt.

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- **High Quality Portfolio.**

Presence in Key Markets. We believe that our hotels are located in desirable markets with major demand generators and significant barriers to entry for new supply. In 2010, approximately 76% of the revenues generated by the 31 hotels were earned by hotels located in key gateway markets such as Boston, New York, Washington, D.C./Baltimore, Chicago, Orlando, Miami Beach, Los Angeles, Orange County and San Diego. Over time, we expect the revenues of hotels located in key gateway markets to grow more quickly than the average for U.S. hotels as a result of stronger economic drivers as well as higher levels of international travel.

Upper Upscale and Upscale Concentration. The upper upscale and upscale segments, which represented approximately 95% of the hotel revenue generated by the 31 hotels during 2010, tend to outperform the lodging industry generally based on Smith Travel Research data compiled over the past 20 years.

Nationally Recognized Brands. Most of our hotels are operated under nationally recognized brands, including Marriott, Fairmont, Hilton, Hyatt and Starwood. We believe that affiliations with strong brands improve the appeal of our hotels to a broad set of travelers and help to drive business to our hotels.

Recently Renovated Hotels. From January 1, 2006 through December 31, 2010, we invested \$345.3 million in capital renovations throughout the 31 hotels. We believe that these capital renovations have improved the competitiveness of our hotels and have helped to position our portfolio for future growth.

- **Seasoned Management Team.**

Proven Acquisitions/Dispositions Experience. We believe that our significant acquisition and disposition experience will allow us to continue to execute our cycle-appropriate strategy to redeploy capital from slower growth to higher growth hotels. From the date of our initial public offering through December 31, 2010, we acquired interests in 17 hotels and sold 32 hotels. Pursuant to our cycle-appropriate strategy, our focus shifted from acquisitions to dispositions in 2007, 2008 and for the majority of 2009 as the lodging cycle peaked and experienced a down cycle. Towards the later part of 2009 and into 2010, our focus shifted to the selective acquisition of upper upscale hotels as we believe we have entered a recovery phase in the lodging cycle. We will maintain this focus in 2011, as we believe pending debt maturities may create opportunities for well-capitalized companies to acquire individual hotel assets at attractive values.

Proactive Asset Management. We have a proactive asset management team focused on growing the long-term revenues and enhancing the profitability of our hotels. We seek to achieve these goals by working with our operators to develop hotel-level master plans, which include positioning and capital renovation plans. We believe that a proactive asset management program can help to grow the revenues of our hotel portfolio and maximize operational efficiency by leveraging best practices and innovations across our various hotels, and by initiating well-timed focused capital improvements aimed at improving the appeal of our hotels.

Demonstrated Financial Acumen. We have a highly experienced finance team focused on minimizing our cost of capital and maximizing our financial flexibility by proactively managing our capital structure and opportunistically sourcing appropriate capital for growth.

Business Strategy

Our long-term objective is to own a consistent portfolio of institutional quality upper upscale hotels, which are well located within major markets. We seek to maximize total returns and shareholder value through a comprehensive cycle-appropriate capital allocation and portfolio management strategy. Our strategy is designed to minimize our weighted average cost of capital, maximize our financial flexibility and generate attractive returns on our investments by improving the long-term growth of our portfolio's cash flows. Our strategy emphasizes acquisitions and capital renovations during the growth phase of the lodging cycle, dispositions during the mature phase of the cycle, and cash preservation during down phases of the cycle. During all phases of the lodging cycle, we focus on driving top-line revenues and bottom-line profitability through proactive asset management. Our strategy includes:

- Acquiring upper upscale and high quality hotels with nationally recognized brands in markets with high barriers to entry;

- Enhancing the value of our hotels through major capital projects and repositionings;

- Optimizing the performance of our portfolio through proactive asset management;

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- Recycling capital through opportunistic dispositions of non-core assets; and
- Minimizing our cost of capital through disciplined balance sheet management.

Through our industry relationships and our extensive experience in acquiring and upgrading hotel properties, as well as our financial structuring capabilities, flexible capital structure, strong liquidity position and REIT structure, we believe we are well positioned to grow our business as the lodging cycle recovers. In addition to hotel acquisitions, we may seek to grow our portfolio by making investments in defaulted and/or distressed debt positions in loan-to-own hotel transactions, utilizing our REIT structure to effect strategic combinations with select property owners, effecting portfolio purchases from institutional and other owners seeking portfolio liquidity, and by providing capital solutions to illiquid owners facing debt maturities or capital requirements.

Competition

The hotel industry is highly competitive. Our hotels compete with other hotels for guests in each of their markets. Competitive advantage is based on a number of factors, including location, quality of accommodations, convenience, brand affiliation, room rates, service levels and amenities, and level of customer service. Competition is often specific to the individual markets in which our hotels are located and includes competition from existing and new hotels operated under brands in the luxury, upper upscale and upscale segments. Increased competition could harm our occupancy or revenues or may lead our operators to increase service or amenity levels, which may reduce the profitability of our hotels.

We believe that competition for the acquisition of hotels is fragmented. We face competition from institutional pension funds, private equity investors, other REITs and numerous local, regional and national owners, including franchisors, in each of our markets. Some of these entities may have substantially greater financial resources than we do and may be able and willing to accept more risk than we believe we can prudently manage. During the recovery phase of the lodging cycle, when we seek to acquire hotels, competition among potential buyers may increase the bargaining power of potential sellers, which may reduce the number of suitable investment opportunities available to us or increase pricing. Similarly, during times when we seek to sell hotels, competition from other sellers may increase the bargaining power of the potential property buyers.

Twenty-seven of the 31 hotels are operated under nationally recognized brands as of December 31, 2010. We believe that the market's perception of quality and service associated with the brands our hotels operate under, including Marriott, Fairmont, Hilton and Hyatt, is an important driver of demand.

Management Agreements

All of our 31 hotels are managed by third parties pursuant to management agreements with our TRS Lessee or its subsidiaries. As of December 31, 2010, 13 of our hotels were managed by IHR, 12 of our hotels were managed by Marriott, and the other 6 hotels were individually

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managed by Davidson, Denihan, Fairmont, Hilton, Hyatt and Sage. The following is a general description of our third party management agreements.

IHR. Our management agreements with IHR require us to pay a management fee ranging from 1.0% to 2.1% of gross revenues; plus an incentive fee of 10.0% of the excess of net operating income over a threshold. The incentive fee, however, may not exceed a range of 0.5% to 1.9% of the total revenues for all the hotels managed by IHR for any fiscal year. Our TRS Lessee has guaranteed all fees payable to IHR.

With the exception of the IHR management agreements at the Sheraton Cerritos and Hilton Times Square (which expire in 2012 and 2015, respectively; and, with respect to the Sheraton Cerritos, the management agreement automatically renews for successive two year terms and, with respect to the Hilton Times Square, we have the right to renew for one term of five years), the IHR management agreements expire in 2024 and provide us the right to renew each management agreement for up to two additional terms of five years each, absent a prior termination by either party.

Marriott. Our management agreements with Marriott require us to pay Marriott a base management fee between 2.25% and 3.0% of total revenue. These management agreements expire between 2014 and 2055, absent prior termination by either party. Additionally, eight of these management agreements require payment of an incentive fee of 20.0% of the excess of gross operating profit over a certain threshold; one of these management agreements requires payment of an incentive fee of 15.0% of the excess of gross operating profit over a certain threshold through 2011, an incentive fee equal to a fixed sum if gross operating profit is over a certain threshold for years 2012 and 2013 and thereafter 20.0% of the excess of gross operating profit over a certain threshold; one of the management agreements requires payment of an incentive fee of 10.0% of adjusted gross operating profit, limited to 3.0% of gross revenue; and one of the management agreements requires payment of an incentive fee of 20.0% of gross operating profit, subject to deferral if Sunstone does not receive its priority distribution. The management agreements with Marriott may be terminated earlier than the stated term if certain events occur, including the failure of Marriott to satisfy certain performance standards, a condemnation of, a casualty to, or force majeure event involving a hotel, the withdrawal or revocation of any license or permit required in connection with the operation of a hotel and upon a default by Marriott or us that is not cured prior to the expiration of any applicable cure periods. In certain instances, Marriott has rights of first refusal to either purchase or lease hotels, or to terminate the applicable management agreement in the event we sell the respective hotel.

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Davidson. Our Embassy Suites Chicago, Illinois hotel is operated under a management agreement with Davidson. The agreement expires in 2015 and provides us with the right to renew for up to two additional terms of five years each, absent a prior termination by either party. The management agreement requires us to pay 2.0% of total revenue as a base management fee and calls for an incentive fee (capped at 1.0% of total revenue) of 15.0% of the excess of net operating income over a certain threshold and an additional incentive fee in the amount of 1.0% of total revenue upon achieving a certain level of net operating income. The base and incentive management fees payable to Davidson under the management agreement have an aggregate cap of 4.0% of total revenue.

Denihan. Our Royal Palm Miami Beach, Florida hotel is operated under a management agreement with Denihan. The agreement expires in 2023 and provides us the right to renew for up to two additional terms of five years each, absent a prior termination by either party. The management agreement requires us to pay a base management fee ranging from 1.0% to 2.5% of gross revenues from 2010 to 2023. In addition, the management agreement calls for payment of a leased food and beverage management fee equal to 2.0% of any leased food and beverage gross revenue. Furthermore, the management agreement calls for payment of an incentive fee of 15.0% of the excess of net operating income over a certain threshold through June 2013, an incentive fee of 20.0% of the excess of net operating income over a certain threshold for July 2013 through December 2014, and an incentive fee of 15.0% of the excess of net operating income over a certain threshold for 2015 through June 2023. During any renewal term, the management agreement calls for payment of a base management fee of 3.0% of gross revenue and an incentive fee equal to 15.0% of the excess of net operating income over \$20.0 million. The base and incentive management fees together with the leased food and beverage fee payable to Denihan under the management agreement have an aggregate cap of 4.5% of gross revenue.

Fairmont. Our Fairmont Newport Beach, California hotel is operated under a management agreement with Fairmont. The agreement expires in 2015 (absent early termination by either party) and provides Fairmont with two extension options, the first option having a term of twenty years and the second option having a term of 10 years. The agreement requires us to pay 3.0% of total revenue as a base management fee and calls for payment of incentive fees ranging from 20.0% to 30.0% of the hotel's net profit above certain net profit thresholds. The base and incentive management fees payable to Fairmont under the management agreement have an aggregate cap of 6.0% of total revenue. In addition, we entered into an agreement with Fairmont whereby Fairmont will provide us with a limited performance guaranty up to \$6.0 million to ensure, subject to certain limitations, a return on equity to us. Under the terms of this agreement, we received \$3.5 million of the \$6.0 million performance guaranty during 2008, and \$2.5 million of the performance guaranty during 2009. As of December 31, 2009, we have fully utilized this \$6.0 million performance guaranty.

Hilton. Our Embassy Suites La Jolla, California hotel is operated under a management agreement with Hilton. The agreement expires in 2016 (absent early termination by either party), and provides no renewal options. The agreement requires us to pay a base management fee ranging from 1.5% of gross revenue in 2006 to 2.25% of gross revenue in 2010 through 2016. The agreement includes an incentive fee of 15.0% of our net profit at the hotel in excess of certain net profit thresholds.

Hyatt. Our Hyatt Regency Newport Beach, California hotel is operated under a management agreement with Hyatt. This agreement expires in 2019 and provides either party the right to renew for successive periods of ten years (provided that the term of the agreement shall in no event extend beyond 2039), absent early termination by either party. The agreement requires us to pay 3.5% of total hotel revenue as a base management fee, with an additional 0.5% of total revenue payable to Hyatt based upon the hotel achieving specific operating thresholds.

Sage. Our Hilton Del Mar, California hotel is operated under a management agreement with Sage. The agreement expires in 2015 and provides us the right to renew for up to two additional terms of five years each, absent a prior termination by either party. The agreement requires us to pay 2.0% of total revenues as a base management fee and calls for an incentive fee of 10.0% of the excess of net operating income over certain thresholds as an incentive management fee. The base and incentive management fees payable to Sage under the management agreement have an aggregate cap of 4.0% of total revenue.

The existing management agreements with Marriott, Fairmont, Hilton and Hyatt require the manager to furnish chain services that are generally made available to other hotels managed by that operator. Costs for these chain services are reimbursed by us. Such services include: (1) the development and operation of computer systems and reservation services; (2) management and administrative services; (3) marketing and sales services; (4) human resources training services; and (5) such additional services as may from time to time be more efficiently performed on a national, regional or group level.

Franchise Agreements

As of December 31, 2010, 14 of the 31 hotels were operated subject to franchise agreements. Franchisors provide a variety of benefits to franchisees, including nationally recognized brands, centralized reservation systems, national advertising, marketing programs and publicity designed to increase brand awareness, training of personnel and maintenance of operational quality at hotels across the brand system.

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The franchise agreements generally specify management, operational, record-keeping, accounting, reporting and marketing standards and procedures with which our subsidiary, as the franchisee, must comply. The franchise agreements obligate the subsidiary to comply with the franchisors' standards and requirements with respect to training of operational personnel, safety, maintaining specified insurance, the types of services and products ancillary to guest room services that may be provided by the subsidiary, display of signage and the type, quality and age of furniture, fixtures and equipment included in guest rooms, lobbies and other common areas. The franchise agreements for our hotels require that we reserve up to 5.0% of the gross revenues of the hotels into a reserve fund for capital expenditures.

The franchise agreements also provide for termination at the franchisor's option upon the occurrence of certain events, including failure to pay royalties and fees or to perform other obligations under the franchise license, bankruptcy and abandonment of the franchise or a change in control. The subsidiary that is the franchisee is responsible for making all payments under the franchise agreements to the franchisors, however the Company guarantees certain obligations under the franchise agreements. Five of the hotels we deeded back in 2010 pursuant to our 2009 secured debt restructuring program remain subject to franchise agreements. If the franchise agreements on these five hotels were to be terminated, we may be liable for up to \$19.6 million in termination fees.

Tax Status

We have elected to be taxed as a REIT under Sections 856 through 859 of the Code, commencing with our taxable year ending December 31, 2004. Under current federal income tax laws, we are required to distribute at least 90% of our net taxable income to our stockholders. While REITs enjoy certain tax benefits relative to C corporations, as a REIT we may, however, be subject to certain federal, state and local taxes on our income and property. We may also be subject to federal income and excise tax on our undistributed income.

Taxable REIT Subsidiary

Subject to certain limitations, a REIT is permitted to own, directly or indirectly, up to 100% of the stock of a taxable REIT subsidiary, or TRS. The TRS may engage in businesses that are prohibited to a REIT. In particular, a hotel REIT is permitted to own a TRS that leases hotels from the REIT, rather than requiring the lessee to be an unaffiliated third party. However, a hotel leased to a TRS still must be managed by an unaffiliated third party in the business of managing hotels. The TRS provisions are complex and impose certain conditions on the use of TRSs. This is to assure that TRSs are subject to an appropriate level of federal corporate taxation.

A TRS is a fully taxable corporation that may earn income that would not be qualifying income if earned directly by us. A TRS may perform activities such as development, and other independent business activities. However, a TRS may not directly or indirectly operate or manage any hotels or provide rights to any brand name under which any hotel is operated.

We and the TRS Lessee must make a joint election with the IRS for the TRS Lessee to be treated as a TRS. A corporation of which a qualifying TRS owns, directly or indirectly, more than 35% of the voting power or value of the corporation's stock will automatically be treated as a TRS. Overall, no more than 25% of the value of our assets may consist of securities of one or more TRS, and no more than 25% of the value of our assets may consist of the securities of TRSs and other assets that are not qualifying assets for purposes of the 75% asset test. The 75% asset test generally requires that at least 75% of the value of our total assets be represented by real estate assets, cash, or government securities.

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The rent that we receive from a TRS qualifies as rents from real property as long as the property is operated on behalf of the TRS by a person who qualifies as an independent contractor and who is, or is related to a person who is, actively engaged in the trade or business of operating qualified lodging facilities for any person unrelated to us and the TRS (an eligible independent contractor). A qualified lodging facility is a hotel, motel or other establishment in which more than one-half of the dwelling units are used on a transient basis. A qualified lodging facility does not include any facility where wagering activities are conducted. A qualified lodging facility includes customary amenities and facilities operated as part of, or associated with, the lodging facility as long as such amenities and facilities are customary for other properties of a comparable size and class owned by other unrelated owners.

We have formed the TRS Lessee as a wholly owned TRS. We lease each of our hotels to the TRS Lessee or one of its subsidiaries. These leases provide for a base rent plus variable rent based on occupied rooms and departmental revenues. These leases must contain economic terms which are similar to a lease between unrelated parties. If they do not, the IRS could impose a 100% excise tax on certain transactions between our TRS and us or our tenants that are not conducted on an arm's-length basis. We believe that all transactions between us and the TRS Lessee are conducted on an arm's-length basis. Further, the TRS rules limit the deductibility of interest paid or accrued by a TRS to us to assure that the TRS is subject to an appropriate level of corporate taxation.

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The TRS Lessee has engaged eligible independent contractors to manage the hotels it leases from Sunstone Hotel Partnership, LLC.

Ground and Air Lease Agreements

At December 31, 2010, six of the 31 hotels are subject to ground or air leases with unaffiliated parties that cover either all or portions of their respective properties. As of December 31, 2010, the remaining terms of these ground and air leases (including renewal options) range from approximately 38 to 86 years. These leases generally require us to make rental payments and payments for all or portions of charges, costs, expenses and liabilities, including real and personal property taxes, insurance and utilities associated with the leased property.

Any proposed sale of a property that is subject to a ground or air lease or any proposed assignment of our leasehold interest as ground or air lessee under the ground or air lease may require the consent of the applicable ground or air lessor. As a result, we may not be able to sell, assign, transfer or convey our ground or air lessee's interest in any such property in the future absent the consent of the ground or air lessor, even if such transaction may be in the best interests of our stockholders. Two of the six leases prohibit the sale or conveyance of the hotel and assignment of the lease by us to another party without first offering the lessor the opportunity to acquire our interest in the associated hotel and property upon the same terms and conditions as offered by us to the third party.

Two of the six leases allow us the option to acquire the ground lessor's interest in the ground lease subject to certain exercisability provisions. At this time, we do not intend to exercise any option to purchase the ground lessor's interest in any of the leases.

Offices

We lease our headquarters located at 120 Vantis, Suite 350, Aliso Viejo, California 92656 from an unaffiliated third party. We occupy our headquarters under a lease that terminates on August 30, 2018.

Employees

At February 1, 2011, we had 35 employees. We believe that our relations with our employees are positive. All persons employed in the day-to-day operations of the hotels are employees of the management companies engaged by the TRS Lessee or its subsidiaries to operate such hotels.

Environmental

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Environmental reviews have been conducted on all of our hotels. Environmental consultants retained by our lenders have conducted Phase I environmental site assessments on many of our properties. In certain instances, these Phase I assessments relied on older environmental assessments prepared in connection with prior financings. Phase I assessments are designed to evaluate the potential for environmental contamination of properties based generally upon site inspections, facility personnel interviews, historical information and certain publicly available databases. Phase I assessments will not necessarily reveal the existence or extent of all environmental conditions, liabilities or compliance concerns at the properties. While some of these assessments have led to further investigation and sampling, none of the environmental assessments have revealed, nor are we aware of, any environmental liability (including asbestos-related liability) that we believe would harm our business, financial position, results of operations or cash flow.

Under various federal, state and local laws and regulations, an owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on the property. These laws often impose such liability without regard to whether the owner knew of, or was responsible for, the presence of hazardous or toxic substances. Furthermore, a person that arranges for the disposal or transports for disposal or treatment of a hazardous substance at another property may be liable for the costs of removal or remediation of hazardous substances released into the environment at that property. The costs of remediation or removal of such substances may be substantial, and the presence of such substances, or the failure to promptly remediate such substances, may adversely affect the owner's ability to sell such real estate or to borrow using such real estate as collateral. In connection with the ownership and operation of our properties, we or the TRS Lessee, as the case may be, may be potentially liable for such costs.

As an owner of real estate, we are not directly involved in the operation of our properties or other activities that produce meaningful levels of greenhouse gas emissions. As a result, we have not implemented a formal program to measure or manage emissions associated with our corporate office or hotels. Although we do not believe that climate change represents a direct material risk to our business, we could be indirectly affected by climate change and other environmental issues to the extent these issues negatively affect the broader economy or result in increased regulation or costs.

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We have provided unsecured environmental indemnities to certain lenders. We have performed due diligence on the potential environmental risks including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate us to reimburse the guaranteed parties for damages related to environmental matters. There is generally no term or damage limitation on these indemnities; however, if an environmental matter arises, we could have recourse against other previous owners. Although we have tried to mitigate environmental risk through insurance, this insurance may not cover all or any of the environmental risks we encounter.

ADA Regulation

Our properties must comply with various laws and regulations, including Title III of the Americans with Disabilities Act (ADA) to the extent that such properties are public accommodations as defined by the ADA. The ADA may require removal of structural barriers to access by persons with disabilities in certain public areas of our properties where such removal is readily achievable. We believe that our properties are in substantial compliance with the ADA; however, noncompliance with the ADA could result in capital expenditures, the imposition of fines or an award of damages to private litigants. The obligation to make readily achievable accommodations is an ongoing one, and we will continue to assess our properties and to make alterations as appropriate in this respect.

Seasonality and Volatility

We experience some seasonality in our business. Revenue for hotels in tourist areas generally is substantially greater during tourist season than other times of the year. Quarterly revenue also may be adversely affected by events beyond our control, such as extreme weather conditions, climate change, terrorist attacks or alerts, public health concerns, airline strikes, cost of air travel or reduced airline capacity, economic factors and other considerations affecting travel.

Inflation

Inflation may affect our expenses, including, without limitation, by increasing costs such as labor, food, taxes, property and casualty insurance and utilities.

Securities Exchange Act Reports

Our internet address is www.sunstonehotels.com. Periodic and current Securities and Exchange Commission (SEC) reports and amendments to those reports, such as our annual proxy statement, our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, are available, free of charge, through links displayed on our web site as soon as reasonably practicable after we file such material with, or furnish it to, the SEC. In addition, the SEC maintains a website that contains these reports at www.sec.gov. Our website and the SEC website and the information on our and the SEC s website is not a part of this Annual Report on Form 10-K.

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Item 1A. Risk Factors

The statements in this section describe some of the significant risks to our business and should be considered carefully. In addition, these statements constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995, as amended.

Risks Related to Our Business

The uncertain environment in the lodging industry and the economy generally will continue to impact our financial results and growth.

The recent U.S. recession and global economic slowdown and the uncertainty over their respective depths and durations have adversely affected our business. In addition, volatility in transportation fuel costs, increases in air and ground travel costs and decreases in airline capacity have reduced and may continue to reduce the demand for our hotel rooms. Accordingly, our financial results have been and may continue to be harmed if the economic slowdown continues for a prolonged period or becomes worse, if conditions in the lodging industry do not improve, or if transportation fuel costs return to the recent high levels for an extended period or increase further.

Volatility in the debt and equity markets may adversely affect our ability to acquire or sell hotel assets.

The continuation or intensification of volatility in the global financial markets may have a material adverse effect on our financial condition or results of operations. Among other things, over time, the capital markets have experienced periods of extreme price volatility, dislocations and liquidity disruptions, all of which have exerted downward pressure on stock prices, widened credit spreads on prospective debt financing and led to declines in the market values of U.S. and foreign stock exchanges. Future dislocations in the debt markets may reduce the amount of capital that is available to finance real estate, which, in turn may limit our ability to finance the acquisition of hotels or the ability of purchasers to obtain financing for hotels that we wish to sell, either of which may have a material adverse impact on revenues, income and/or cash flow.

We have historically used capital obtained from debt and equity markets, along with mortgage debt, to acquire hotel assets. If these markets are difficult to access as a result of low demand for debt or equity securities, higher capital costs and interest rates, a low value for capital securities (including our common or preferred stock), and more restrictive lending standards, our ability to obtain capital for acquisitions on favorable terms or at all could be adversely affected. Similar factors could also adversely affect the ability of others to obtain capital and therefore could make it more difficult to sell hotel assets.

Changes in the debt and equity markets may adversely affect the value of our hotels.

The value of hotel real estate has an inverse correlation to the capital costs of hotel investors. If capital costs increase, real estate values may decrease. Capital costs are generally a function of interest rates on mortgage debt and return expectations of equity investors. Interest rates for

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hotel mortgages had increased by several percentage points from 2007 to 2009 before moderating in 2010. Equity investor return expectations have also risen during the same time period. If capital costs increase from current levels, and if the income generated by our hotels does not increase by amounts sufficient to cover such higher capital costs, the market value of our hotel real estate may decline. In some cases, the value of our hotel real estate has and may continue to decline below the amount of the debt securing such hotel real estate.

As of December 31, 2010, we had approximately \$1.1 billion of outstanding debt, and carrying such debt may impair our financial flexibility or harm our business and financial results by imposing requirements on our business.

Of our total debt, approximately \$98.3 million matures over the next four years (none in 2011, \$33.3 million in 2012, \$65.0 million in 2013, assuming we repay our Operating Partnership's 4.60% exchangeable senior notes (the Senior Notes) remaining balance of \$62.5 million at the first put date in 2013, and none in 2014). The \$98.3 million does not include \$14.8 million of scheduled loan amortization payments due in 2011, \$17.0 million due in 2012, \$18.1 million due in 2013, or \$19.1 million due in 2014. Carrying our outstanding debt may adversely impact our business and financial results by:

- requiring us to use a substantial portion of our funds from operations to make required payments on principal and interest, which will reduce the amount of cash available to us for distributions to our stockholders and for our operations and capital expenditures, future business opportunities and other purposes;
- making us more vulnerable to economic and industry downturns and reducing our flexibility in responding to changing business and economic conditions;
- limiting our ability to undertake refinancings of debt or borrow more money for operations or capital expenditures or to finance acquisitions; and
- compelling us to sell or deed back properties, possibly on disadvantageous terms, in order to make required payments of interest and principal.

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We also may incur additional debt in connection with future acquisitions of real estate, which may include loans secured by some or all of the hotels we acquire. In addition to our outstanding debt, at December 31, 2010, we had \$2.1 million in outstanding letters of credit.

During 2009, pursuant to a completed secured debt restructuring program, we voluntarily elected to cease the subsidization of debt service on mortgages securing some of our hotels. If operating fundamentals decline from 2010, we may voluntarily elect to cease the subsidization of debt service on additional mortgages in the future, which could reduce the number of hotels we own and our revenues and affect our ability to raise equity or debt financing.

In the context of determining whether to cease the subsidization of debt service on mortgages secured by some of our hotels, we balanced the interests of our stockholders against other considerations, including relationships with lenders whom we may in the future seek to do business. During 2009, pursuant to secured debt restructuring negotiations with respect to certain of our mortgage loans (the 2009 secured debt restructuring program), we ultimately determined that it was in our best interest to voluntarily cease the subsidization of debt service shortfalls under four of our non-recourse mortgages totaling \$303.9 million, which were secured by 11 of our hotels. During 2010, we transferred the titles on 10 of these hotels to either the lenders or new owners, and the related debt was extinguished. We reacquired the Renaissance Westchester in June 2010 for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with this repurchase, the hotel's \$29.2 million non-recourse mortgage was cancelled. The title transfers of the 10 hotels reduced our assets and our debt, and could have an adverse effect on our ability to raise equity or debt capital in the future, as well as increase the cost of such capital. In addition, five of the 10 hotels remain subject to franchise agreements which contain corporate guaranties. If the franchise agreements on these five hotels were to be terminated, we may be liable for up to \$19.6 million in termination fees.

In addition to the foregoing loans, we may face issues with other loans in the future, some of which may be beyond our control, including our ability to service payment obligations from the cash flow of the applicable hotel, or the inability to refinance existing debt at the applicable maturity date. In such event, we may elect to default on the applicable loan and, as a result, the lenders would have the right to exercise various remedies under the loan documents, which would include foreclosure on the applicable hotels. Any such defaults, whether voluntary or involuntary, could result in a default under our other debt or otherwise have an adverse effect on our business, results of operations or financial condition.

If we were to default on our secured debt in the future, the loss of our property securing the debt may negatively affect our ability to satisfy other obligations.

A majority of our debt is secured by first deeds of trust on our properties. Using our properties as collateral increases our risk of property losses because defaults on indebtedness secured by properties may result in foreclosure actions initiated by lenders and ultimately our loss of the property that secures any loan under which we are in default. For tax purposes, a foreclosure on any of our properties would be treated as a sale of the property. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we would recognize taxable income on foreclosure but would not necessarily receive any cash proceeds. As a result, we may be required to identify and utilize other sources of cash for distributions to our stockholders.

We anticipate that we will refinance our indebtedness from time to time to repay our debt, and our inability to refinance on favorable terms, or at all, could impact our operating results.

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Because we anticipate that our internally generated cash will be adequate to repay only a portion of our indebtedness prior to maturity, we expect that we will be required to repay debt from time to time through refinancings of our indebtedness and/or offerings of equity or debt. The amount of our existing indebtedness may impede our ability to repay our debt through refinancings. While we have worked to conduct fair negotiations with lenders holding mortgages secured by some of our hotels, our election to cease the subsidization of debt service on certain of such mortgages pursuant to our 2009 secured debt restructuring program may negatively impact our ability to secure favorable financing in the future. If we are unable to refinance our indebtedness on acceptable terms, or at all, and are unable to negotiate an extension with the lender, we may be in default or forced to sell one or more of our properties on potentially disadvantageous terms, which might increase our borrowing costs, result in losses to us and reduce the amount of cash available to us for distributions to our stockholders. If prevailing interest rates or other factors at the time of any refinancing result in higher interest rates on new debt, our interest expense would increase, which would harm our operating results.

Financial covenants in our debt instruments may restrict our operating or acquisition activities.

Our credit facility contains, and other potential financings that we may incur or assume in the future may contain, restrictions, requirements and other limitations on our ability to incur additional debt, as well as financial covenants relating to the performance of those properties. Our ability to borrow under these agreements is subject to compliance with these financial and other covenants. If we are unable to engage in activities that we believe would benefit those properties or we are unable to incur debt to pursue those activities, our growth may be limited. Obtaining consents or waivers from compliance with these covenants may not be possible, or if possible, may cause us to incur additional costs.

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Our Series C preferred stock contains financial covenants that could limit our financial flexibility and harm our financial condition.

Our Series C cumulative convertible preferred stock (the Series C preferred stock), contains fixed charge coverage and debt ratio limitations, and other financings that we may incur or assume in the future may contain financial and operating covenants, including net worth requirements, fixed charge coverage and debt ratios and other limitations on our ability to make distributions or other payments to our stockholders as well as limitations on our ability to sell all or substantially all of our assets and engage in mergers, consolidations and certain acquisitions. Failure to meet our financial covenants could result from, among other things, changes in our results of operations, the incurrence of debt or changes in general economic conditions. Specifically, if we fail to meet certain financial covenants in the Series C preferred stock for four consecutive quarters a financial ratio violation will occur. During the continuation of a financial ratio violation, among other things, we would be restricted from paying dividends on our common stock, and may incur a 50 basis point per quarter dividend increase on the Series C preferred stock. Additionally, the Series C preferred stockholders would gain the right to appoint one board member. As of July 2010, the Series C preferred stock is redeemable at our option, in whole or in part, for cash at a redemption price of \$24.375 per share, plus accrued and unpaid dividends up to and including the redemption date, without any prepayment penalties.

Our organizational documents contain no limitations on the amount of debt we may incur, so we may become too highly leveraged.

Our organizational documents do not limit the amount of indebtedness that we may incur. If we increase the level of our borrowings, then the resulting increase in cash flow that must be used for debt service would reduce cash available for distribution and could harm our ability to make payments on our outstanding indebtedness and our financial condition.

Two of our directors have economic interests in other real estate investments, including hotels, which may result in conflicts and competing demands on their time.

Two of our directors, Messrs. Alter and Wolff, are actively involved in the management of entities that invest in real estate, including hotels. Accordingly, these directors may have a conflict of interest in evaluating acquisition opportunities in which we and those entities both have a potential interest. These potential conflicts have been disclosed to, and reviewed and approved by the board of directors, and are evaluated by our board of directors on an ongoing basis.

We face competition for hotel acquisitions and dispositions, and we may not be successful in completing hotel acquisitions or dispositions that meet our criteria, which may impede our business strategy.

Our business strategy is predicated on a cycle-appropriate approach to hotel acquisitions and dispositions. We may not be successful in identifying or completing acquisitions or dispositions that are consistent with our strategy. We compete with institutional pension funds, private equity investors, other REITs, owner-operators of hotels, franchise-owned hotels and others who are engaged in the acquisition of hotels, and we rely on such entities as purchasers of hotels we seek to sell. These competitors may affect the supply/demand dynamics and, accordingly, increase the price we must pay for hotels or hotel companies we seek to acquire, and these competitors may succeed in acquiring those hotels or hotel companies themselves. Furthermore, our potential acquisition targets may find our competitors to be more attractive suitors because they may have greater marketing and financial resources, may be willing to pay more, or may have a more compatible operating philosophy. In addition, the number of entities competing for suitable hotels may increase in the future, which would increase demand for these hotels and the

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prices we must pay to acquire them, which, although beneficial to dispositions of hotels, may materially impact our ability to acquire new properties. We are also unable to predict certain market changes including changes in supply of, or demand for, similar real properties in a particular area. If we pay higher prices for hotels, our profitability may be reduced. Also, future acquisitions of hotels or hotel companies may not yield the returns we expect and, if financed using our equity, may result in stockholder dilution. In addition, our profitability may suffer because of acquisition-related costs or amortization costs for acquired intangible assets, and the integration of such acquisitions may cause disruptions to our business and may strain management resources.

Delays in the acquisition, renovation, development and construction of real properties may have adverse effects on our results of operations and returns to our stockholders.

Delays we encounter in the selection, acquisition, renovation and development of real properties could adversely affect investor returns. Our ability to commit to purchase specific assets will depend, in part, on the amount of our available cash at a given time. Where properties are acquired prior to the start of construction or during the early stages of construction, it will typically take several months to complete construction and rent available space. For example, we do not expect the renovation on the Royal Palm Miami Beach hotel that we acquired in 2010 to be completed prior to the fourth quarter of

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2012. Renovation programs may take longer and cost more than initially expected. Therefore, stockholders may suffer delays in receiving cash distributions attributable to those particular real properties. We may incur additional risks when we make periodic progress payments or other advances to builders prior to completion of construction. Each of those factors could result in increased costs of a project or loss of our investment. Furthermore, the price we agree to pay for a real property will be based on our projections of income and expenses and estimates of the fair market value of real property upon completion of construction. If our projections are inaccurate, we may pay too much for a property.

The acquisition of a portfolio of hotels or a company presents more risks to our business and financial results than the acquisition of a single hotel.

We have acquired in the past, and may acquire in the future, multiple hotels in single transactions to seek to reduce acquisition costs per hotel and enable us to expand our hotel portfolio more rapidly. We may also evaluate acquiring companies that own hotels. Multiple hotel and company acquisitions, however, are generally more complex than single hotel acquisitions and, as a result, the risk that they will not be completed is greater. These acquisitions may also result in our owning hotels in new markets, which places additional demands on our ability to actively asset manage the hotels. In addition, we may be required by a seller to purchase a group of hotels as a package, even though one or more of the hotels in the package do not meet our investment criteria. In those events, we expect to attempt to sell the hotels that do not meet our investment criteria, but may not be able to do so on acceptable terms or may have to pay a 100% prohibited transactions tax on any gain. These hotels may harm our operating results if they operate below our underwriting or we sell them at a loss. Also, a portfolio of hotels may also be more difficult to integrate with our existing hotels than a single hotel, may strain our management resources and may make it more difficult to find one or more management companies to operate the hotels. Any of these risks could harm our operating results.

Joint venture investments could be adversely affected by our lack of sole decision-making authority, our reliance on a co-venturer's financial condition and disputes between us and our co-venturers.

We may co-invest in the future with third parties through partnerships, joint ventures or other entities, acquiring non-controlling interests in or sharing responsibility for managing the affairs of a property, partnership, joint venture or other entity. In such event, we would not be in a position to exercise sole decision-making authority regarding the property, partnership, joint venture or other entity. Investments in partnerships, joint ventures or other entities may, under certain circumstances, involve risks not present were a third party not involved, including the possibility that partners or co-venturers might become bankrupt or fail to fund their share of required capital contributions. Partners or co-venturers may have economic or other business interests or goals which are inconsistent with our business interests or goals, and may be in a position to take actions contrary to our policies or objectives. Such investments may also have the potential risk of impasses on decisions, such as a sale, because neither we nor the partner or co-venturer would have full control over the partnership or joint venture. Disputes between us and partners or co-venturers may result in litigation or arbitration that would increase our expenses and prevent our officers and/or trustees from focusing their time and effort on our business. Consequently, actions by, or disputes with, partners or co-venturers might result in subjecting properties owned by the partnership or joint venture to additional risk. In addition, we may in certain circumstances be liable for the actions of our third party partners or co-venturers.

The mortgage loans we currently own, or mortgage loans we may invest in at a future date, may be affected by unfavorable real estate market conditions, which could decrease the value of those loans and the return on our investment.

The mortgage loans we currently own, or mortgage loans we may invest in at a future date, may be at risk of defaults by the borrowers on those mortgage loans. These defaults may be caused by conditions beyond our control, including interest rate levels and local and other economic conditions affecting real estate values. We do not know whether the values of the properties securing the mortgage loans we currently own or

any potential mortgage loans acquired in the future will remain at the levels existing on the dates of origination of those mortgage loans. If the values of the underlying properties were to drop, our risk would increase because of the lower value of the security associated with such loans.

The mortgage loans we currently own, or mortgage loans we may invest in at a future date, may be subject to interest rate fluctuations that could reduce our returns as compared to market interest rates and reduce the value of the mortgage loans in the event we sell them.

With respect to the mortgage loans we currently own, or mortgage loans we may invest in at a future date, we could yield a return that is lower than the current rate in existence when the loans were acquired. If interest rates decrease, we will be adversely affected to the extent that mortgage loans are prepaid because we may not be able to make new loans at the higher interest rate. If we invest in variable-rate loans and interest rates decrease, our revenues will also decrease. Finally, if we invest in variable-rate loans and interest rates increase, the value of the loans we own at such time would decrease, which would lower the proceeds we would receive in the event we sell such assets. For these reasons, our returns on those loans and the value of your investment will be subject to fluctuations in interest rates.

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The loans in which we invest may involve greater risks of loss than senior loans secured by income-producing real properties.

We invest in hotel loans, including mezzanine loans that take the form of subordinated loans secured by second mortgages on the underlying real property or loans secured by a pledge of the ownership interests of the entity owning the real property, the entity that owns the interest in the entity owning the real property or other assets. These types of investments involve a higher degree of risk than direct hotel investments because the investment may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our investment. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the real property and increasing the risk of loss of principal.

If we make or invest in mortgage loans with the intent of gaining ownership of the hotel secured by or pledged to the loan, our ability to perfect an ownership interest in the hotel is subject to the sponsor's willingness to forfeit the property in lieu of the debt.

If we invest in a mortgage loan or note secured by the equity interest in a property with the intention of gaining ownership through the foreclosure process, the time it will take for us to perfect our interest in the property may depend on the sponsor's willingness to cooperate during the foreclosure process. The sponsor may elect to file bankruptcy which could materially impact our ability to perfect our interest in the property and could result in a loss on our investment in the debt or note.

In the past, events beyond our control, including an economic slowdown and terrorism, harmed the operating performance of the hotel industry generally and the performance of our hotels, and if these or similar events occur again, our operating and financial results may be harmed by declines in average daily room rates and/or occupancy.

The performance of the lodging industry has traditionally been closely linked with the performance of the general economy. The majority of our hotels are classified as upper upscale or upscale hotels. In an economic downturn, these types of hotels may be more susceptible to a decrease in revenue, as compared to hotels in other categories that have lower room rates in part because upper upscale and upscale hotels generally target business and high-end leisure travelers. In periods of economic difficulties, business and leisure travelers may reduce travel costs by limiting travel or by using lower cost accommodations. In addition, the terrorist attacks of September 11, 2001 had a dramatic adverse effect on business and leisure travel, and on the occupancy and average daily rate, or ADR, of our hotels. Future terrorist activities could have a harmful effect on both the industry and us. Likewise, the volatility in the credit and equity markets and the economic recession will likely continue to have an adverse effect on our business.

Certain of our long-lived assets and goodwill have in the past become impaired and may become impaired in the future.

We periodically review each of our hotels and any related goodwill for possible impairment. In 2010, we recognized an impairment loss of \$1.9 million to property and goodwill impairment losses related to an office building and land adjacent to one of our hotels based on estimated proceeds expected to be received from the possible sale of this property. During 2009, we recognized impairment losses totaling \$252.2 million, which included: \$25.5 million to property and goodwill impairment losses to reduce the carrying value of one hotel and one parcel of land

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adjacent to one of our hotels on our balance sheets to their fair values; \$3.9 million to property and goodwill impairment losses related to goodwill on two of our hotels; \$1.4 million to property and goodwill impairment losses related to the write-off of deferred costs associated with a potential time share development; \$26.0 million to equity in net losses of unconsolidated joint ventures in order to reduce our investment in the Doubletree Guest Suites Times Square joint venture to zero on our balance sheets; \$192.3 million to discontinued operations to reduce the carrying values of 11 hotels on our balance sheet to their fair values; and, \$3.0 million to discontinued operations related to goodwill on four hotels. Our other hotels and related goodwill may become impaired, or our hotels and related goodwill which have previously become impaired may become further impaired, in the future, which may adversely affect our financial condition and results of operations.

We own primarily upper upscale and upscale hotels, and the upper upscale and upscale segments of the lodging market are highly competitive and may be subject to greater volatility than other segments of the market, which could negatively affect our profitability.

The upper upscale and upscale segments of the hotel business are highly competitive. Our hotels compete on the basis of location, room rates and quality, service levels, reputation and reservations systems, among many other factors. There are

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many competitors in our hotel chain scale segments, and many of these competitors have substantially greater marketing and financial resources than we have. This competition could reduce occupancy levels and room revenue at our hotels, which would harm our operations. Over-building in the hotel industry may increase the number of rooms available and may decrease occupancy and room rates. We will also face competition from nationally recognized hotel brands with which we are not associated. In addition, in periods of weak demand, profitability is negatively affected by the relatively high fixed costs of operating upper upscale and upscale hotels when compared to other classes of hotels.

Rising operating expenses or low occupancy rates could reduce our cash flow and funds available for future distributions.

Our hotels, and any hotels we buy in the future, are and will be subject to operating risks common to the lodging industry in general. If any hotel is not occupied at a level sufficient to cover our operating expenses, then we could be required to spend additional funds for that hotel's operating expenses. In the future, our hotels will be subject to increases in real estate and other tax rates, utility costs, operating expenses, insurance costs, repairs and maintenance and administrative expenses, which could reduce our cash flow and funds available for future distributions.

A significant portion of our hotels are geographically concentrated in California and, accordingly, we could be disproportionately harmed by an economic downturn in this area of the country or a natural disaster, such as an earthquake.

As of December 31, 2010, nine of the 31 hotels, the largest concentration of our hotels in any state, representing approximately 25% of our rooms and approximately 24% of our 2010 revenues generated by the 31 hotels, are located in California. The concentration of our hotels in California exposes our business to economic conditions, competition and real and personal property tax rates unique to California. Natural disasters in California, such as earthquakes, fires or mudslides, would disproportionately affect our hotel portfolio. The California economy and tourism industry, in comparison to other parts of the country, is negatively affected to a greater extent by changes and downturns in certain industries, including the entertainment and high technology industries. It is also possible that because of our California concentration, a change in California laws applicable to hotels and the lodging industry may have a greater impact on us than a change in comparable laws in another geographical area in which we have hotels. Adverse developments in California could harm our revenue or increase our operating expenses in that state.

The operating results of some of our individual hotels are significantly impacted by group contract business and room nights generated by large corporate transient customers, and the loss of such customers for any reason could harm our operating results.

Group contract business and room nights generated by other large corporate transient customers can significantly impact the results of operations of our hotels. These contracts and customers vary from hotel to hotel and change from time to time. Such group contracts are typically for a limited period of time after which they may be put up for competitive bidding. The impact and timing of large events are not always easy to predict. As a result, the operating results for our individual hotels can fluctuate as a result of these factors, possibly in adverse ways, and these fluctuations can affect our overall operating results.

Because most of our hotels are operated under franchise agreements or are brand managed, termination of these franchise or management agreements or circumstances that negatively affect the franchisor or the hotel brand could cause us to lose business at our hotels or lead to a default or acceleration of our obligations under certain of our notes payable.

As of December 31, 2010, 27 of the 31 hotels, representing approximately 86% of our rooms, were operated under franchise or management agreements with international franchisors or hotel management companies, such as Marriott, Fairmont, Hilton and Hyatt. In general, under these arrangements, the franchisor or brand manager provides marketing services and room reservations and certain other operating assistance, but requires us to pay significant fees to it and to maintain the hotel in a required condition. If we fail to maintain these required standards, then the franchisor or hotel brand may terminate its agreement with us and obtain damages for any liability we may have caused. Moreover, from time to time, we may receive notices from franchisors or the hotel brands regarding our alleged non-compliance with the franchise agreements or brand standards, and we may disagree with these claims that we are not in compliance. Any disputes arising under these agreements could also lead to a termination of a franchise or management agreement and a payment of liquidated damages. Such a termination may trigger a default or acceleration of our obligations under some of our notes payable. In addition, as our franchise or management agreements expire, we may not be able to renew them on favorable terms or at all. If we were to lose a franchise or hotel brand for a particular hotel, it could harm the operation, financing, leverage opportunity or value of that hotel due to the loss of the franchise or hotel brand name, marketing support and centralized reservation system. Moreover, negative publicity affecting a franchisor or hotel brand in general could reduce the revenue we receive from the hotels subject to that particular franchise or brand. Any loss of revenue at a hotel could harm the ability of the TRS Lessee, to whom we have leased our hotels as a result of certain federal income tax restrictions on lodging REITs, to pay rent to the Operating Partnership and could harm our ability to pay dividends on our common stock or preferred stock.

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Our franchisors and brand managers require us to make capital expenditures pursuant to property improvement plans, or PIPs, and the failure to make the expenditures required under the PIPs or to comply with brand standards could cause the franchisors or hotel brands to terminate the franchise or management agreements.

Historically, some of our franchisors and brand managers require that we make renovations to some of our hotels in connection with revisions to our franchise or management agreements. In addition, upon regular inspection of our hotels, our franchisors and hotel brands may determine that additional renovations are required to bring the physical condition of our hotels into compliance with the specifications and standards each franchisor or hotel brand has developed. In connection with the acquisitions of hotels, franchisors and hotel brands may also require PIPs, which set forth their renovation requirements. If we do not satisfy the PIP renovation requirements, the franchisor or hotel brand may have the right to terminate the applicable agreement. In addition, in the event that we are in default under any franchise agreement as a result of our failure to comply with the PIP requirements, in general, we will be required to pay the franchisor liquidated damages, generally equal to a percentage of gross room revenue for the preceding two-, three- or five-year period for the hotel or a percentage of gross revenue for the preceding twelve-month period for all hotels operated under the franchised brand if the hotel has not been operating for at least two years.

Because we are a REIT, we depend on third parties to operate our hotels, which could harm our results of operations.

In order to qualify as a REIT, we cannot directly operate our hotels or participate in the decisions affecting the daily operations of our hotels. Accordingly, we must enter into management agreements with eligible independent contractors to manage our hotels. Thus, independent management companies, including IHR, Marriott, Davidson, Denihan, Fairmont, Hilton, Hyatt and Sage, control the daily operations of our hotels.

As of December 31, 2010, IHR operated 13 of the 31 hotels. Additionally, subsidiaries of Marriott operated 12 of our hotels, and Davidson, Denihan, Fairmont, Hilton, Hyatt and Sage each operated one of our hotels. Under the terms of our management agreements with these companies, although we actively participate in setting operating strategies, we do not have the authority to require any hotel to be operated in a particular manner or to govern any particular aspect of the daily operations of any hotel (e.g., setting room rates, etc.). We depend on these independent management companies to operate our hotels as provided in the applicable management agreements. Thus, even if we believe a hotel is being operated inefficiently or in a manner that does not result in satisfactory ADR, occupancy rates and RevPAR, we do not necessarily have contractual rights to cause our independent management companies to change their method of operation at our hotels. We can only seek redress if a management company violates the terms of its applicable management agreement with us or fails to meet performance objectives set forth in the applicable management agreement, and then only to the extent of the remedies provided in the management agreement. Additionally, while our management agreements typically provide for limited contractual penalties in the event that we terminate the applicable management agreement upon an event of default, such terminations could result in significant disruptions at the affected hotels. If any of the foregoing occurs at franchised hotels, our relationships with the franchisors may be damaged, and we may be in breach of one or more of our franchise or management agreements.

We cannot assure you that our management companies will successfully manage our hotels. A failure by our management companies to successfully manage our hotels could lead to an increase in our operating expenses or a decrease in our revenue, or both, which would reduce the amount available for dividends on our common stock and our preferred stock. In addition, the management companies may operate other hotels that may compete with our hotels or divert attention away from the management of our hotels.

If our management companies are not successful in managing our hotels or we terminate any of our management agreements and enter into new agreements with different management companies, the day to day operations of our hotels may be disrupted.

As of December 31, 2010, 13 of the 31 hotels are managed and operated by IHR pursuant to management agreements with the TRS Lessee or its subsidiaries. In addition, 18 of the 31 hotels are managed by Marriott, Davidson, Denihan, Fairmont, Hilton, Hyatt or Sage under management agreements with the TRS Lessee or its subsidiaries. Three of these agreements were entered into during 2010. If we were to terminate any of these agreements and enter into new agreements with different hotel operators, the day to day operations of our hotels may be disrupted. In addition, we cannot assure you that any new management agreement would contain terms that are favorable to us. Also, we cannot assure you that a new management company would be successful in managing our hotels.

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Our hotels have an ongoing need for renovations and potentially significant capital expenditures in connection with acquisitions and other capital improvements, some of which are mandated by applicable laws or regulations or agreements with third parties, and the costs of such renovations or improvements may exceed our expectations or cause other problems.

In addition to capital expenditures required by our franchise and loan agreements, from time to time we will need to make capital expenditures to comply with applicable laws and regulations, to remain competitive with other hotels and to maintain the economic value of our hotels. We also may need to make significant capital improvements to hotels that we acquire. Occupancy and ADR are often affected by the maintenance and capital improvements at a hotel, especially in the event that the maintenance or improvements are not completed on schedule or if the improvements require significant closures at the hotel. The costs of capital improvements we need or choose to make could harm our financial condition and reduce amounts available for distribution to our stockholders. These capital improvements may give rise to the following additional risks, among others:

- construction cost overruns and delays;

- a possible shortage of available cash to fund capital improvements and the related possibility that financing for these capital improvements may not be available to us on affordable terms;

- uncertainties as to market demand or a loss of market demand after capital improvements have begun;

- disruption in service and room availability causing reduced demand, occupancy and rates;

- possible environmental problems; and

- disputes with franchisors regarding our compliance with the requirements under the relevant franchise agreement.

Because we are a REIT, we depend on the TRS Lessee to make rent payments to us, and its inability to do so could harm our revenue and our ability to make distributions to our stockholders.

Due to certain federal income tax restrictions on hotel REITs, we cannot directly operate our hotel properties. Therefore, we lease our hotel properties to the TRS Lessee, which contracts with third party hotel managers to manage our hotels. Our revenue and our ability to make distributions to our stockholders will depend solely upon the ability of the TRS Lessee to make rent payments under these leases. In general, under the leases with the TRS Lessee, we will receive from the TRS Lessee both fixed rent and variable rent based upon a percentage of gross revenues and the number of occupied rooms. As a result, we participate in the operations of our hotels only through our share of rent paid

pursuant to the leases.

The TRS Lessee's ability to pay rent is affected by factors beyond its control, such as changes in general economic conditions, the level of demand for hotels and the related services of our hotels, competition in the lodging and hospitality industry, the ability to maintain and increase gross revenue at our hotels and other factors relating to the operations of our hotels.

Although failure on the part of the TRS Lessee to materially comply with the terms of a lease (including failure to pay rent when due) would give us the right to terminate the lease, repossess the hotel and enforce the payment obligations under the lease, such steps may not provide us with any substantive relief since the TRS Lessee is our subsidiary. If we were to terminate a lease, we would then be required to find another lessee to lease the hotel because we cannot operate hotel properties directly and remain qualified as a REIT. We cannot assure you that we would be able to find another lessee or that, if another lessee were found, we would be able to enter into a new lease on terms as favorable to us.

Because six of the 31 hotels are subject to ground or air leases with unaffiliated parties, termination of these leases by the lessors could cause us to lose the ability to operate these hotels altogether and incur substantial costs in restoring the premises.

Our rights to use the land underlying six of the 31 hotels are based upon our interest under long-term ground or air leases with unaffiliated parties. Pursuant to the terms of the ground or air leases for these hotels, we are required to pay all rent due and comply with all other lessee obligations. As of December 31, 2010, the terms of these ground or air leases (including renewal options) range from approximately 38 to 86 years. Any pledge of our interest in a ground or air lease may also require the consent of the applicable lessor and its lenders. As a result, we may not be able to sell, assign, transfer or convey our lessee's interest in any hotel subject to a ground or air lease in the future absent consent of such third parties even if such transactions may be in the best interest of our stockholders.

The lessors may require us, at the expiration or termination of the ground or air leases, to surrender or remove any improvements, alterations or additions to the land at our own expense. The ground or air leases also generally require us to restore the premises following a casualty and to apply in a specified manner any proceeds received in connection therewith. We may have to restore the premises if a material casualty, such as a fire or an act of nature, occurs and the cost thereof exceeds available insurance proceeds.

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Risks Related to Our Organization and Structure

Provisions of Maryland law and our organizational documents may limit the ability of a third party to acquire control of our company and may serve to limit our stock price.

Provisions of Maryland law and our charter and bylaws could have the effect of discouraging, delaying or preventing transactions that involve an actual or threatened change in control of us, and may have the effect of entrenching our management and members of our board of directors, regardless of performance. These provisions include the following:

Aggregate Stock and Common Stock Ownership Limits. In order for us to qualify as a REIT, no more than 50% of the value of outstanding shares of our stock may be owned, actually or constructively, by five or fewer individuals at any time during the last half of each taxable year. To assure that we will not fail to qualify as a REIT under this test, subject to some exceptions, our charter prohibits any stockholder from owning beneficially or constructively more than 9.8% (in number or value, whichever is more restrictive) of the outstanding shares of our common stock or more than 9.8% of the value of the outstanding shares of our capital stock. Any attempt to own or transfer shares of our capital stock in excess of the ownership limit without the consent of our board of directors will be void and could result in the shares (and all dividends thereon) being automatically transferred to a charitable trust. The board of directors has granted waivers of the aggregate stock and common stock ownership limits to three look through entities such as mutual or investment funds. These three entities may beneficially own up to 18% in number or value of our common stock and our capital stock. This ownership limitation may prevent a third party from acquiring control of us if our board of directors does not grant an exemption from the ownership limitation, even if our stockholders believe the change in control is in their best interests.

Authority to Issue Stock. Our charter authorizes our board of directors to cause us to issue up to 500,000,000 shares of common stock and up to 100,000,000 shares of preferred stock. Our charter authorizes our board of directors to amend our charter without stockholder approval to increase or decrease the aggregate number of shares of stock or the number of shares of any class or series of our stock that it has authority to issue, to classify or reclassify any unissued shares of our common stock or preferred stock and to set the preferences, rights and other terms of the classified or reclassified shares. Issuances of additional shares of stock may have the effect of delaying or preventing a change in control of our company, including change of control transactions offering a premium over the market price of shares of our common stock, even if our stockholders believe that a change of control is in their interest.

Number of Directors, Board Vacancies, Term of Office. Under our charter and bylaws, we have elected to be subject to certain provisions of Maryland law which vest in the board of directors the exclusive right to determine the number of directors and the exclusive right, by the affirmative vote of a majority of the remaining directors, to fill vacancies on the board even if the remaining directors do not constitute a quorum. Any director elected to fill a vacancy will hold office until the next annual meeting of stockholders, and until his or her successor is elected and qualifies. As a result, stockholder influence over these matters is limited.

Limitation on Stockholder Requested Special Meetings. Our bylaws provide that our stockholders have the right to call a special meeting only upon the written request of the stockholders entitled to cast not less than a majority of all the votes entitled to be cast by the stockholders at such meeting. This provision makes it more difficult for stockholders to call special meetings.

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Advance Notice Provisions for Stockholder Nominations and Proposals. Our bylaws require advance written notice for stockholders to nominate persons for election as directors at, or to bring other business before, any meeting of our stockholders. This bylaw provision limits the ability of our stockholders to make nominations of persons for election as directors or to introduce other proposals unless we are notified and provided certain required information in a timely manner prior to the meeting.

Authority of our Board to Amend our Bylaws. Our bylaws provide that our board of directors has the exclusive power to adopt, alter or repeal any provision of the bylaws or to make new bylaws, except with respect to amendments to the provision of our bylaws regarding our opt out of the Maryland Business Combination and Control Share Acquisition Acts. Thus, our stockholders may not effect any changes to our bylaws other than as noted in the preceding sentence.

Duties of Directors. Maryland law requires that a director perform his or her duties (1) in good faith, (2) in a manner he or she reasonably believes to be in the best interests of the corporation and (3) with the care that an ordinary prudent person in a like position would use under similar circumstances. The duty of the directors of a Maryland corporation does not require them to (1) accept, recommend or respond on behalf of the corporation to any proposal by a person seeking to acquire control of the corporation, (2) authorize the corporation to redeem any rights under, or modify or render inapplicable, a stockholders' rights plan, (3) elect on behalf of the corporation to be subject to or refrain from electing on behalf of the corporation to be subject to the unsolicited takeover provisions of Maryland law, (4) make a determination under the Maryland Business Combination Act or the Maryland Control Share Acquisition Act or (5) act or fail to act solely because of the effect the act or failure to act may have on an acquisition or potential acquisition of control of the corporation or the amount or type of consideration that may be offered or paid to the stockholders in an acquisition. Moreover, under Maryland law the act of the

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directors of a Maryland corporation relating to or affecting an acquisition or potential acquisition of control is not subject to any higher duty or greater scrutiny than is applied to any other act of a director. Maryland law also contains a statutory presumption that an act of a director of a Maryland corporation satisfies the applicable standards of conduct for directors under Maryland law. These provisions increase the ability of our directors to respond to a takeover and may make it more difficult for a third party to effect an unsolicited takeover.

Unsolicited Takeover Provisions. Provisions of Maryland law permit the board of a corporation with a class of equity securities registered under the Exchange Act and at least three independent directors, without stockholder approval, to implement possible takeover defenses, such as a classified board or a two-thirds vote requirement for removal of a director. These provisions, if implemented, may make it more difficult for a third party to effect a takeover.

We rely on our senior management team, the loss of whom could significantly harm our business.

Our continued success will depend to a significant extent on the efforts and abilities of our senior management team. These individuals are important to our business and strategy and to the extent that any of them departs and is not replaced with a qualified substitute, such person's departure could harm our operations and financial condition. Our former Chief Executive Officer, Arthur L. Buser, resigned in December 2010, and we promoted Kenneth E. Cruse from Executive Vice President and Chief Financial Officer to President and Chief Financial Officer. In addition, in February 2011, we announced the appointment of John V. Arabia to replace Mr. Cruse as Chief Financial Officer.

Risks Related to the Lodging and Real Estate Industries

A number of factors, many of which are common to the lodging industry and beyond our control, could affect our business, including the following:

- general economic and business conditions affecting the lodging and travel industry, both nationally and locally, including a prolonged U.S. recession;

- threat of terrorism, terrorist events, airline strikes or other factors that may affect travel patterns and reduce the number of business and commercial travelers and tourists;

- recent volatility in the credit or equity markets and its effect on the general economy and, as a result, the demand for lodging;

- increased competition from other hotels in our markets;

- new hotel supply in our markets, which could harm our occupancy levels and revenue at our hotels;
- unexpected changes in business, commercial and leisure travel and tourism;
- increases in operating costs due to inflation, labor costs (including the impact of unionization), workers' compensation and health-care related costs, utility costs, insurance and unanticipated costs such as acts of nature and their consequences and other factors that may not be offset by increased room rates;
- changes in interest rates and in the availability, cost and terms of debt financing and other changes in our business that adversely affect our ability to comply with covenants in our debt financing;
- changes in our relationships with, and the performance and reputation of, our management companies and franchisors;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the related costs of compliance with laws and regulations, fiscal policies and ordinances; and
- adverse effects of international market conditions, which may diminish the desire for leisure travel or the need for business travel, as well as national, regional and local economic and market conditions in which our hotels operate and where our customers live.

These factors could harm our financial condition, results of operations and ability to make distributions to our stockholders.

The hotel business is seasonal and seasonal variations in revenue at our hotels can be expected to cause quarterly fluctuations in our revenue.

Quarterly revenue may also be harmed by events beyond our control, such as extreme weather conditions, terrorist attacks or alerts, contagious diseases, airline strikes, economic factors and other considerations affecting travel. Seasonal fluctuations in revenue may affect our ability to make distributions to our stockholders or to fund our debt service.

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The use of internet travel intermediaries by consumers may harm our profitability as a result of increased commissions or lower room rates.

Some of our hotel rooms are booked through independent third party internet travel intermediaries. Because we may continue to selectively use these third party internet intermediaries to generate sales, they may be able to obtain higher commissions, reduced room rates or achieve other significant contract concessions from us. If the amount of sales made through internet intermediaries increases significantly and we fail to appropriately price room inventory in a manner that maximizes yields, or we are unable to do so, our room revenue may flatten or decrease and our profitability may decline.

The illiquidity of real estate investments and the lack of alternative uses of hotel properties could significantly limit our ability to respond to adverse changes in the performance of our hotels and harm our financial condition.

Because real estate investments are relatively illiquid, our ability to promptly sell one or more of our hotels in response to changing economic, financial and investment conditions is limited. The real estate market, including our hotels, is affected by many factors, such as general economic conditions, availability of financing, interest rates and other factors, including supply and demand, that are beyond our control. We may not be able to sell any of our hotels on favorable terms. It may take a long time to find a willing purchaser and to close the sale of a hotel if we want to sell. Should we decide to sell a hotel during the term of that particular hotel's management agreement, we may have to pay termination fees, which could be substantial, to the applicable management company.

In addition, hotels may not be readily converted to alternative uses if they were to become unprofitable due to competition, age of improvements, decreased demand or other factors. The conversion of a hotel to alternative uses would also generally require substantial capital expenditures and may give rise to substantial payments to our franchisors, management companies and lenders.

We may be required to expend funds to correct defects or to make improvements before a hotel can be sold. We may not have funds available to correct those defects or to make those improvements and, as a result, our ability to sell the hotel would be restricted. In acquiring a hotel, we may agree to lock-out provisions that materially restrict us from selling that hotel for a period of time or impose other restrictions on us, such as a limitation on the amount of debt that can be placed or repaid on that hotel to address specific concerns of sellers. These lock-out provisions would restrict our ability to sell a hotel. These factors and any others that would impede our ability to respond to adverse changes in the performance of our hotels could harm our financial condition and results of operations.

Claims by persons relating to our properties could affect the attractiveness of our hotels or cause us to incur additional expenses.

We could incur liabilities resulting from loss or injury to our hotels or to persons at our hotels. These losses could be attributable to us or result from actions taken by a management company. Claims such as these, whether or not they have merit, could harm the reputation of a hotel or cause us to incur expenses to the extent of insurance deductibles or losses in excess of policy limitations, which could harm our results of operations.

Uninsured and underinsured losses could harm our financial condition, results of operations and ability to make distributions to our stockholders.

Various types of catastrophic losses, such as losses due to wars, terrorist acts, earthquakes, floods, hurricanes, pollution or environmental matters, generally are either uninsurable or not economically insurable, or may be subject to insurance coverage limitations, such as large deductibles or co-payments. Of the 31 hotels, nine are located in California, which has been historically at greater risk to certain acts of nature (such as fires, earthquakes and mudslides) than other states.

In the event of a catastrophic loss, our insurance coverage may not be sufficient to cover the full current market value or replacement cost of our lost investment. Should an uninsured loss or a loss in excess of insured limits occur, we could lose all or a portion of the capital we have invested in a hotel, as well as the anticipated future revenue from the hotel. In that event, we might nevertheless remain obligated for any notes payable or other financial obligations related to the property, in addition to obligations to our ground lessors, franchisors and managers. Inflation, changes in building codes and ordinances, environmental considerations and other factors might also keep us from using insurance proceeds to replace or renovate a hotel after it has been damaged or destroyed. Under those circumstances, the insurance proceeds we receive might be inadequate to restore our economic position on the damaged or destroyed hotel.

Since September 11, 2001, it has generally become more difficult and expensive to obtain property and casualty insurance, including coverage for terrorism. When our current insurance policies expire, we may encounter difficulty in obtaining or renewing property or casualty insurance on our hotels at the same levels of coverage and under similar terms. Such insurance may be more limited and for some catastrophic risks (e.g., earthquake, fire, flood and terrorism) may not be generally available at current levels. Even if we are able to renew our policies or to obtain new policies at levels and with limitations consistent with our current policies, we cannot be sure that we will be able to obtain such insurance at premium rates that are commercially reasonable. If we are unable to obtain adequate insurance on our hotels for certain risks, it could cause us to be in default under specific covenants on certain of our indebtedness or other contractual commitments we have to our ground lessors, franchisors and managers which require us to maintain adequate insurance on our properties to protect against the risk of loss. If this were to occur, or if we were unable to obtain adequate insurance and our properties experienced damages which would otherwise have been covered by insurance, it could harm our financial condition and results of operations.

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We may not be able to recover fully under our existing terrorism insurance for losses caused by some types of terrorist acts, and federal terrorism legislation does not ensure that we will be able to obtain terrorism insurance in adequate amounts or at acceptable premium levels in the future.

We obtain terrorism insurance as part of our all-risk property insurance program. However, our all-risk policies have limitations such as per occurrence limits and sublimits that might have to be shared proportionally across participating hotels under certain loss scenarios. Also, all-risk insurers only have to provide terrorism coverage to the extent mandated by the Terrorism Risk Insurance Act (the TRIA) for certified acts of terrorism namely those which are committed on behalf of non-United States persons or interests. Furthermore, we do not have full replacement coverage for all of our properties for acts of terrorism committed on behalf of United States persons or interests (noncertified events), as well as for certified events, as our terrorism coverage for such incidents is subject to sublimits and/or annual aggregate limits. In addition, property damage related to war and to nuclear, biological and chemical incidents is excluded under our policies. To the extent we have property damage directly related to fire following a nuclear, biological or chemical incident, however, our coverage will extend to reimburse us for our losses. While the TRIA provides for the reimbursement of insurers for losses resulting from nuclear, biological and chemical perils, the TRIA does not require insurers to offer coverage for these perils and, to date, insurers are not willing to provide this coverage, even with government reinsurance. The TRIA is due to expire on December 31, 2014. There is no guaranty that terrorism insurance will be readily available or affordable before or after expiration of the TRIA in December 2014. As a result of the above, there remains considerable uncertainty regarding the extent and adequacy of terrorism coverage that will be available to protect our interests in the event of future terrorist attacks that impact our properties.

Laws and governmental regulations may restrict the ways in which we use our hotel properties and increase the cost of compliance with such regulations. Noncompliance with such regulations could subject us to penalties, loss of value of our properties or civil damages.

Our hotel properties are subject to various federal, state and local laws relating to the environment, fire and safety and access and use by disabled persons. Under these laws, courts and government agencies have the authority to require us, if we are the owner of a contaminated property, to clean up the property, even if we did not know of or were not responsible for the contamination. These laws also apply to persons who owned a property at the time it became contaminated. In addition to the costs of cleanup, environmental contamination can affect the value of a property and, therefore, an owner's ability to borrow funds using the property as collateral or to sell the property. Under such environmental laws, courts and government agencies also have the authority to require that a person who sent waste to a waste disposal facility, such as a landfill or an incinerator, pay for the clean-up of that facility if it becomes contaminated and threatens human health or the environment.

Furthermore, various court decisions have established that third parties may recover damages for injury caused by property contamination. For instance, a person exposed to asbestos while staying in or working at a hotel may seek to recover damages for injuries suffered. Additionally, some of these environmental laws restrict the use of a property or place conditions on various activities. For example, some laws require a business using chemicals (such as swimming pool chemicals at a hotel) to manage them carefully and to notify local officials that the chemicals are being used.

We could be responsible for the types of costs discussed above. The costs to clean up a contaminated property, to defend against a claim, or to comply with environmental laws could be material and could reduce the funds available for distribution to our stockholders. Future laws or regulations may impose material environmental liabilities on us, or the current environmental condition of our hotel properties may be affected by the condition of the properties in the vicinity of our hotels (such as the presence of leaking underground storage tanks) or by third parties unrelated to us.

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Our hotel properties are also subject to the Americans with Disabilities Act of 1990, or the ADA. Under the ADA, all public accommodations must meet various Federal requirements related to access and use by disabled persons. Compliance with the ADA's requirements could require removal of access barriers and non-compliance could result in the U.S. government imposing fines or in private litigants winning damages. If we are required to make substantial modifications to our hotels, whether to comply with the ADA or other changes in governmental rules and regulations, our financial condition, results of operations and the ability to make distributions to our stockholders could be harmed. In addition, we are required to operate our hotel properties and laundry facilities in compliance with fire and safety regulations, building codes and other land use regulations, as they may be adopted by governmental agencies and become applicable to our properties.

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Tax and Employee Benefit Plan Risks

If we fail to qualify as a REIT, our distributions will not be deductible by us and our income will be subject to federal and state taxation, reducing our cash available for distribution.

We are a REIT under the Code, which affords us significant tax advantages. The requirements for qualifying as a REIT, however, are complex. If we fail to meet these requirements, our distributions will not be deductible by us and we will have to pay a corporate federal and state level tax on our income. This would substantially reduce our cash available to pay distributions and your yield on your investment in our common stock. In addition, such a tax liability might cause us to borrow funds, liquidate some of our investments or take other steps which could negatively affect our results of operations. Moreover, if our REIT status is terminated because of our failure to meet a technical REIT requirement or if we voluntarily revoke our election, we would generally be disqualified from electing treatment as a REIT for the four taxable years following the year in which REIT status is lost.

Even as a REIT, we may become subject to federal, state or local taxes on our income or property, reducing our cash available for distribution.

Even as a REIT, we may become subject to federal income taxes and related state taxes. For example, if we have net income from a prohibited transaction, that income will be subject to a 100% tax. A prohibited transaction is, in general, the sale or other disposition of inventory or property, other than foreclosure property, held primarily for sale to customers in the ordinary course of business. We may not be able to make sufficient distributions to avoid excise taxes applicable to REITs. We may also decide to retain income we earn from the sale or other disposition of our property and pay federal income tax directly on that income. In that event, our stockholders would be treated as if they earned that income and paid the tax on it directly. However, stockholders that are tax-exempt, such as charities or qualified pension plans, would have no benefit from their deemed payment of that tax liability.

We may also be subject to state and local taxes on our income or property, either directly or at the level of our operating partnership or at the level of the other companies through which we indirectly own our assets. We cannot assure you that we will be able to continue to satisfy the REIT requirements, or that it will be in our best interests to continue to do so.

If the leases of our hotels to our taxable REIT subsidiary are not respected as true leases for federal income tax purposes, we would fail to qualify as a REIT.

To qualify as a REIT, we must satisfy two gross income tests, under which specified percentages of our gross income must be passive income, like rent. For the rent paid pursuant to the leases of our hotels to the Operating Partnership by our taxable REIT subsidiary, the TRS Lessee, which constitutes substantially all of our gross income, to qualify for purposes of the gross income tests, the leases must be respected as true leases for federal income tax purposes and not be treated as service contracts, joint ventures or some other type of arrangement. If the leases are not respected as true leases for federal income tax purposes, we would fail to qualify as a REIT.

Our taxable REIT subsidiary is subject to special rules that may result in increased taxes.

Several Code provisions ensure that a taxable REIT subsidiary is subject to an appropriate level of federal income taxation. For example, a taxable REIT subsidiary, such as the TRS Lessee, is limited in its ability to deduct interest payments made to an affiliated REIT. In addition, the REIT has to pay a 100% penalty tax on some payments that it receives if the economic arrangements between us and the taxable REIT subsidiary are not comparable to similar arrangements between unrelated parties. The IRS may successfully assert that the economic arrangements of any of our inter-company transactions, including the hotel leases, are not comparable to similar arrangements between unrelated parties.

We may be required to pay a penalty tax upon the sale of a hotel.

The federal income tax provisions applicable to REITs provide that any gain realized by a REIT on the sale of property held as inventory or other property held primarily for sale to customers in the ordinary course of business is treated as income from a prohibited transaction that is subject to a 100% penalty tax. Under current law, unless a sale of real property qualifies for a safe harbor, the question of whether the sale of a hotel (or other property) constitutes the sale of property held primarily for sale to customers is generally a question of the facts and circumstances regarding a particular transaction. We may make sales that do not satisfy the requirements of the safe harbors or the IRS may successfully assert that one or more of our sales are prohibited transactions and, therefore we may be required to pay a penalty tax.

We also may be subject to corporate level income tax on certain built-in gains.

We hold certain properties acquired from C corporations (and may acquire additional such properties in the future), in which we must adopt the C corporation's tax basis in that asset as our tax basis. If we sell any such property within ten years of the date on which we acquire it, then we will have to pay tax on the gain at the highest regular corporate tax rate.

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An investment in our common stock or Series C preferred stock may not be suitable for every employee benefit plan.

When considering an investment in our common stock or Series C preferred stock, an individual with investment discretion over assets of any pension plan, profit-sharing plan, retirement plan, individual retirement account under Section 408(a) of the Code or other employee benefit plan covered by the Employee Retirement Income Security Act of 1974, as amended, or ERISA, should consider whether the investment satisfies the requirements of Section 404 of ERISA or other applicable laws. In particular, attention should be paid to the diversification requirements of Section 404(a)(1)(C) of ERISA in light of all the facts and circumstances, including the portion of the plan's portfolio of which the investment will be a part. All plan investors should also consider whether the investment is prudent and meets plan liquidity requirements as there may be only a limited market in which to sell or otherwise dispose of our common stock, and whether the investment is permissible under the plan's governing instrument. We have not, and will not, evaluate whether an investment in our common stock or Series C preferred stock is suitable for any particular plan.

Risks Related to Our Common Stock

We could be exposed to substantial liabilities for events or circumstances that predate the consummation of our initial public offering.

In connection with the formation and structuring transactions consummated at the time of our initial public offering, we assumed the liabilities (known and unknown) associated with certain properties and entities contributed to us in connection with those formation and structuring transactions. In addition, in connection with IHR's agreement to purchase the corporate subsidiary of Sunstone Hotel Investors, LLC that managed certain of our hotels and employed the employees of such hotels, IHR required that we indemnify it from any liabilities of the corporate subsidiary that accrued prior to the consummation of our initial public offering. These potential liabilities may include, without limitation, liabilities associated with the employees who currently work or previously worked for the corporate subsidiary. At this time, we are not aware of, or able to quantify, any potential liabilities which may arise as a result of our acquisition of the hotel properties and entities in these formation and structuring transactions or the indemnification of IHR. Any such claims could give rise to economic liabilities which could be substantial and for which we would have no recourse. If any such liability is established against us, our financial condition could be harmed.

The market price of our equity securities may vary substantially.

The trading prices of equity securities issued by REITs may be affected by changes in market interest rates and other factors. During 2010, our stock price fluctuated from a low of \$8.14 to a high of \$13.42. One of the factors that may influence the price of our common stock or preferred stock in public trading markets is the annual yield from distributions on our common stock or preferred stock, if any, as compared to yields on other financial instruments. An increase in market interest rates, or a decrease in our distributions to stockholders, may lead prospective purchasers of our stock to demand a higher annual yield, which could reduce the market price of our equity securities.

In addition to the risk factors discussed, other factors that could affect the market price of our equity securities include the following:

- a prolonged U.S. recession impacting the market for common equity generally;

- actual or anticipated variations in our quarterly or annual results of operations;
- changes in market valuations of companies in the hotel or real estate industries;
- changes in expectations of our future financial performance or changes in our estimates by securities analysts;
- the trading volumes of our stock;
- additional issuances of our common stock or other securities, including the issuance of our preferred stock, in the foreseeable future;
- the addition or departure of board members;
- disputes with any of our hotel operators; and
- announcements by us or our competitors of acquisitions, investments or strategic alliances.

Our distributions to stockholders may vary.

We paid a quarterly cash dividend of \$0.50 per share of Series A cumulative redeemable preferred stock, or the Series A preferred stock, and a quarterly cash dividend of \$0.393 per share of Series C preferred stock in each of January, April, July and October 2010. In October 2010, our board of directors authorized the payment of a quarterly cash dividend of \$0.50 per share of Series A preferred stock, and a quarterly cash dividend of \$0.393 per share of Series C preferred stock. We paid such dividends in January 2011. Distributions will be authorized and determined by our board of directors in its sole discretion from time to time and will be dependent upon a number of factors, including projected taxable income, restrictions under applicable law and our capital requirements. In addition, our Series C preferred stock contains covenants that may restrict us from paying dividends or making distributions. Consequently, our dividends may fluctuate or may be eliminated depending on changes in our operations.

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Distributions on our common stock may be made in the form of cash, stock, or a combination of both.

As a REIT, we are required to distribute at least 90% of our taxable income to our stockholders. Typically, we generate cash for distributions through our operations, the disposition of assets, or the incurrence of additional debt. We have elected in the past, and may elect in the future, to pay dividends on our common stock in cash, shares of common stock or a combination of cash and shares of common stock. The Internal Revenue Service issued Revenue Procedure 2009-15 which provided guidance stating that certain stock distributions made by REITs and declared with respect to taxable years of REITs ending on or before December 31, 2009 would qualify for the dividends paid deduction. To satisfy the conditions of Revenue Procedure 2009-15, we would be required to, among other things, provide each stockholder the opportunity to elect to receive its distribution in either cash or stock, and any limitation on the aggregate amount of cash distributed must not be less than 10% of the aggregate value of the distribution. Revenue Procedure 2009-15 expires on December 31, 2011, and any extension of those provisions is uncertain. If we elect to pay subsequent dividends on our common stock in cash, shares of common stock or a combination of cash and shares of common stock, we would do so only after obtaining prior approval from the Internal Revenue Service. Changes in our dividend policy could adversely affect the price of our stock.

Shares of our common stock that are or become available for sale could affect the share price.

Sales of a substantial number of shares of our common stock, or the perception that sales could occur, could adversely affect prevailing market prices for our common stock. In addition, a substantial number of shares of our common stock have been and will be issued or reserved for issuance from time to time under our employee benefit plans or pursuant to securities we may issue that are convertible into shares of our common stock or securities that are exchangeable for shares of our common stock. As of December 31, 2010, the Operating Partnership had \$62.5 million outstanding in aggregate principal amount of Senior Notes exchangeable under certain conditions for shares of our common stock at an exchange rate equal to 32.9179 shares of our common stock for each \$1,000 principal amount of notes (which equates to an exchange price of \$30.38 per share) for a total of approximately 2.1 million shares. The exchange rate is subject to further adjustment for various reasons, including as a result of the payment of dividends to common stockholders.

Our earnings and cash distributions will affect the market price of shares of our common stock.

We believe that the market value of a REIT's equity securities is based primarily on the value of the REIT's owned real estate, capital structure, debt levels and perception of the REIT's growth potential and its current and potential future cash distributions, whether from operations, sales, acquisitions, development or refinancings. Because our market value is based on a combination of factors, shares of our common stock may trade at prices that are higher or lower than the net value per share of our underlying assets. To the extent we retain operating cash flow for investment purposes, working capital reserves or other purposes rather than distributing the cash flow to stockholders, these retained funds, while increasing the value of our underlying assets, may negatively impact the market price of our common stock. Our failure to meet the market's expectation with regard to future earnings and cash distributions would likely adversely affect the market price of our common stock.

Our dividend policy and market interest rates may affect the price of shares of our common stock.

We have not paid a dividend on our common stock since January 2009. We believe that investors consider the relationship of dividend yield to market interest rates to be an important factor in deciding whether to buy or sell shares of a REIT. If market interest rates increase, prospective

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purchasers of REIT shares may expect a higher dividend rate. Thus, higher market interest rates, the absence of dividends or changes in our dividend rate in the future could cause the market price of our shares to decrease.

Item 1B. Unresolved Staff Comments

None.

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The following table sets forth additional summary information with respect to our hotels as of December 31, 2010:

Hotel	City	State	Chain Scale Segment(1)	Service Category	Rooms	Manager
Marriott	Boston	Massachusetts	Upper Upscale	Full Service	412	Marriott
Marriott	Del Mar	California	Upper Upscale	Full Service	284	Marriott
Marriott	Houston	Texas	Upper Upscale	Full Service	390	IHR
Marriott	Park City	Utah	Upper Upscale	Full Service	199	IHR
Marriott	Philadelphia	Pennsylvania	Upper Upscale	Full Service	289	Marriott
Marriott	Portland	Oregon	Upper Upscale	Full Service	249	IHR
Marriott	Quincy	Massachusetts	Upper Upscale	Full Service	464	Marriott
Marriott	Rochester	Minnesota	Upper Upscale	Full Service	203	IHR
Marriott	Troy	Michigan	Upper Upscale	Full Service	350	Marriott
Marriott	Tysons Corner	Virginia	Upper Upscale	Full Service	396	Marriott
Courtyard by Marriott (2)	Los Angeles	California	Upscale	Select Service	179	IHR
Renaissance Harborplace (2)	Baltimore	Maryland	Upper Upscale	Full Service	622	Marriott
Renaissance Los Angeles Airport	Los Angeles	California	Upper Upscale	Full Service	499	Marriott
Renaissance Long Beach	Long Beach	California	Upper Upscale	Full Service	374	Marriott
Renaissance Orlando at SeaWorld® (3)	Orlando	Florida	Upper Upscale	Full Service	781	Marriott
Renaissance Washington D.C.	Washington, D.C.	District of Columbia	Upper Upscale	Full Service	807	Marriott
Renaissance Westchester	White Plains	New York	Upper Upscale	Full Service	347	Marriott
Residence Inn by Marriott	Rochester	Minnesota	Upscale	Extended Stay	89	IHR
Fairmont (2)	Newport Beach	California	Luxury	Full Service	444	Fairmont
Hilton	Del Mar	California	Upper Upscale	Full Service	257	Sage
Hilton	Houston	Texas	Upper Upscale	Full Service	480	IHR
Hilton (2)	Times Square	New York	Upper Upscale	Full Service	460	IHR
Doubletree	Minneapolis	Minnesota	Upscale	Full Service	229	IHR
Embassy Suites	Chicago	Illinois	Upper Upscale	Full Service	367	Davidson
Embassy Suites	La Jolla	California	Upper Upscale	Full Service	340	Hilton
Hyatt Regency (2)	Newport Beach	California	Upper Upscale	Full Service	403	Hyatt
Sheraton (2)	Cerritos	California	Upper Upscale	Full Service	203	IHR
Independent Kahler Inn & Suites	Rochester	Minnesota	Upper Midscale	Extended Stay	271	IHR
Independent Royal Palm	Miami Beach	Florida	Upscale	Full Service	409	Denihan
Independent The Kahler Grand	Rochester	Minnesota	Upscale	Full Service	668	IHR
Independent Valley River Inn	Eugene	Oregon	Upscale	Full Service	257	IHR
Total number of rooms					11,722	

(1) As defined by Smith Travel Research.

(2) Subject to a ground or air lease with an unaffiliated third party.

(3) 85% ownership interest.

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In addition to the hotel properties listed above, as of December 31, 2010, we also have a 38% equity interest in a joint venture that owns the 460-room Doubletree Guest Suites Times Square, located in New York City, New York. We also own an 88,000 square foot commercial laundry facility in Rochester, Minnesota and lease a 65,000 square foot commercial laundry facility in Salt Lake City, Utah. The commercial laundry facility in Rochester, Minnesota services our hotels in the area, as well as the Mayo Clinic and other surrounding hospitals and businesses. The commercial laundry facility in Salt Lake City, Utah services our hotels in the area, as well as third party contracts. In addition, we own one undeveloped parcel of land in Craig, Colorado and an office building in Troy, Michigan.

In January 2011, we purchased the outside 62% equity interests in our Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the hotel.

Geographic Diversity

We own a geographically diverse portfolio of hotels located in 13 states and in Washington, D.C. The following tables summarize the 31 hotels by region as of December 31, 2010, and the operating statistics by region for 2010, 2009 and 2008 (operating statistics may include periods prior to when we acquired or reacquired our interest in the hotels):

Region	Number of Hotels	Number of Rooms	Percentage of 2010
			Revenues
California (1)	9	2,983	24.3%
Other West(2)	5	1,575	9.9%
Midwest (3)	7	2,177	14.2%
East (4)	10	4,987	51.6%
Total	31	11,722	100.0%

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Region	2010			2009			2008		
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
California (1)	75.0%	\$ 124.37	\$ 93.28	72.5%	\$ 125.45	\$ 90.95	78.6%	\$ 148.12	\$ 116.42
Other West(2)	62.7%	\$ 111.86	\$ 70.14	66.7%	\$ 115.58	\$ 77.09	78.2%	\$ 123.34	\$ 96.45
Midwest (3)	64.5%	\$ 131.76	\$ 84.99	64.7%	\$ 126.54	\$ 81.87	67.0%	\$ 146.80	\$ 98.36
East (4)	70.6%	\$ 182.26	\$ 128.68	69.2%	\$ 178.67	\$ 123.64	73.2%	\$ 204.31	\$ 149.55
Weighted Average	69.6%	\$ 149.11	\$ 103.78	68.9%	\$ 147.09	\$ 101.35	74.1%	\$ 168.12	\$ 124.58
Year-over-year change	70bps	1.4%	2.4%	(520)bps	(12.5)%	(18.6)%	NA	NA	NA

-
- (1) All of these hotels are located in Southern California.
 - (2) Includes Oregon, Texas and Utah.
 - (3) Includes Illinois, Michigan and Minnesota.
 - (4) Includes Florida, Maryland, Massachusetts, New York, Pennsylvania, Virginia and Washington, D.C.

Item 3. Legal Proceedings

We are involved from time to time in various claims and other legal actions in the ordinary course of business. We do not believe that the resolution of any pending legal matters will have a material adverse effect on our financial position or results of operations when resolved.

Item 4. Removed and Reserved

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the NYSE under the symbol SHO. On February 11, 2011, the last reported price per share of common stock on the NYSE was \$10.61. The table below sets forth the high and low closing price per share of our common stock as reported on the NYSE and the cash dividends per share of common stock we declared with respect to each period.

	High	Low	Dividends Declared	
2009:				
First Quarter	\$ 5.95	\$ 1.99	\$	0.00
Second Quarter	\$ 7.61	\$ 2.50	\$	0.00
Third Quarter	\$ 7.61	\$ 4.37	\$	0.00
Fourth Quarter	\$ 9.03	\$ 6.95	\$	0.00
2010:				
First Quarter	\$ 11.18	\$ 8.14	\$	0.00
Second Quarter	\$ 13.42	\$ 9.86	\$	0.00
Third Quarter	\$ 10.95	\$ 8.27	\$	0.00
Fourth Quarter	\$ 10.93	\$ 9.33	\$	0.00

We may pay quarterly cash dividends to common stockholders at the discretion of our Board of Directors. The amount of each quarterly cash dividend, if any, depends on our funds from operations, financial condition and capital requirements, annual distribution requirements under the REIT provisions of the Code and such other factors our Board of Directors deems relevant. We have elected in the past, and may elect in the future, to pay dividends on our common stock in cash, or a combination of cash and shares of common stock pursuant to Revenue Procedure 2009-15. The Company intends to maintain its annual common dividend payouts at a level approximating 100% of taxable income.

As of February 11, 2011, we had approximately 29 holders of record of our common stock. In order to comply with certain requirements related to our qualification as a REIT, our charter limits the number of common shares that may be owned by any single person or affiliated group to 9.8% of the outstanding common shares, subject to the ability of our board to waive this limitation under certain conditions.

Information relating to compensation plans under which our equity securities are authorized for issuance is set forth in Part III, Item 12 of this Annual Report on Form 10-K.

Fourth Quarter 2010 Purchases of Equity Securities:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly	Maximum Number (or Appropriate Dollar Value) of Shares that

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			Announced Plans or Programs	May Yet Be Purchased Under the Plans or Programs
October 1, 2010	October 31, 2010		\$	\$
November 1, 2010				
November 30, 2010			\$	\$
December 1, 2010	December 31, 2010	101,280	\$ 10.48	\$
Total		101,280		

Item 6. Selected Financial Data

The following table sets forth selected financial information for the Company that has been derived from the consolidated financial statements and notes. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

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	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
Operating Data (\$ in thousands):					
Revenues:					
Room	\$ 428,412	\$ 408,150	\$ 504,104	\$ 492,240	\$ 380,839
Food and beverage	164,378	161,963	201,952	199,831	156,117
Other operating	50,300	53,744	59,140	53,686	42,284
Total revenues	643,090	623,857	765,196	745,757	579,240
Operating expenses:					
Room	109,935	101,780	113,987	109,902	86,922
Food and beverage	120,650	118,629	145,576	144,518	111,204
Other operating	26,871	26,916	29,823	29,755	26,545
Advertising and promotion	33,182	32,295	35,676	34,619	27,576
Repairs and maintenance	28,049	27,360	29,579	27,769	23,372
Utilities	25,232	24,895	28,731	25,840	21,858
Franchise costs	21,474	20,656	24,658	23,770	19,051
Property tax, ground lease and insurance	42,349	43,352	44,993	43,791	39,858
Property general and administrative	77,101	72,823	86,797	86,055	69,395
Corporate overhead	28,803	25,242	21,511	27,849	18,640
Depreciation and amortization	95,500	93,795	93,759	89,925	65,238
Property and goodwill impairment losses	1,943	30,852	57		
Total operating expenses	611,089	618,595	655,147	643,793	509,659
Operating income	32,001	5,262	110,049	101,964	69,581
Equity in net earnings (losses) of					
unconsolidated joint ventures	555	(27,801)	(1,445)	(3,588)	140
Interest and other income	111	1,388	3,639	8,880	4,074
Interest expense	(70,830)	(76,539)	(83,176)	(77,463)	(54,702)
Gain (loss) on extinguishment of debt		54,506		(417)	(9,976)
Income (loss) from continuing operations	(38,163)	(43,184)	29,067	29,376	9,117
Income (loss) from discontinued operations	76,705	(226,424)	42,171	94,500	44,120
Net income (loss)	38,542	(269,608)	71,238	123,876	53,237
Dividends paid on unvested restricted stock					
compensation		(447)	(814)	(1,007)	(856)
Preferred stock dividends and accretion	(20,652)	(20,749)	(20,884)	(20,795)	(19,616)
Undistributed income allocated to unvested					
restricted stock compensation	(102)			(222)	
Undistributed income allocated to Series C					
preferred stock				(1,397)	
Income available (loss attributable) to					
common stockholders	\$ 17,788	\$ (290,804)	\$ 49,540	\$ 100,455	\$ 32,765
Income (loss) from continuing operations					
available (attributable) to common					
stockholders per diluted common share	\$ (0.59)	\$ (0.92)	\$ 0.14	\$ 0.10	\$ (0.20)
Cash dividends declared per common share					
(1)	\$ 0.00	\$ 0.00	\$ 1.20	\$ 1.31	\$ 1.22
Balance sheet data (\$ in thousands):					
Investment in hotel properties, net	\$ 2,034,223	\$ 1,923,392	\$ 2,004,914	\$ 2,002,329	\$ 1,696,885
Total assets	\$ 2,436,106	\$ 2,513,530	\$ 2,805,611	\$ 3,049,152	\$ 2,760,373
Total debt (2)	\$ 1,143,303	\$ 1,203,797	\$ 1,389,783	\$ 1,394,904	\$ 1,170,778
Total liabilities	\$ 1,236,807	\$ 1,526,867	\$ 1,791,103	\$ 1,836,894	\$ 1,624,583
Equity	\$ 1,099,299	\$ 886,767	\$ 914,812	\$ 1,112,762	\$ 1,036,494

(1) Does not include non-cash common stock dividend of \$0.60 per share declared in 2008.

- (2) Does not include debt which has been reclassified to discontinued operations.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report.

Overview

Sunstone Hotel Investors, Inc. is a Maryland corporation. We operate as a self-managed and self-administered real estate investment trust, or REIT. A REIT is a legal entity that directly or indirectly owns real estate assets. REITs generally are not subject to federal income taxes at the corporate level as long as they pay stockholder dividends equivalent to 100% of their taxable income. REITs are required to distribute to stockholders at least 90% of their taxable income. We own, directly or indirectly, 100% of the interests of Sunstone Hotel Partnership, LLC (the Operating Partnership), which is the entity that directly or indirectly owns our hotel properties. We also own 100% of the interests of our taxable REIT subsidiary, Sunstone Hotel TRS Lessee, Inc., which leases all of our hotels from the Operating Partnership, and engages third parties to manage our hotels. In addition, as of December 31, 2010, we owned 50% of BuyEfficient, LLC (BuyEfficient), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment. In January 2011, we purchased the outside 50% share in BuyEfficient for \$8.6 million, and as a result, we are now the sole owner of BuyEfficient.

We own primarily upper upscale and upscale hotels in the United States. As of December 31, 2010, we owned 31 hotels (the 31 hotels). Of the 31 hotels, we classify 29 as upscale or upper upscale, one as luxury and one as upper midscale as defined by Smith Travel Research, Inc. In addition to our wholly owned hotels, as of December 31, 2010, we owned a 38% equity interest in a joint venture that owns the Doubletree Guest Suites Times Square in New York, and we owned other non-hotel investments. In January 2011, we purchased the outside 62% equity interests in the Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million. As a result, we are now the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square. The majority of our hotels are operated under nationally recognized brands such as Marriott, Fairmont, Hilton and Hyatt, which are among the most respected and widely recognized brands in the lodging industry. While we believe the largest and most stable segment of demand for hotel rooms is represented by travelers who prefer the consistent service and quality associated with nationally recognized brands, we also believe that in certain markets the strongest demand growth may come from travelers who prefer non-branded hotels that focus on highly customized service standards.

We seek to own hotels in urban locations that benefit from significant barriers to entry by competitors. Most of our hotels are considered business, convention, or airport hotels, as opposed to resort, leisure or extended-stay hotels. The hotels comprising our 31 hotel portfolio average 378 rooms in size.

The demand for lodging generally fluctuates with the overall economy. We refer to these changes in demand as the lodging cycle, and we seek to employ a cycle-appropriate portfolio management strategy. During the recovery and growth phases of the lodging cycle, our strategy emphasizes active investment, both in terms of acquisitions of new hotels and selective renovations of our existing portfolio, while also balancing our liquidity and leverage policies. During the mature phase of the lodging cycle, our strategy emphasizes net hotel dispositions, and during cyclical declines, our strategy emphasizes capital preservation.

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Through all phases of the lodging cycle, we seek to maximize the value of our portfolio through proactive asset management, which entails working closely with our third party hotel operators to develop plans and actions designed to enhance revenues, minimize operational expenses and maximize the appeal of our hotels to travelers.

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During 2010, we began to see improving business and consumer sentiment, which may point to an impending economic recovery, and which may lead to a period of positive fundamentals in the lodging industry. Accordingly, we believe we are currently in the early stages of a recovery phase of the lodging cycle. Consistent with our cycle-appropriate strategy, we believe that acquiring hotels now may likely create long-term value, and we expect to deploy a portion of our cash balance in 2011 towards selective hotel acquisitions. During 2010, we selectively deployed a portion of our cash to fund certain transactions such as the purchase of two hotel loans for \$4.0 million, which had a combined principal amount of \$35.0 million, and the acquisition of the Royal Palm Miami Beach for a net purchase price of \$117.6 million, excluding transaction costs. Our acquisition program is aimed at generating attractive returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. We intend to select the brands and operators for our hotels that we believe will lead to the highest returns. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans. Future acquisitions may be funded by our issuance of additional debt or equity securities, including our common and preferred OP units, or by draws on our \$150.0 million senior corporate credit facility entered into in November 2010.

Consistent with our cycle-appropriate strategy, during 2010, we issued 19,500,000 shares of our common stock. Net proceeds from this offering of approximately \$190.6 million were contributed to our subsidiary, Sunstone Hotel Partnership LLC, which will use the proceeds for growth capital expenditures, future acquisitions and other general corporate purposes, including working capital.

As of December 31, 2010, the weighted average term to maturity of our debt is approximately 7 years, and 100% of our debt is fixed rate with a weighted average interest rate of 5.5%. Of our total debt, approximately \$98.3 million matures over the next four years (none in 2011, \$33.3 million in 2012, \$65.0 million in 2013, assuming we repay our Senior Notes remaining balance of \$62.5 million at the first put date in 2013 and none in 2014). The \$98.3 million does not include \$14.8 million of scheduled loan amortization payments due in 2011, \$17.0 million due in 2012, \$18.1 million due in 2013, or \$19.1 million due in 2014. In January 2011, we purchased the outside 62% equity interests in our Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The hotel is encumbered by approximately \$270.0 million of non-recourse senior mortgage and mezzanine debt that matures in January 2012 and bears a blended interest rate of LIBOR + 115 basis points. We expect to refinance this debt during 2011 and intend to fund any refinancing shortfalls with existing cash.

Operating Activities

Operating Performance Indicators. The following performance indicators are commonly used in the hotel industry:

- *Occupancy;*

- *Average daily room rate, or ADR;*

- *Revenue per available room, or RevPAR, which is the product of occupancy and ADR, and does not include food and beverage revenue, or other operating revenue;*

- *Comparable RevPAR*, which we define as the RevPAR generated by hotels we owned as of the end of the reporting period, but excluding those hotels that experienced material and prolonged business interruption due to renovations, re-branding or property damage during either the most recent calendar year presented or the calendar year immediately preceding it. For hotels that were not owned for the entirety of the comparison periods, comparable RevPAR is calculated using RevPAR generated during periods of prior ownership. We refer to this subset of our hotels used to calculate comparable RevPAR as our Comparable Portfolio. Currently our Comparable Portfolio includes all 31 hotels except the Royal Palm Miami Beach, which is undergoing renovation and repositioning that began in 2010. Our Comparable Portfolio also includes operating results for the Renaissance Westchester for all periods presented, including the period in 2010 while it was held in receivership;
- *RevPAR index*, which is the quotient of a hotel's RevPAR divided by the average RevPAR of its competitors, multiplied by 100. A RevPAR index in excess of 100 indicates a hotel is achieving higher RevPAR than its competitors. In addition to absolute RevPAR index, we monitor changes in RevPAR index;
- *EBITDA*, which is income available (loss attributable) to common stockholders excluding: preferred stock dividends; interest expense (including prepayment penalties, if any); provision for income taxes, including income taxes applicable to sale of assets; and depreciation and amortization;
- *Adjusted EBITDA*, which includes EBITDA but excludes: amortization of deferred stock compensation; the impact of any gain or loss from asset sales; impairment charges; and any other identified adjustments;
- *Funds from operations*, or FFO, which includes income available (loss attributable) to common stockholders, excluding gains and losses from sales of property, plus real estate-related depreciation and amortization (excluding amortization of deferred financing costs), and after adjustment for unconsolidated partnerships and joint ventures; and

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- *Adjusted FFO*, which includes FFO but excludes prepayment penalties, written-off deferred financing costs, impairment losses and other identified adjustments.

Revenues. Substantially all of our revenues are derived from the operation of our hotels. Specifically, our revenues consist of the following:

- *Room revenue*, which is the product of the number of rooms sold and the ADR;
- *Food and beverage revenue*, which is comprised of revenue realized in the hotel food and beverage outlets as well as banquet and catering events; and
- *Other operating revenue*, which includes ancillary hotel revenue such as performance guaranties, if any, and other items primarily driven by occupancy such as telephone, transportation, parking, spa, entertainment and other guest services. Additionally, this category includes, among other things, operating revenue from our two commercial laundry facilities located in Rochester, Minnesota and Salt Lake City, Utah, as well as hotel space leased by third parties.

Expenses. Our expenses consist of the following:

- *Room expense*, which is primarily driven by occupancy and, therefore, has a significant correlation with room revenues;
- *Food and beverage expense*, which is primarily driven by food and beverage sales and banquet and catering bookings and, therefore, has a significant correlation with food and beverage revenues;
- *Other operating expense*, which includes the corresponding expense of other operating revenue, advertising and promotion, repairs and maintenance, utilities, and franchise costs;
- *Property tax, ground lease and insurance expense*, which includes the expenses associated with property tax, ground lease and insurance payments, each of which is primarily a fixed expense, but property tax is subject to regular revaluations based on the specific tax regulations and practices of each municipality;

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- *Property general and administrative expense*, which includes our property-level general and administrative expenses, such as payroll and related costs, professional fees, travel expenses, and management fees;
- *Corporate overhead expense*, which includes our corporate-level expenses, such as payroll and related costs, amortization of deferred stock compensation, severance expense, acquisition and due diligence costs, professional fees, travel expenses and office rent;
- *Depreciation and amortization expense*, which includes depreciation on our hotel buildings, improvements, furniture, fixtures and equipment, along with amortization on our franchise fees and intangibles; and
- *Property and goodwill impairment losses expense*, which includes the charges we have recognized to reduce the carrying value of assets on our balance sheets to their fair value and to write-off goodwill in association with our impairment evaluations.

Other Revenue and Expense. Other revenue and expense consists of the following:

- *Equity in net earnings (losses) of unconsolidated joint ventures*, which includes our portion of net earnings or losses from our joint ventures;
- *Interest and other income*, which includes interest we have earned on our restricted and unrestricted cash accounts, as well as any gains or losses we have recognized on sales of assets other than hotels;
- *Interest expense*, which includes interest expense incurred on our outstanding debt, accretion of the Senior Notes, amortization of deferred financing fees, any write-offs of deferred financing fees, and any loan penalties and fees incurred on our debt;
- *Gain on extinguishment of debt*, which includes the gain we recognized on the repurchase and cancellation of the Senior Notes;
- *Dividends paid on unvested restricted stock compensation*, which includes dividends earned on our unvested restricted stock awards; and,
- *Preferred stock dividends and accretion*, which includes dividends earned on our 8.0% Series A Cumulative Redeemable Preferred Stock (Series A preferred stock) and Series C Cumulative Convertible Redeemable Preferred Stock (Series C preferred stock) and redemption value accretion on our Series C preferred stock.

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Factors Affecting Our Operating Results. The primary factors affecting our operating results include overall demand for hotel rooms, the pace of new hotel development, or supply, and the relative performance of our operators in increasing revenue and controlling hotel operating expenses.

- **Demand.** The demand for lodging generally fluctuates with the overall economy. In 2010, following a two-year cyclical trough, we began to see signs of improving demand trends, and Comparable Portfolio RevPAR increased 2.6% as compared to 2009. Consistent with prior trends, we anticipate that lodging demand will continue to improve as the U.S. economy continues to strengthen. Historically, cyclical troughs are followed by extended periods of relatively strong demand, resulting in a cyclical lodging growth phase. We expect hotel demand to strengthen in 2011.
- **Supply.** The addition of new competitive hotels affects the ability of existing hotels to drive RevPAR and profits. The development of new hotels is largely driven by construction costs and expected performance of existing hotels. The recession and credit crisis which occurred in 2008 and 2009 served to restrict credit and tighten lending standards, which resulted in a meaningful curtailment of funding for new hotel construction projects. Moreover, with demand still meaningfully below peak levels, new supply in many markets is difficult to justify economically. Accordingly, we believe hotel development will be constrained until operating trends of existing hotels improve to levels where developer return targets can be achieved, and until the construction financing markets recover. Given the one to three year timeline needed to construct a typical hotel, we expect a window of at least two to four years during which hotel supply, as indicated by the number of new hotel openings, will be below historical levels.
- **Revenues and expenses.** We believe that marginal improvements in RevPAR index, even in the face of declining revenues, are a good indicator of the relative quality and appeal of our hotels, and our operators' effectiveness in maximizing revenues. Similarly, we also evaluate our operators' effectiveness in minimizing incremental operating expenses in the context of increasing revenues or, conversely, in reducing operating expenses in the context of declining revenues.

With respect to improving RevPAR index, we continue to work with our hotel operators to optimize revenue management initiatives while taking into consideration market demand trends and the pricing strategies of competitor hotels in our markets. We also develop capital investment programs designed to ensure each of our hotels is well renovated and positioned to appeal to groups and individual travelers fitting target guest profiles. Our revenue management initiatives are generally oriented towards maximizing ADR even if the result may be lower occupancy than may be achieved through lower ADR, as increases in RevPAR attributable to increases in ADR may be accompanied by minimal additional expenses, while increases in RevPAR attributable to higher occupancy may result in higher variable expenses such as housekeeping, labor and utilities expense. Thus, increases in RevPAR associated with higher ADR may result in higher hotel EBITDA margins. Increases in RevPAR associated with higher occupancy may result in less EBITDA margin improvement.

With respect to maximizing operational flow through, we continue to work with our operators to identify operational efficiencies designed to reduce expenses while minimally affecting guest experience. Key asset management initiatives include reducing hotel staffing levels, increasing the efficiency of the hotels, such as installing energy efficient management and inventory control systems, and selectively combining certain food and beverage outlets. Our operational efficiency initiatives may be difficult to implement, as most categories of variable operating expenses, such as utilities and certain labor costs, such as housekeeping, fluctuate with changes in occupancy. Furthermore, our hotels operate with significant fixed costs, such as general and administrative expense, insurance, property taxes, and other expenses associated with owning hotels, over which our operators may have little control. We have experienced increases in hourly wages, employee benefits (especially health insurance) and utility costs, which have negatively affected our operating margins. Moreover, there are limits to how far our operators can reduce expenses without adversely affecting the competitiveness of our hotels.

Operating Results. The following table presents our operating results for our total portfolio for 2010 and 2009, including the amount and percentage change in the results between the two periods. The table presents the results of operations included in the consolidated statements of operations, and includes the 31 hotels (11,722 rooms) as of December 31, 2010 and 29 hotels (10,966 rooms) as of December 31, 2009. Income from discontinued operations for 2010 includes: the results of operations and the gain on extinguishment of debt for the eight hotels which secured the non-recourse mortgage with Massachusetts Mutual Life Insurance Company (the Mass Mutual eight hotels: Renaissance Atlanta Concourse; Hilton Huntington; Residence Inn by Marriott Manhattan Beach; Marriott Provo; Courtyard by Marriott San Diego (Old Town); Holiday Inn Downtown San Diego; Holiday Inn Express San Diego (Old Town); and Marriott Salt Lake City (University Park)), which were deeded back to the lender in November 2010 pursuant to our 2009 secured debt restructuring program; the results of operations and the gain on extinguishment of debt for the Marriott Ontario Airport, which was sold by the receiver in August 2010 pursuant to our 2009 secured debt restructuring program; the gain on extinguishment of debt for the W San Diego, which was deeded back to the lender in July 2010 pursuant to our 2009 secured debt restructuring program; and the gain on extinguishment of debt for the Renaissance Westchester, which we reacquired in June 2010. Loss from discontinued operations for 2009 includes the results of operations for the Marriott Napa Valley,

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Marriott Riverside, and Hyatt Suites Atlanta Northwest which were sold in 2009, as well as the Mass Mutual eight hotels, Marriott Ontario Airport, W San Diego, and Renaissance Westchester which have been deconsolidated from our operations due to the deed backs and title transfers noted above. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

	2010	2009	Change \$	Change %
	(dollars in thousands, except statistical data)			
REVENUES				
Room	\$ 428,412	\$ 408,150	\$ 20,262	5.0%
Food and beverage	164,378	161,963	2,415	1.5%
Other operating	50,300	53,744	(3,444)	(6.4)%
Total revenues	643,090	623,857	19,233	3.1%
OPERATING EXPENSES				
Hotel operating	407,742	395,883	11,859	3.0%
Property general and administrative	77,101	72,823	4,278	5.9%
Corporate overhead	28,803	25,242	3,561	14.1%
Depreciation and amortization	95,500	93,795	1,705	1.8%
Property and goodwill impairment losses	1,943	30,852	(28,909)	(93.7)%
Total operating expenses	611,089	618,595	(7,506)	(1.2)%
Operating income	32,001	5,262	26,739	508.2%
Equity in net earnings (losses) of unconsolidated joint ventures	555	(27,801)	28,356	102.0%
Interest and other income	111	1,388	(1,277)	(92.0)%
Interest expense	(70,830)	(76,539)	5,709	7.5%
Gain on extinguishment of debt		54,506	(54,506)	(100.0)%
Loss from continuing operations	(38,163)	(43,184)	5,021	11.6%
Income (loss) from discontinued operations	76,705	(226,424)	303,129	133.9%
Net income (loss)	38,542	(269,608)	308,150	114.3%
Dividends paid on unvested restricted stock compensation		(447)	447	100.0%
Preferred stock dividends and accretion	(20,652)	(20,749)	97	0.5%
Undistributed income allocated to unvested restricted stock compensation	(102)		(102)	(100.0)%
Income available (loss attributable) to common stockholders	\$ 17,788	\$ (290,804)	\$ 308,592	106.1%

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The following table presents our operating results for our total portfolio for 2009 and 2008, including the amount and percentage change in the results between the two periods. The table presents the results of operations included in the consolidated statements of operations, and includes the 29 hotels (10,966 rooms) as of December 31, 2009 and 2008. Loss from discontinued operations for 2009 includes the results of operations for the Marriott Napa Valley, Marriott Riverside, and Hyatt Suites Atlanta Northwest which were sold in 2009, as well as the Mass Mutual eight hotels deeded back to the lender in November 2010, Marriott Ontario Airport sold by the receiver in August 2010, W San Diego deeded back to the lender in July 2010, and Renaissance Westchester reacquired by the Company in June 2010. Income from discontinued operations for 2008 includes the results of operations for the Hyatt Regency Century Plaza and Crowne Plaza Grand Rapids which were sold in 2008, the results of operations for the Marriott Napa Valley, Marriott Riverside and Hyatt Suites Atlanta Northwest which were sold in 2009, as well as the Mass Mutual eight hotels, Marriott Ontario Airport, W San Diego, and Renaissance Westchester which have been deconsolidated from our operations due to the deed backs and title transfers noted above. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

	2009	2008	Change \$	Change %
	(dollars in thousands, except statistical data)			
REVENUES				
Room	\$ 408,150	\$ 504,104	\$ (95,954)	(19.0)%
Food and beverage	161,963	201,952	(39,989)	(19.8)%
Other operating	53,744	59,140	(5,396)	(9.1)%
Total revenues	623,857	765,196	(141,339)	(18.5)%
OPERATING EXPENSES				
Hotel operating	395,883	453,023	(57,140)	(12.6)%
Property general and administrative	72,823	86,797	(13,974)	(16.1)%
Corporate overhead	25,242	21,511	3,731	17.3%
Depreciation and amortization	93,795	93,759	36	0.0%
Property and goodwill impairment losses	30,852	57	30,795	54,026.3%
Total operating expenses	618,595	655,147	(36,552)	(5.6)%
Operating income	5,262	110,049	(104,787)	(95.2)%
Equity in net losses of unconsolidated joint ventures	(27,801)	(1,445)	(26,356)	(1,823.9)%
Interest and other income	1,388	3,639	(2,251)	(61.9)%
Interest expense	(76,539)	(83,176)	6,637	8.0%
Gain on extinguishment of debt	54,506		54,506	100.0%
Income (loss) from continuing operations	(43,184)	29,067	(72,251)	(248.6)%
Income (loss) from discontinued operations	(226,424)	42,171	(268,595)	(636.9)%
Net income (loss)	(269,608)	71,238	(340,846)	(478.5)%
Dividends paid on unvested restricted stock compensation	(447)	(814)	367	45.1%
Preferred stock dividends and accretion	(20,749)	(20,884)	135	0.6%
Income available (loss attributable) to common stockholders	\$ (290,804)	\$ 49,540	\$ (340,344)	(687.0)%

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Operating Statistics. Included in the following tables are comparisons of the key operating metrics for our hotel portfolio for the years ended December 31, 2010, 2009 and 2008. The comparisons do not include the results of operations for the three hotels sold in 2009 and the two hotels sold in 2008. The comparisons also do not include the W San Diego and the Mass Mutual eight hotels which were deeded back to their respective lenders in 2010, or the Marriott Ontario Airport which was sold by the receiver in 2010.

	Occ%	2010 ADR	RevPAR	Occ%	2009 ADR	RevPAR	Occ%	Change ADR	RevPAR
Total Portfolio (31 hotels) (1)	69.6%	\$ 149.11	\$ 103.78	68.9%	\$ 147.09	\$ 101.35	70bps	1.4%	2.4%
Comparable Portfolio (30 hotels) (2)	70.0%	\$ 148.83	\$ 104.18	69.0%	\$ 147.19	\$ 101.56	100bps	1.1%	2.6%
	Occ%	2009 ADR	RevPAR	Occ%	2008 ADR	RevPAR	Occ%	Change ADR	RevPAR
Total Portfolio (31 hotels) (1)	68.9%	\$ 147.09	\$ 101.35	74.1%	\$ 168.12	\$ 124.58	(520)bps	(12.5)%	(18.6)%
Comparable Portfolio (30 hotels) (2)	69.0%	\$ 147.19	\$ 101.56	74.2%	\$ 167.68	\$ 124.42	(520)bps	(12.2)%	(18.4)%

(1) Includes results for the 31 hotels owned by the Company as of December 31, 2010, including the Renaissance Westchester, reacquired by the Company in June 2010, and the Royal Palm Miami Beach, acquired by the Company in August 2010, for all periods presented.

(2) Includes the Company's total portfolio noted above, but excludes the Royal Palm Miami Beach which is undergoing renovation and repositioning beginning in 2010.

Non-GAAP Financial Measures. The following table reconciles income available (loss attributable) to common stockholders to EBITDA and Adjusted EBITDA for our hotel portfolio for the years ended December 31, 2010, 2009 and 2008. We believe EBITDA and Adjusted EBITDA are useful to investors in evaluating our operating performance because these measures help investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest expense and preferred stock dividends) and our asset base (primarily depreciation and amortization) from our operating results. We also use EBITDA and Adjusted EBITDA as measures in determining the value of hotel acquisitions and dispositions. We caution investors that amounts presented in accordance with our definitions of EBITDA and Adjusted EBITDA may not be comparable to similar measures disclosed by other companies, because not all companies calculate these non-GAAP measures in the same manner. EBITDA and Adjusted EBITDA should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. EBITDA and Adjusted EBITDA may include funds that may not be available for our discretionary use to fund interest expense, capital expenditures or general corporate purposes. Although we believe that EBITDA and Adjusted EBITDA can enhance an investor's understanding of our results of operations, these non-GAAP financial measures, when viewed individually, are not necessarily a better indicator of any trend as compared to GAAP measures such as net income (loss) or cash flow from operations. In addition, you should be aware that adverse economic and market conditions may harm our cash flow.

	2010	2009	2008
Income available (loss attributable) to common stockholders	\$ 17,788	\$ (290,804)	\$ 49,540
Dividends paid on unvested restricted stock compensation		447	814
Series A and C preferred stock dividends	20,652	20,749	20,884

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Undistributed income allocated to unvested restricted stock compensation	102		
Operations held for investment:			
Depreciation and amortization	95,500	93,795	93,759
Amortization of lease intangibles	281		
Interest expense	65,457	71,940	78,538
Interest expense default rate	884	472	
Amortization of deferred financing fees	1,597	1,823	1,133
Write-off of deferred financing fees	1,585	284	
Loan penalties and fees	311	207	
Non-cash interest related to discount on Senior Notes	996	1,813	3,505
Unconsolidated joint ventures:			
Depreciation and amortization	52	5,131	5,000
Interest expense		2,614	5,168
Amortization of deferred financing fees		192	1,547
Discontinued operations:			
Depreciation and amortization	5,432	17,265	25,655
Interest expense	8,639	16,941	18,049
Interest expense default rate	7,071	1,407	
Amortization of deferred financing fees	441	566	569
Loan penalties and fees	1,021	3,784	

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EBITDA	227,809	(51,374)	304,161
Operations held for investment:			
Amortization of deferred stock compensation	3,942	4,055	3,975
(Gain) loss on sale of other assets	382	(375)	
Gain on extinguishment of debt		(54,506)	
Impairment loss	1,943	30,852	57
Closing costs Royal Palm Miami Beach acquisition	6,796		
Due diligence costs abandoned project	959		
Costs associated with CEO severance	2,242		
Bad debt expense on corporate note receivable		5,557	
Unconsolidated joint ventures:			
Amortization of deferred stock compensation	32	47	47
Impairment loss		26,007	
Discontinued operations:			
Gain on extinguishment of debt	(86,235)		
(Gain) loss on sale of hotel properties		13,052	(26,013)
Impairment loss		195,293	2,847
	(69,939)	219,982	(19,087)
Adjusted EBITDA	\$ 157,870	\$ 168,608	\$ 285,074

Adjusted EBITDA was \$157.9 million in 2010 as compared to \$168.6 million in 2009 and \$285.1 million in 2008. Adjusted EBITDA decreased in 2010 as compared to 2009 primarily due to decreased operating income from discontinued operations combined with increased costs incurred during 2010 to transition our hotels to new management companies. Adjusted EBITDA decreased in 2009 as compared to 2008 primarily due to decreased earnings at our hotels.

The following table reconciles income available (loss attributable) to common stockholders to FFO and Adjusted FFO for our hotel portfolio for the years ended December 31, 2010, 2009 and 2008. We believe that the presentation of FFO and Adjusted FFO provide useful information to investors regarding our operating performance because they are measures of our operations without regard to specified non-cash items such as real estate depreciation and amortization, gain or loss on sale of assets and certain other items which we believe are not indicative of the performance of our underlying hotel properties. We believe that these items are more representative of our asset base and our acquisition and disposition activities than our ongoing operations. We also use FFO as one measure in determining our results after taking into account the impact of our capital structure. We caution investors that amounts presented in accordance with our definitions of FFO and Adjusted FFO may not be comparable to similar measures disclosed by other companies, because not all companies calculate these non-GAAP measures in the same manner. FFO and Adjusted FFO should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. FFO and Adjusted FFO may include funds that may not be available for our discretionary use to fund interest expense, capital expenditures or general corporate purposes. Although we believe that FFO and Adjusted FFO can enhance an investor's understanding of our results of operations, these non-GAAP financial measures, when viewed individually, are not necessarily a better indicator of any trend as compared to GAAP measures such as net income (loss) or cash flow from operations. In addition, you should be aware that adverse economic and market conditions may harm our cash flow.

	2010	2009	2008
Income available (loss attributable) to common stockholders	\$ 17,788	\$ (290,804)	\$ 49,540
Dividends paid on unvested restricted stock compensation		447	814
Series C preferred stock dividends (1)			6,784
Undistributed income allocated to unvested restricted stock compensation	102		
Operations held for investment:			

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Real estate depreciation and amortization	94,950	93,248	92,953
Amortization of lease intangibles	281		
(Gain) loss on sale of other assets	382	(375)	
Unconsolidated joint ventures:			
Real estate depreciation and amortization		5,060	4,949
Discontinued operations:			
Real estate depreciation and amortization	5,432	17,265	25,655
(Gain) loss on sale of hotel properties		13,052	(26,013)

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Operations held for investment:			
Interest expense default rate	884	472	
Write-off of deferred financing fees	1,585	284	
Loan penalties and fees	311	207	
Gain on extinguishment of debt		(54,506)	
Impairment loss	1,943	30,852	57
Closing costs Royal Palm Miami Beach acquisition	6,796		
Due diligence costs abandoned project	959		
Costs associated with CEO severance	2,242		
Amortization of deferred stock compensation associated with CEO severance	1,074		
Bad debt expense on corporate note receivable		5,557	
Unconsolidated joint ventures:			
Impairment loss		26,007	
Discontinued operations:			
Interest expense default rate	7,071	1,407	
Loan penalties and fees	1,021	3,784	
Gain on extinguishment of debt	(86,235)		
Impairment loss		195,293	2,847
	(62,349)	209,357	2,904

(1) Our Series C preferred stock has been excluded from the calculation of FFO and Adjusted FFO for the years ended December 31, 2010 and 2009 as their inclusion would have been anti-dilutive.

Adjusted FFO was \$56.6 million in 2010 as compared to \$47.3 million in 2009 and \$157.6 million in 2008. Adjusted FFO increased in 2010 as compared to 2009 primarily due to lower interest expense, partially offset by decreased operating income from discontinued operations combined with increased costs incurred during 2010 to transition our hotels to new management companies. Adjusted FFO decreased in 2009 as compared to 2008 primarily due to decreased earnings at our hotels, partially offset by lower interest expense.

Room revenue. Room revenue increased \$20.3 million, or 5.0%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. The results of operations for the Renaissance Westchester are included in continuing operations from the date we reacquired the hotel (June 2010) forward. The 2009 results of operations for the Renaissance Westchester are included in discontinued operations as possession and control of the hotel was held by a court-appointed receiver. In addition, we acquired the Royal Palm Miami Beach hotel in August 2010. Room revenue generated by the Renaissance Westchester and included in continuing operations as well as room revenue generated by the Royal Palm Miami Beach (the new hotels) for 2010 was \$10.3 million. Room revenue generated by the 29 hotels we acquired prior to January 1, 2008 (our existing portfolio) increased \$10.0 million in 2010 as compared to 2009 due to an increase in occupancy (\$5.3 million) combined with an increase in ADR (\$4.7 million).

Room revenue decreased \$96.0 million, or 19.0%, for the year ended December 31, 2009 as compared to the year ended December 31, 2008. Room revenue generated by our existing portfolio decreased in 2009 as compared to 2008 due to a decrease in occupancy (\$26.2 million) combined with a decrease in ADR (\$69.8 million).

Food and beverage revenue. Food and beverage revenue increased \$2.4 million, or 1.5%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Food and beverage revenue generated by the new hotels in 2010 was \$3.8 million. Food and beverage revenue generated from our existing portfolio decreased \$1.4 million in 2010 as compared to 2009. This decrease is primarily due to lower revenues generated in 2010 by our Washington D.C. area hotels, which benefited from the 2009 presidential inauguration. Food and beverage revenue also decreased in 2010 as compared to 2009 due to a reduction in business at our Houston, Texas hotels with one customer who is operating under a contract with the United States government. Additionally, many of our hotels began to consolidate food and beverage outlets during 2009 in order to maximize profitability, which continued into 2010.

Food and beverage revenue decreased \$40.0 million, or 19.8%, for the year ended December 31, 2009 as compared to the year ended December 31, 2008. Food and beverage revenue generated from our existing portfolio decreased in 2009 as compared to 2008 primarily due to declines in occupancy, as well as to a reduction in city-wide conventions and meetings held at our hotels, which caused decreases in banquet, catering, restaurant and room service revenue. Restaurant revenue also decreased in 2009 as compared to 2008 as many of our hotels closed their restaurants during slow periods of the day in order to save costs.

Other operating revenue. Other operating revenue decreased \$3.4 million, or 6.4%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Other operating revenue generated by the new hotels in 2010 was \$0.9 million. Other operating revenue generated by our existing portfolio decreased \$4.3 million in 2010 compared to 2009. A substantial portion of our other operating revenue in 2009 resulted from a performance guaranty provided by the manager

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of the Fairmont Newport Beach. We recognized \$2.5 million of the \$6.0 million performance guaranty during 2009, and zero during 2010. As of December 31, 2009, we had fully utilized the entire \$6.0 million performance guaranty. Other operating revenue also decreased in 2010 as compared to 2009 due to decreased cancellation, attrition, telephone and guest movie revenue in our existing portfolio slightly offset by increased parking and spa revenue in our existing portfolio and increased revenue at our two commercial laundry facilities.

Other operating revenue decreased \$5.4 million, or 9.1%, for the year ended December 31, 2009 as compared to the year ended December 31, 2008. A substantial portion of our other operating revenue in both 2009 and 2008 resulted from a performance guaranty provided by the manager of the Fairmont Newport Beach. We recognized \$2.5 million of the \$6.0 million performance guaranty during the year ended December 31, 2009, and recognized \$3.5 million of the performance guaranty during the year ended December 31, 2008. Other revenue generated from our existing portfolio also decreased during 2009 as compared to 2008 primarily due to decreases in telephone, retail, business center and guest movie revenue, resulting from the decrease in occupancy at our hotels and to the fact that discretionary spending by our hotel guests decreased in 2009 as a result of the recession, combined with decreased cancellation and attrition revenue. These decreases were partially offset by increases in parking revenue due to new contracts at several of our hotels.

Hotel operating expenses. Hotel operating expenses, which are comprised of room, food and beverage, advertising and promotion, repairs and maintenance, utilities, franchise costs, property tax, ground lease and insurance, and other hotel operating expenses increased \$11.9 million, or 3.0%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Hotel operating expenses generated by the new hotels in 2010 totaled \$10.7 million. Hotel operating expenses for our existing portfolio increased \$1.2 million during 2010 as compared to 2009. This increase in hotel operating expenses is primarily related to the increase in related room revenue. In addition, hotel operating expenses increased in 2010 as compared to 2009 due to costs incurred of \$0.2 million during 2010 related to our management company transitions, increased franchise fees and assessments due to higher revenue, and increased ground lease expense due to higher costs at several of our hotels. These increases were partially offset by decreases in the following expenses: food and beverage expense and other operating expense due to the decline in related revenue; departmental payroll due to staff reductions and cost cutting initiatives implemented throughout 2009; repairs and maintenance as the hotels continued to cancel or delay unnecessary expenditures; utilities due to reductions in gas rates and usage at several of our hotels; and property taxes due to reassessments on several of our hotels.

Hotel operating expenses decreased \$57.1 million, or 12.6%, for the year ended December 31, 2009 as compared to the year ended December 31, 2008. This decrease in hotel operating expenses is the result of cost cutting initiatives, as well as lower occupancy rates at our hotels. Hotel operating expenses declined during 2009 as compared to 2008 due to decreases in the following expenses: departmental payroll due to staff reductions and cost cutting initiatives; advertising and repairs and maintenance as the hotels developed more efficient operating models; utilities due to the decline in occupancy and to reductions in gas rates at several of our hotels; franchise fees and assessments due to the decreased revenue; and ground lease due to the elimination of expense at our Renaissance Orlando at SeaWorld® as we purchased the land underlying the hotel in September 2008. These decreases were slightly offset by increased property taxes due to increased tax rates at several of our hotels combined with \$0.2 million in supplemental prior year taxes assessed on several of our hotels in 2009, slightly offset by \$0.8 million in property tax credits received at several of our hotels in 2009 and by \$0.2 million in prior year tax reimbursements collected from the buyer upon our second quarter 2009 sale of land adjacent to one of our hotels.

Property general and administrative expense. Property general and administrative expense increased \$4.3 million, or 5.9%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Property general and administrative expense generated by the new hotels in 2010 totaled \$2.3 million. Hotel operating expenses for our existing portfolio increased \$2.0 million during 2010 as compared to 2009. Management fees and credit and collection expenses increased in our existing portfolio due to the increase in revenue. In addition, property general and administrative expense in our existing portfolio increased due to increased payroll, employee recruitment, relocation and training. These increases were partially offset by decreased legal and sales tax audit expenses.

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Property general and administrative expense decreased \$14.0 million, or 16.1%, for the year ended December 31, 2009 as compared to the year ended December 31, 2008, primarily due to decreased management fees and credit and collection expenses due to the decline in revenue, combined with decreased payroll and related costs, employee recruitment, employee relations, employee relocation, training, legal and travel due to staff reductions and cost control initiatives as our hotels worked to control costs during the recession. These decreases were slightly offset by an increase in sales tax audit expense due to audits at several of our hotels.

Corporate overhead expense. Corporate overhead expense increased \$3.6 million, or 14.1%, during the year ended December 31, 2010 as compared to the year ended December 31, 2009 primarily due to increased due diligence costs. During 2010 we incurred due diligence costs of \$6.8 million related to our acquisition of the Royal Palm Miami Beach, which primarily related to costs specific with the foreclosure auction process as well as the acquisition of a portion of the hotel's outstanding debt at a discount. Previously, these due diligence costs would have been capitalized as part of the acquisition; however, under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) revised

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business combinations guidance, these costs are expensed for acquisitions on or after January 1, 2009. We incurred an additional \$1.3 million in due diligence costs during 2010 related to acquisition projects that were abandoned, as compared to \$0.2 million in due diligence costs incurred in 2009. In addition, corporate overhead expense increased in 2010 as compared to 2009 due to \$3.3 million in CEO severance expenses, increased legal expenses and by \$0.5 million in retention bonuses accrued during 2010 to incentivize certain hotel-level employees to stay through the management company transitions. These increases were partially offset by decreased bad debt expense. In December 2009, we determined that a \$5.6 million note received from the buyer of 13 hotels we sold in 2006, along with the related interest accrued on the note may be uncollectible. As such, we recorded bad debt expense of \$5.6 million to corporate overhead in 2009 to reserve against both the discounted note and the related interest receivable. Corporate overhead expenses also decreased in 2010 as compared to 2009 due to decreased sales tax expense, office rent, and relocation expense.

Corporate overhead expense increased \$3.7 million, or 17.3%, during the year ended December 31, 2009 as compared to the year ended December 31, 2008 due in part to \$5.6 million in bad debt expense recorded in 2009, along with \$0.8 million in corporate severance due to our corporate reorganization in the second quarter of 2009 and \$0.1 million in relocation expense. In December 2009, we determined that a \$5.6 million note received from the buyer of 13 hotels we sold in 2006, along with the related interest accrued on the note may be uncollectible. As such, we recorded bad debt expense of \$5.6 million to corporate overhead to reserve against both the discounted note and the related interest receivable. These increases were partially offset by decreases in salaries, wages and deferred stock compensation in 2009 as compared to 2008. During the second quarter of 2009, we made certain changes to our organizational structure, and as a result, our corporate workforce was reduced by approximately 40%, resulting in decreases in salaries, wages and deferred stock compensation. In addition, corporate overhead decreased due to reductions in sales tax expenses, audit and legal fees, recruitment, entity level state franchise and minimum tax payments, conferences and meetings, and travel.

Depreciation and amortization expense. Depreciation and amortization expense increased \$1.7 million, or 1.8%, for the year ended December 31, 2010 as compared to the year ended December 31, 2009. Depreciation and amortization expense generated by the new hotels in 2010 totaled \$2.5 million. Depreciation and amortization in our existing portfolio decreased \$0.8 million during 2010 as compared to 2009 primarily due to the fact that we reduced the depreciable assets of our existing portfolio by \$25.4 million during the second quarter of 2009, as well as due to reduced renovations and purchases of furniture, fixtures and equipment for our hotel properties.

Depreciation and amortization expense remained relatively flat for the year ended December 31, 2009 as compared to the year ended December 31, 2008. Additional depreciation recognized on hotel renovations and purchases of furniture, fixtures and equipment for our hotel properties was offset due to the fact that we reduced the depreciable assets of our existing portfolio by \$25.4 million during 2009 due to impairment charges.

Property and goodwill impairment losses. Property and goodwill impairment losses totaled \$1.9 million for the year ended December 31, 2010, \$30.9 million for the year ended December 31, 2009, and \$0.1 million for the year ended December 31, 2008. During 2010, we recognized a property impairment loss of \$1.9 million on an office building and land adjacent to one of our hotels in anticipation of its possible sale. In conjunction with our quarterly impairment evaluations performed during 2009, we recognized a \$25.4 million impairment loss on the Marriott Del Mar to reduce the carrying value of this hotel to its fair value. In addition, during 2009 we recognized a \$1.4 million impairment loss related to costs associated with a potential timeshare development, and recognized a \$0.1 million impairment loss on a parcel of land adjacent to one of our hotels which we sold in June 2009. We also wrote off \$1.3 million of goodwill associated with the Marriott Park City and \$2.6 million of goodwill associated with the Marriott Rochester. In 2008 we recognized a \$0.1 million impairment loss on a vacant parcel of land which was sold in January 2009.

Equity in net earnings (losses) of unconsolidated joint ventures. Equity in net earnings (losses) of unconsolidated joint ventures totaled earnings of \$0.6 million for the year ended December 31, 2010, a net loss of \$27.8 million for the year ended December 31, 2009, and a net loss of \$1.4

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million for the year ended December 31, 2008. In 2010, we recognized income of \$0.6 million on our BuyEfficient joint venture, and zero on our Doubletree Guest Suites Times Square joint venture. Though the Doubletree Guest Suites Times Square joint venture recognized earnings during 2010, we did not recognize any portion of these earnings due to the fact that the joint venture had cumulative losses in excess of our investment, and we reduced our interest in this partnership to zero at December 31, 2009. The excess cumulative losses resulted primarily from the hotel's fourth quarter 2009 impairment charge. In 2009, we recognized a \$28.3 million loss on our Doubletree Guest Suites Times Square joint venture. This \$28.3 million loss was comprised of a \$2.3 million operating loss and a \$26.0 million impairment loss. Also during 2009, we recognized income of \$0.5 million on our BuyEfficient joint venture. In 2008, we recognized a \$1.6 million loss on our Doubletree Guest Suites Times Square joint venture, and income of \$0.2 million on our BuyEfficient joint venture.

In January 2011, we increased our ownership in both the BuyEfficient and Doubletree Guest Suites Times Square joint ventures, and will present both of these investments in 2011 on a consolidated basis. We purchased the outside 50% share in the BuyEfficient joint venture for \$8.6 million, and the outside 62% equity interests in the Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million. As a result, we are now the sole owner of both BuyEfficient and the 460-room Doubletree Guest Suites Times Square.

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Interest and other income. Interest and other income totaled \$0.1 million for the year ended December 31, 2010, \$1.4 million for the year ended December 31, 2009 and \$3.6 million for the year ended December 31, 2008. In 2010, we recognized \$0.3 million in interest income and \$0.1 million in other miscellaneous income, partially offset by a loss of \$0.3 million on sales and dispositions of surplus furniture, fixtures and equipment (FF&E) located in several of our hotels and in our corporate office. In 2009, we recognized \$0.9 million in interest income, \$0.4 million on the sale of surplus FF&E located in two of our hotels and \$0.1 million in other miscellaneous income. In 2008, we recognized \$3.4 million in interest income and \$0.2 million in other miscellaneous income.

Interest expense. Interest expense is as follows (in thousands):

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
Interest expense	\$ 65,457	\$ 71,940	\$ 78,538
Interest expense default rate	884	472	
Accretion of Senior Notes	996	1,813	3,505
Amortization of deferred financing fees	1,597	1,823	1,133
Write-off of deferred financing fees	1,585	284	
Loan penalties and fees	311	207	
	\$ 70,830	\$ 76,539	\$ 83,176

Interest expense decreased \$5.7 million, or 7.5%, during the year ended December 31, 2010 as compared to the year ended December 31, 2009. Interest expense decreased \$6.5 million during 2010 as compared to 2009 as a result of decreases in our loan balances combined with our repurchase of \$64.0 million in aggregate principal amount of the Senior Notes in the first quarter of 2009 and an additional \$123.5 million in the second quarter of 2009, as well as the repayment of \$83.0 million in April 2010 to release three hotels from the Mass Mutual loan. In addition, interest expense due to the accretion of the Senior Notes decreased \$0.8 million during 2010 as compared to 2009 due to the repurchases of the Senior Notes in 2009. Interest expense also decreased \$0.2 million during 2010 as compared to 2009 due to a decrease in amortization of deferred financing fees related to the repayment of the \$83.0 million noted above, as well as the termination of our credit facility in February 2010, partially offset by an increase in fees associated with our new credit facility entered into in November 2010, combined with our repurchase of the Senior Notes and the amendment of our loan on the Renaissance Baltimore during the third quarter of 2009. These decreases were partially offset by an increase of \$1.3 million in interest expense due to the write-off of deferred financing fees. During 2010, we wrote-off \$1.5 million in deferred financing fees related to the termination of our credit facility in February 2010, and \$0.1 million in deferred financing fees related to the release of the three hotels from the Mass Mutual loan in April 2010. During 2009, we wrote off \$0.3 million in deferred financing fees associated with the amendment of our credit facility. Interest expense also increased during 2010 as compared to 2009 due to our elective defaults pursuant to our 2009 secured debt restructuring program as one of the lenders increased our interest rate by 5.0% causing an additional \$0.4 million in default interest and an additional \$0.1 million in penalties and fees.

Interest expense decreased \$6.6 million, or 8.0%, during the year ended December 31, 2009 as compared to the year ended December 31, 2008. Interest expense decreased \$6.6 million as a result of decreases in our loan balances combined with our repurchase of \$64.0 million in aggregate principal amount of the Senior Notes in the first quarter of 2009 and an additional \$123.5 million repurchased in May 2009. In addition, during the first quarter of 2009, we adopted FASB ASC 470-20, *Debt with Conversion and Other Options* (ASC 470-20). As part of this adoption, we recorded an additional \$1.8 million in interest expense for the year ended December 31, 2009, and we retrospectively adjusted interest expense by an additional \$3.5 million for the year ended December 31, 2008. Interest expense due to the accretion of the Senior Notes decreased by \$1.7 million during 2009 as compared to 2008 due to the repurchase of \$64.0 million in aggregate principal amount of Senior Notes in the first quarter of 2009 combined with an additional \$123.5 million repurchased in May 2009. Partially offsetting these decreases, interest expense increased in 2009 as compared to 2008 due to an increase in amortization of deferred financing fees of \$0.7 million related to an increase in fees associated with our repurchase of the Senior Notes, the amendment of our credit facility during the second quarter of 2009 and the amendment of our loan on the Renaissance Baltimore during the third quarter of 2009. In addition, interest expense increased in 2009 as compared to 2008 due to \$0.3 million recognized in 2009 related to the write-off of deferred financing fees associated with the amendment of our credit facility, as

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well as \$0.5 million in default interest and \$0.2 million in loan penalties and fees recognized in 2009 due to our elective defaults pursuant to our 2009 secured debt restructuring program.

Our weighted average interest rate per annum was approximately 5.5% at both December 31, 2010 and 2008, and 5.6% at December 31, 2009. At December 31, 2010, all of our outstanding notes payable had fixed interest rates.

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Gain on extinguishment of debt. Gain on extinguishment of debt totaled zero for the year ended December 31, 2010, \$54.5 million for the year ended December 31, 2009 and zero for the year ended December 31, 2008. During 2009, we recognized a gain of \$54.5 million due to the repurchase and cancellation of \$187.5 million in aggregate principal amount of the Senior Notes.

Income (loss) from discontinued operations. Income (loss) from discontinued operations is as follows (in thousands):

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
Operating revenues	\$ 71,105	\$ 136,777	\$ 250,584
Operating expenses	(58,031)	(114,893)	(187,306)
Interest expense	(17,172)	(22,698)	(18,618)
Depreciation and amortization expense	(5,432)	(17,265)	(25,655)
Property and goodwill impairment losses		(195,293)	(2,847)
Gain on extinguishment of debt	86,235		
Gain (loss) on sale of hotels		(13,052)	26,013

As described under Investing Activities Dispositions, we sold three hotels during 2009 and two hotels during 2008. In addition, pursuant to our 2009 secured debt restructuring program we reclassified the operating results of 11 hotels to discontinued operations: W San Diego, transferred to a receiver in September 2009 and deeded back to the lender in July 2010; Renaissance Westchester, transferred to a receiver in December 2009 and reacquired by the Company in June 2010; Marriott Ontario Airport, transferred to a receiver in March 2010 and sold by the receiver in August 2010; and the Mass Mutual eight hotels, deeded back to the lender in November 2010. As a result of these deed backs and title transfers, we have disposed of all assets and liabilities from our operations held for non-sale disposition segment. Accordingly, all assets, liabilities and the operations from our non-sale disposition segment have been reclassified to discontinued operations. Consistent with the Property, Plant and Equipment Topic of the FASB ASC, we have reclassified the results of operations for all of these hotels, along with any impairments recognized, the gains or losses on the hotel sales and the gains on extinguishment of debt for the W San Diego, Renaissance Westchester, Marriott Ontario Airport and Mass Mutual eight hotels to discontinued operations.

Dividends paid on unvested restricted stock compensation. Common stock dividends earned on our unvested restricted stock awards were zero for the year ended December 31, 2010, \$0.4 million for the year ended December 31, 2009 and \$0.8 million for the year ended December 31, 2008.

Preferred stock dividends and accretion. Preferred stock dividends and accretion decreased \$0.1 million, or 0.5% during the year ended December 31, 2010 as compared to the year ended December 31, 2009. Though the dividend rate for our Series A preferred stock and Series C preferred stock remained at \$2.00 and \$1.572, respectively, per share for 2010 and 2009, preferred stock dividends and accretion decreased in 2010 due to the fact that the initial carrying value of our Series C preferred stock was fully accreted to its redemption value during the third quarter of 2010. Preferred stock dividends and accretion decreased \$0.1 million, or 0.6%, during the year ended December 31, 2009 as compared to the year ended December 31, 2008 due to a decrease in the dividend rate for our Series C preferred stock to \$1.572 per share during 2009 from \$1.605 per share during 2008.

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Undistributed income allocated to unvested restricted stock compensation. In accordance with ASC 260-10, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. As such, undistributed income of \$0.1 million for 2010 and zero for both 2009 and 2008 were allocated to the participating securities.

Investing Activities

Acquisitions. In light of the recent cyclical downturn, we did not acquire any hotel properties during either 2009 or 2008. Our only material real estate acquisition during 2008 was made in September, when we acquired 32.6 acres of land underlying our Renaissance Orlando at SeaWorld® hotel using available cash on hand for \$30.7 million, including costs of the acquisition. Prior to our acquisition, the land had been leased from a third party. As a result of this acquisition, property tax, ground lease and insurance expense has been reduced by \$2.1 million, \$2.0 million and \$0.7 million for the years ended December 31, 2010, 2009 and 2008, respectively.

With better market clarity and in anticipation of an economic recovery, public REIT valuations improved significantly during the course of 2009. While hotel sale transactions were relatively limited in number during 2009, the hotel sale transactions that were consummated during 2010 indicate that hotel trading values have not recovered commensurately with

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public REIT valuations. Consistent with our cycle-appropriate strategy, we shifted our focus at the end of 2009 towards the pursuit of selective hotel acquisitions. Our acquisitions program is aimed at generating attractive returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans.

In April 2010, we purchased two hotel loans with a combined principal amount of \$32.5 million for a total purchase price of \$3.7 million. The loans included (i) a \$30.0 million, 8.5% mezzanine loan maturing in January 2017 secured by the equity interests in our Doubletree Guest Suites Times Square joint venture, and (ii) one-half of a \$5.0 million, 8.075% subordinate note maturing in November 2010 secured by the 101-room boutique hotel known as Twelve Atlantic Station in Atlanta, Georgia. We purchased the mezzanine loan for \$3.45 million and the subordinate note for \$250,000. In November 2010, we purchased the remaining half of the Twelve Atlantic Station subordinate note for an additional \$250,000. In November 2010, the subordinate note was modified to provide for monthly interest only payments of 3.5%, with the remaining interest due at maturity, and the maturity date was extended to November 2012. As the subordinate note was in default, the borrower was required to bring the subordinate note current. As of December 31, 2010, the subordinate note secured by the Twelve Atlantic Station was not in default, however, we are accounting for the Twelve Atlantic Station loan using the cost recovery method until such time as the expected cash flows from the loan are reasonably probable and estimable. As of December 31, 2010, the debt on the Doubletree Guest Suites Times Square was not in default, however interest on the mezzanine loan was deferred in accordance with the provisions of the loan, and we accounted for the loan using the cost recovery method. In January 2011, we purchased the outside 62% equity interests in our Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. After our acquisition of the remaining interests in the hotel, the mezzanine loan will remain in effect for tax purposes, but will be eliminated in consolidation on our financial statements.

In June 2010, we reacquired the 347-room Renaissance Westchester in White Plains, New York. In 2009, we transferred possession and control of the hotel to a court-appointed receiver pursuant to our 2009 secured debt restructuring program. In connection with this transfer, we deconsolidated this hotel and reclassified the assets and liabilities, including the \$25.2 million hotel net asset and the hotel's \$29.2 million 4.98% non-recourse mortgage, to discontinued operations on our balance sheets. Additionally, we reclassified the Renaissance Westchester's results of operations and cash flows to discontinued operations on our statements of operations and cash flows. We reacquired the Renaissance Westchester in June 2010 for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled. We recorded a \$6.7 million gain on extinguishment of debt to discontinued operations in June 2010.

In August 2010, we used available cash on hand to acquire the Royal Palm hotel in Miami Beach, Florida at a foreclosure auction for a gross purchase price of \$126.1 million excluding transaction costs. Prior to the auction, we purchased a portion of the hotel's outstanding debt at a discount to par resulting in a net purchase price of approximately \$117.6 million.

The following table sets forth the hotels we have acquired and reacquired since January 1, 2008:

Hotels	Rooms	Acquisition Date
2010:		
Royal Palm Miami Beach, Miami Beach, Florida	409	August 27, 2010
Renaissance Westchester, White Plains, New York (1)	347	June 14, 2010
2009:		
No hotel acquisitions		
2008:		
No hotel acquisitions		

-
- (1) Hotel deeded back to the lender and reacquired by the Company on June 14, 2010.

The cost for the two hotel acquisitions was approximately \$142.4 million, or \$188,000 per room.

Dispositions . We did not sell any hotels during 2010. During the second quarter of 2010, we disposed of the Renaissance Westchester, and subsequently reacquired the hotel from the lender in June 2010. During the third quarter of 2010, we completed our previously announced deed back of the W San Diego and the Marriott Ontario Airport which was sold by the receiver. Titles to the W San Diego and Marriott Ontario Airport were transferred to the lender and third party purchaser, respectively. During the fourth quarter of 2010, we completed our previously announced deed back of the Mass

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Mutual eight hotels, and titles to the hotels were transferred to the lender. Consistent with our cycle-appropriate strategy, we were a net seller of hotels in 2009 and 2008. In May 2009, we sold the Marriott Napa Valley for net proceeds of \$34.8 million, and a net loss of \$13.7 million. In June 2009, we sold the Marriott Riverside for net proceeds of \$18.7 million and a net gain of \$2.9 million. In July 2009 we sold the Hyatt Suites Atlanta Northwest for net proceeds of \$7.8 million and a net gain of \$18,000, after having recorded an impairment loss in June 2009 of \$4.9 million in order to reduce the carrying value of this hotel on our balance sheet to its fair value. We retained the net proceeds from these three sales in cash. In May 2008, we sold the Hyatt Regency Century Plaza for net proceeds of \$358.8 million, and a net gain of \$42.1 million. In July 2008, we used a portion of the net proceeds to repay amounts outstanding under our credit facility, which had been used to fund the repurchase of 7,374,179 shares of our common stock for \$129.0 million (excluding fees and costs). In December 2008, we sold the Crowne Plaza Grand Rapids for net proceeds of \$3.6 million, including a \$2.0 million note receivable that we collected in January 2009, and a net loss of \$16.1 million.

The following table sets forth the hotels we have sold or disposed of since January 1, 2008:

Hotels	Rooms	Disposition Date
2010:		
Courtyard by Marriott, San Diego (Old Town), California (1)	176	November 1, 2010
Hilton, Huntington, New York (1)	302	November 1, 2010
Holiday Inn Downtown, San Diego, California (1)	220	November 1, 2010
Holiday Inn Express, San Diego (Old Town), California (1)	125	November 1, 2010
Marriott, Provo, Utah (1)	330	November 1, 2010
Marriott, Salt Lake City (University Park), Utah (1)	218	November 1, 2010
Renaissance Atlanta Concourse, Atlanta, Georgia (1)	387	November 1, 2010
Residence Inn by Marriott, Manhattan Beach, California (1)	176	November 1, 2010
Marriott, Ontario Airport, California (1)	299	August 12, 2010
W Hotel, San Diego, California (1)	258	July 2, 2010
Renaissance Westchester, White Plains, New York (1) (2)	347	June 14, 2010
2009:		
Hyatt Suites Atlanta Northwest, Marietta, Georgia	202	July 31, 2009
Marriott, Riverside, California	292	June 18, 2009
Marriott, Napa, California	274	May 20, 2009
2008:		
Crowne Plaza, Grand Rapids, Michigan	320	December 10, 2008
Hyatt Regency, Los Angeles (Century City), California	726	May 30, 2008
Total January 1, 2008 to December 31, 2010	4,652	

(1) Hotels deeded back to the lenders, or sold by the receiver, pursuant to our 2009 secured debt restructuring program.

(2) Hotel reacquired by the Company on June 14, 2010.

The 11 hotels disposed of in 2010 pursuant to our secured debt restructuring program eliminated \$282.7 million of debt from our balance sheet. The aggregate net sale proceeds for the five hotels sold in 2008 and 2009 was \$423.7 million, or \$234,000 per room. The results of operations of all of the hotels identified above and the gains or losses on dispositions and extinguishments of debt through December 31, 2010 are included in discontinued operations for all periods presented through the time of sale. The proceeds from the sales are included in our cash flows from investing activities for the respective periods.

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The following table summarizes our portfolio and room data from January 1, 2008 through December 31, 2010, adjusted for the hotels acquired, reacquired, disposed through non-sale disposition and sold during the respective periods.

	2010	2009	2008
Portfolio Data Hotels			
Number of hotels beginning of period	40	43	45
Add: Acquisitions	1		
Add: Re-acquisitions	1		
Less: Dispositions		(3)	(2)
Less: Non-sale dispositions	(11)		
Number of hotels end of period	31	40	43

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	2010	2009	2008
Portfolio Data Rooms			
Number of rooms beginning of period	13,804	14,569	15,625
Add: Acquisitions	409		
Add: Re-acquisitions	347		
Add: Room expansions		3	
Less: Dispositions		(768)	(1,046)
Less: Non-sale dispositions	(2,838)		
Less: Rooms converted to other usage			(10)
Number of rooms end of period	11,722	13,804	14,569
Average rooms per hotel end of period	378	345	339

Renovations. During 2010, we invested \$57.0 million in capital improvements to our hotel and other real estate portfolio. Consistent with our cycle-appropriate strategy, this investment in capital improvements to our portfolio was \$12.9 million more than the amount we invested in 2009 and \$37.7 million less than the amount we invested in 2008.

Liquidity and Capital Resources

Historical. During the periods presented, our sources of cash included our operating activities, working capital, sales of hotel properties and other assets, distributions received from our unconsolidated joint ventures, proceeds from notes payable including our Operating Partnership's debt securities and our credit facility, and proceeds from our offerings of common stock. Our primary uses of cash were for acquisitions of hotel properties, capital expenditures for hotels, operating expenses, purchases of notes receivable, repayment of notes payable (including repurchases of Senior Notes), repurchases of our common stock, and dividends on our common and preferred stock. We cannot be certain that traditional sources of funds will be available in the future.

Operating activities. Our cash provided by or used in operating activities fluctuates primarily as a result of changes in RevPAR and operating margins of our hotels. Our net cash provided by or used in operating activities may also be affected by changes in our portfolio resulting from hotel acquisitions, dispositions or renovations. Net cash provided by operating activities was \$45.4 million for 2010 compared to \$64.7 million for 2009, and \$160.0 million for 2008. The decrease in 2010 as compared to 2009 was primarily due to an increase in restricted cash during 2010. The decrease in 2009 as compared to 2008 was primarily due to decreased earnings at our hotels during 2009, combined with a decrease in accounts payable and other liabilities.

Investing activities. Our cash provided by or used in investing activities fluctuates primarily as a result of acquisitions, dispositions and renovations of hotels. Net cash provided by or used in investing activities in 2010, 2009 and 2008 was as follows (in thousands):

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
Proceeds from sale of hotel properties and other assets	\$ 63	\$ 64,073	\$ 360,395
Cash received from unconsolidated joint ventures	900	500	5,675
Restricted cash replacement reserve	(931)	(1,823)	5,136

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Acquisitions of notes receivable	(3,950)		
Acquisitions of hotel properties and land	(142,410)		(30,695)
Renovations and additions to hotel properties and other real estate	(56,984)	(44,105)	(94,697)
Net cash provided by (used in) investing activities	\$ (203,312)	\$ 18,645	\$ 245,814

Pursuant to our cycle-appropriate strategy, we acquired one hotel and reacquired one hotel in 2010, and did not acquire any hotels in either 2009 or 2008. Net cash used in investing activities was \$203.3 million in 2010 as compared to net cash provided of \$18.6 million in 2009, and net cash provided of \$245.8 million in 2008. During 2010, we paid \$117.6 million to acquire the Royal Palm Miami Beach and \$24.8 million to reacquire the Renaissance Westchester, for a total cash outlay of \$142.4 million. In addition, we increased the balance in our restricted cash replacement reserve accounts by \$0.9 million, and we paid \$4.0 million for the purchase of two notes receivable and \$57.0 million for renovations and additions to our portfolio. These cash outflows were partially offset by \$0.1 million of proceeds received from the sale of surplus FF&E at several of our hotels and our corporate office and distributions of \$0.9 million received from one of our unconsolidated joint ventures.

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During 2009, we received \$64.1 million from the sale of hotel properties and other assets, which included \$61.3 million from the sale of three hotels, a \$2.0 million payment on a note receivable from the buyer of a hotel we sold in December 2008, \$0.4 million from the sale of certain excess FF&E located in two of our hotels, and \$0.4 million from the sales of two vacant parcels of land. In addition, we received \$0.5 million from one of our unconsolidated joint ventures, increased the balance in our restricted cash replacement reserve accounts by \$1.8 million, and paid cash of \$44.1 million for renovations and additions to our portfolio.

During 2008, we received net proceeds of \$360.4 million from the sale of the two hotels, decreased the balance in our restricted cash replacement reserve accounts by \$5.1 million, and received \$5.7 million from one of our unconsolidated joint ventures. During 2008, we also acquired the land underlying one of our hotels for \$30.7 million, paid an additional \$14,000 for two hotels acquired in 2007, and received a \$35,000 deposit paid in 2007 for a total cash outlay of \$30.7 million. In addition, we paid cash of \$94.7 million for renovations and additions to our portfolio.

Financing activities. Our cash provided by or used in financing activities fluctuates primarily as a result of our issuance and repayment of notes payable, including the repurchase of Senior Notes, repayments on our credit facility and the issuance and repurchase of other forms of capital, including preferred equity and common stock. Net cash provided by financing activities was \$82.6 million in 2010 as compared to net cash provided of \$93.8 million in 2009, and net cash used of \$293.7 million in 2008. Net cash provided by financing activities for 2010 consisted primarily of \$199.9 million in proceeds received from the issuance of common stock and \$92.5 million in proceeds received from the new loan on the Hilton Times Square. These cash inflows were partially offset by \$175.2 million of principal payments on our notes payable and related costs, including \$83.0 million paid to release three hotels from the Mass Mutual loan, \$81.0 million to pay off the loan on the Hilton Times Square in connection with the refinance of the loan and \$11.2 million of principal amortization. In addition, net cash provided by financing activities for 2010 includes \$20.5 million of dividends paid to our stockholders, \$9.2 million in costs associated with the issuance of our common stock, and \$4.8 million in deferred financing costs paid in connection with our new credit facility and the refinancing of the Hilton Times Square loan.

Net cash provided by financing activities in 2009 consisted primarily of \$269.1 million in proceeds received from the issuance of common stock and \$60.0 million in proceeds received from our credit facility. These cash inflows were partially offset by \$117.5 million used to repurchase a portion of our Senior Notes including related costs, \$74.4 million of principal payments on our credit facility and notes payable, \$27.9 million of dividends paid to our stockholders, \$12.0 million in costs associated with the issuance of our common stock, and \$3.5 million in deferred financing fees paid in connection with amendments to our Senior Notes indenture, our credit facility and our loan secured by the Renaissance Baltimore.

Net cash used in financing activities in 2008 consisted primarily of \$190.4 million of principal payments on our credit facility and notes payable, \$184.5 million used to repurchase shares of our common stock, \$99.8 million of dividends paid to our stockholders, and \$0.1 million in deferred financing costs partially offset by \$181.0 million in proceeds received from draws on our credit facility.

Future. We expect our primary uses of cash to be for acquisitions of hotels, including possibly for hotel portfolios, capital investments in our hotels, operating expenses, repayment of principal on our notes payable and credit facility, interest expense and dividends. We expect our primary sources of cash will continue to be our operating activities, working capital, notes payable, sales of hotel properties, and proceeds from public and private offerings of debt securities and common and preferred stock. Our ability to incur additional debt depends on a number of factors, including our leverage, the value of our unencumbered assets and borrowing restrictions imposed by lenders under our existing notes payable, as well as other factors affecting the general willingness or ability of lenders to provide loans. Our ability to raise funds through the issuance of equity securities depends on, among other things, general market conditions for hotel companies and REITs and market perceptions about us. We will continue to analyze alternate sources of capital in an effort to minimize our capital costs and maximize our financial flexibility. However, when needed, the capital markets may not be available to us on favorable terms or at all.

We believe that our current cash balance, our cash flow from operations, our access to capital markets and our unencumbered properties will provide us with sufficient liquidity to meet our current operating expenses and other expenses directly associated with our business (including payment of dividends on our capital stock, if declared) for the foreseeable future, and in any event for at least the next 12 months.

Debt. In February 2010, we elected to terminate our existing \$80.0 million credit facility, and we wrote off \$1.5 million in related deferred financing costs. The termination of the facility eliminated approximately \$0.6 million in fees and associated costs per annum. In November 2010, we entered into a new \$150.0 million senior corporate credit facility (the new credit facility). The interest rate for the new credit facility ranges from 325 to 425 basis points over LIBOR, depending

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on our overall leverage. The initial term of the new credit facility is three years with an option to extend for an additional one year. Subject to approval by the lender group, the new credit facility may be increased to \$250.0 million. The new credit facility contains customary events of default relating to payments and breaches of representations and warranties, and is pledged by 12 of our unencumbered hotels (Courtyard by Marriott Los Angeles Airport, Fairmont Newport Beach, Hyatt Regency Newport Beach, Kahler Inn & Suites Rochester, Marriott Quincy, Marriott Portland, Marriott Rochester, Renaissance Los Angeles Airport, Renaissance Westchester, Residence Inn by Marriott Rochester, Royal Palm Miami Beach and Sheraton Cerritos).

In November 2010, we entered into a new \$92.5 million non-recourse mortgage on our Hilton Times Square. The new mortgage matures in 2020 and bears a fixed interest rate of 4.97%, with scheduled monthly principal and interest amounts based on a thirty-year amortization. The proceeds from the new mortgage were used in part to repay the maturing \$81.0 million mortgage on our Hilton Times Square, which bore an interest rate of 5.915%. Excess proceeds were retained for general corporate purposes. The new mortgage contains customary events of default relating to payments and breaches of representations and warranties.

In January 2011, we purchased the outside 62% equity interests in our Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The hotel is encumbered by approximately \$270.0 million of non-recourse senior mortgage and mezzanine debt that matures in January 2012 and bears a blended interest rate of LIBOR + 115 basis points. We expect to refinance this debt during 2011 and intend to fund any refinancing shortfall with existing cash.

Consistent with our cycle-appropriate strategy, we initiated the 2009 secured debt restructuring program aimed at addressing cash flow and value deficits among certain of our hotels securing non-recourse mortgage debt. We concluded the program in the fourth quarter of 2009, and, in November 2010, we finalized the remaining deed back of certain hotels associated with loans which entered the program in 2009. Loans subject to our secured debt restructuring program generally met two criteria: (1) the hotel, or hotels as a group, was not generating sufficient cash flow to cover debt service, and under the current terms of the mortgage, the hotel was not expected to generate sufficient cash flow for the foreseeable future, and (2) the present value of the hotel, or hotels as a group, was significantly less than the principal amount of the applicable loan. The loans secured by such hotels, subject to customary exceptions, were non-recourse to us. The primary goal of the 2009 secured debt restructuring program was to amend the terms of mortgage debt to eliminate situations where hotel cash flow and asset values fell short of debt service and loan amounts, respectively. In certain cases, however, where acceptable restructuring terms could not be reached, rather than employing corporate resources to subsidize debt service, we elected to deed back the collateral hotels in satisfaction of the associated debt. The resolution of the final four loans included in our 2009 secured debt restructuring program is discussed further below.

W San Diego. In July 2010, we completed our previously announced deed back of the W San Diego, and title to the hotel was transferred to the lender. We recorded a gain on extinguishment of debt of \$35.4 million to discontinued operations in July 2010, and the net assets and liabilities were removed from our 2010 balance sheet.

Renaissance Westchester. In June 2010, we reacquired the Renaissance Westchester for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled. We recorded a \$6.7 million gain on extinguishment of debt to discontinued operations in June 2010.

Marriott Ontario Airport. In March 2010, possession and control of the Marriott Ontario Airport was transferred to a court-appointed receiver, and we deconsolidated the hotel. In August 2010, the Marriott Ontario Airport was sold by the receiver, and title to the hotel was transferred to the hotel's new owner. We recorded a \$5.1 million gain on extinguishment of debt to discontinued operations in August 2010, and removed the

net assets and liabilities from our 2010 balance sheet.

Massachusetts Mutual Life Insurance Company. During the first quarter of 2010, we reached an agreement in principle with Mass Mutual to secure the release of the three remaining hotels comprising the collateral pool for the Mass Mutual loan (Courtyard by Marriott Los Angeles, Kahler Inn & Suites Rochester and Marriott Rochester). Also pursuant to this agreement, in November 2010, we completed the deed back of the Mass Mutual eight hotels and titles to the hotels were transferred to the lender. In connection with such transfer, Mass Mutual delivered to the Company a covenant and agreement pursuant to which Mass Mutual agreed to not sue the Company for any matter or claim which Mass Mutual may ever have relating to the hotels, the loan or the loan documents. There are certain customary carveouts from this covenant not to sue, including fraud, a breach of the deed in lieu agreement itself and the environmental indemnity agreement delivered at the time the loan was originated. Additionally, we made certain customary representations and warranties, all of which survive the closing for a period of six months. Five of the Mass Mutual eight hotels remain subject to franchise agreements which contain corporate guaranties. If the franchise agreements on these five hotels were to be terminated, we may be liable for up to \$19.6 million in termination fees. We recorded a gain on extinguishment of debt of \$39.0 million to discontinued operations in the fourth quarter of 2010, and the net assets and liabilities were removed from our 2010 balance sheet. Additional gain of \$19.6 million will be deferred until all significant contingencies are resolved.

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Our 2009 secured debt restructuring program, including our elections to initiate the process to deed back the W San Diego, Marriott Ontario Airport, and the Mass Mutual eight hotels, were precipitated by a number of unique, market and hotel-specific factors, and were made after our efforts to amend the loans were unsuccessful. In the future, other factors may lead us to pursue similar options with certain of our other hotels securing non-recourse mortgages. We believe such cases, if any, would be limited in number. We were not in default of the loan covenants on any other of our notes payable at December 31, 2010.

As of December 31, 2010, we had \$1.1 billion of debt, \$333.9 million of cash and cash equivalents, including restricted cash, and total assets of \$2.4 billion. We believe that by controlling debt levels, staggering maturity dates and maintaining a highly flexible capital structure, we can maintain lower capital costs than more highly leveraged companies, or companies with limited flexibility due to restrictive corporate-level financial covenants.

As of December 31, 2010, all of our outstanding debt had fixed interest rates. The majority of our mortgage debt is in the form of single asset loans. We believe this structure is appropriate for the operating characteristics of our business and provides flexibility for assets to be sold subject to the existing debt, and as evidenced by our 2009 secured debt restructuring program, in instances where asset values have declined to levels below the principal amount of the associated mortgage, non-recourse single asset mortgages may limit the degradation in value experienced by our stockholders by shifting a portion of asset risk to our secured lenders.

As of December 31, 2010, the weighted average term to maturity of our debt is approximately 7 years, and the weighted average interest rate on our debt is 5.5%. With our purchase of the remaining interests in the Doubletree Guest Suites Times Square joint venture in January 2011, our first loan maturity, the \$270.0 million mortgage on the Doubletree Guest Suites Times Square, is in January 2012. We expect to refinance this debt during 2011 and intend to fund any refinancing shortfalls with existing cash.

Financial Covenants. We are subject to compliance with various covenants under the Series C preferred stock and the Senior Notes. With respect to our Series C preferred stock, if we fail to meet certain financial ratios for four consecutive quarters, a financial ratio violation will occur. During the continuation of a financial ratio violation, among other things, we would be restricted from paying dividends on our common stock, and may incur a 50 basis point per quarter dividend increase on the Series C preferred stock. Additionally, the Series C preferred stockholders would gain the right to appoint one board member. We do not currently expect to incur a financial ratio violation. Should operations deteriorate from current levels, however, we may fail to meet our financial ratios with respect to our Series C preferred stock for four consecutive quarters, which would cause us to incur a financial ratio violation.

With respect to our Senior Notes, if the maturity dates of more than \$300.0 million of our indebtedness were to be accelerated as the result of uncured defaults, either the trustee or the holders of not less than 25% in principal amount of the outstanding Senior Notes would have the right to declare the Senior Notes and any unpaid interest immediately due and payable. As of February 17, 2011, none of the maturity dates have been accelerated for any of our indebtedness.

Additionally, we believe we may be successful in obtaining mortgages on one or all of our 12 unencumbered hotels which are currently pledged to our new credit facility at December 31, 2010: Courtyard by Marriott Los Angeles Airport, Fairmont Newport Beach, Hyatt Regency Newport Beach, Kahler Inn & Suites Rochester, Marriott Quincy, Marriott Portland, Marriott Rochester, Renaissance Los Angeles Airport, Renaissance Westchester, Residence Inn by Marriott Rochester, Royal Palm Miami Beach and Sheraton Cerritos. These 12 hotels had an aggregate of 3,760 rooms as of December 31, 2010, and generated \$184.1 million in revenue during 2010.

Cash Balance. During the recent economic downturn, we maintained higher than historical cash balances. By minimizing our need to access external capital by maintaining higher than typical cash balances, our financial security and flexibility were meaningfully enhanced. As we believe the lodging cycle has now entered a recovery phase, we expect to deploy a portion of our excess cash balance in 2011 towards selective acquisitions and capital investments in our portfolio. Our acquisition program is aimed at generating attractive returns on our investment dollars, and therefore we may target lodging assets outside of the typical branded, urban, upper upscale profile represented by our existing portfolio in order to capitalize on opportunities which may arise. Additionally, the scope of our acquisitions program may include large hotel portfolios or hotel loans.

Table of Contents**Contractual Obligations**

The following table summarizes our payment obligations and commitments as of December 31, 2010 (in thousands):

	Total	Less than 1 year	Payment due by period (in thousands)		3 to 5 years	More than 5 years
			1 to 3 years			
Notes payable	\$ 1,145,500	\$ 16,486	\$ 131,592	\$ 238,706	\$ 758,716	
Interest obligations on notes payable	420,281	62,344	120,899	109,197	127,841	
Operating lease obligations	308,952	4,423	8,968	9,137	286,424	
Construction commitments	32,965	32,965				
Employment obligations	2,047	938	1,109			
Total	\$ 1,909,745	\$ 117,156	\$ 262,568	\$ 357,040	\$ 1,172,981	

Capital Expenditures and Reserve Funds

We believe we maintain each of our hotels in good repair and condition and in general conformity with applicable franchise and management agreements, ground and air leases, laws and regulations. Our capital expenditures primarily relate to the ongoing maintenance of our hotels and are budgeted in the reserve accounts described in the following paragraph. We also incur capital expenditures for renovation and development. We invested \$57.0 million in our portfolio during 2010. Our renovation budget for 2011 includes \$33.0 million of contractual construction commitments. If we acquire, renovate or develop additional hotels in the future, our capital expenditures will increase.

With respect to our hotels that are operated under management or franchise agreements with major national hotel brands and for all of our hotels subject to first mortgage liens, we are obligated to maintain a FF&E reserve account for future planned and emergency-related capital expenditures at these hotels. The amount funded into each of these reserve accounts is determined pursuant to the management, franchise and loan agreements for each of the respective hotels, ranging between 4.0% and 5.0% of the respective hotel's total annual revenue. As of December 31, 2010, \$28.3 million was held in FF&E reserve accounts for future capital expenditures at the 31 hotels. According to the respective loan agreements, the reserve funds are to be held by the lenders or managers in restricted cash accounts. We generally are not required to spend the entire amount in the FF&E reserve accounts each year.

Off-Balance Sheet Arrangements

As of December 31, 2010, our off-balance sheet arrangements consist of our ownership interests in two joint ventures. For further discussion of our two joint ventures and their effect on our financial condition, results of operations and cash flows, see Note 6 to the consolidated financial statements.

Seasonality and Volatility

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As is typical of the lodging industry, we experience some seasonality in our business as indicated in the table below. Revenue for certain of our hotels is generally affected by seasonal business patterns (*e.g.*, the first quarter is strong in Orlando, the second quarter is strong for the Mid-Atlantic business hotels, and the fourth quarter is strong for New York City). Quarterly revenue also may be adversely affected by renovations, our managers' effectiveness in generating business and by events beyond our control, such as extreme weather conditions, terrorist attacks or alerts, public health concerns, airline strikes or reduced airline capacity, economic factors and other considerations affecting travel. Revenues for our Comparable Portfolio by quarter for 2008, 2009 and 2010 were as follows (dollars in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues					
2008 Comparable Portfolio (30 Hotels) (1)	\$ 174,713	\$ 200,634	\$ 187,763	\$ 206,501	\$ 769,611
2008 Revenues as a percentage of total	22.7%	26.1%	24.4%	26.8%	100.0%
2009 Comparable Portfolio (30 Hotels) (1)	\$ 149,705	\$ 154,883	\$ 148,919	\$ 169,126	\$ 622,633
2009 Revenues as a percentage of total	24.0%	24.9%	23.9%	27.2%	100.0%
2010 Comparable Portfolio(30 Hotels) (1)	\$ 141,158	\$ 161,088	\$ 152,153	\$ 176,283	\$ 630,682
2010 Revenues as a percentage of total	22.4%	25.5%	24.1%	28.0%	100.0%

(1) Includes all hotels owned by the Company as of December 31, 2010, less the Royal Palm Miami Beach which is being renovated and repositioned beginning in 2010. Also includes operating results for the Renaissance Westchester for all periods presented.

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Inflation

Inflation may affect our expenses, including, without limitation, by increasing such costs as labor, food, taxes, property and casualty insurance and utilities.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities.

We evaluate our estimates on an ongoing basis. We base our estimates on historical experience, information that is currently available to us and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect the most significant judgments and estimates used in the preparation of our consolidated financial statements.

- ***Impairment of long-lived assets and goodwill.*** We periodically review each property and any related goodwill for possible impairment. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. We perform a Level 3 analysis of fair value, using a discounted cash flow analysis to estimate the fair value of our properties taking into account each property's expected cash flow from operations, holding period and proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. Our judgment is required in determining the discount rate applied to estimated cash flows, growth rate of the properties, operating income of the properties, the need for capital expenditures, as well as specific market and economic conditions. In June 2010, we recorded an impairment loss of \$1.9 million on an office building and land adjacent to one of our hotels in anticipation of a possible sale.

We account for goodwill in accordance with the Intangibles – Goodwill and Other Topic of the FASB ASC, which states that goodwill has an indefinite useful life that should not be amortized but should be reviewed annually for impairment, or more frequently if events or changes in circumstances indicate that goodwill might be impaired, as well as the Fair Value Measurements and Disclosures Topic of the FASB ASC for financial and nonfinancial assets and liabilities, which establishes a framework for measuring fair value and expands disclosures about fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The review of any potential goodwill impairment requires estimates of fair value for our properties that have goodwill arising from unallocated acquisition costs. These estimates of fair value are prepared using Level 3 measurements.

- ***Depreciation and amortization expense.*** Depreciation expense is based on the estimated useful life of our assets. The life of the assets is based on a number of assumptions, including the cost and timing of capital expenditures to maintain and refurbish our hotels, as well as specific market and economic conditions. Hotel properties and other completed real estate investments are depreciated using the straight-line

method over estimated useful lives ranging from five to 35 years for buildings and improvements and three to 12 years for furniture, fixtures and equipment. While management believes its estimates are reasonable, a change in the estimated lives could affect depreciation expense and net income or the gain or loss on the sale of any of our hotels. We have not changed the estimated useful lives of any of our assets during the periods discussed.

New Accounting Standards and Accounting Changes

In June 2009, the FASB issued a pronouncement which amends GAAP to require more information about transfers of financial assets, eliminates the qualifying special purpose entity (QSPE) concept, changes the requirements for derecognizing financial assets and requires additional disclosures. The FASB issued a second pronouncement in June 2009, which amends GAAP regarding certain guidance for determining whether an entity is a variable interest entity and modifies the methods allowed for determining the primary beneficiary of a variable interest entity. This second pronouncement requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and enhanced disclosures related to an enterprise's involvement in a variable interest entity. Both of these pronouncements are effective for the first annual reporting period that begins after November 15, 2009. The adoption of these two pronouncements did not materially impact the Company.

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In January 2010, the FASB issued a pronouncement to further update the fair value measurement guidance to improve fair value measurement disclosures. This update requires new disclosures related to transfers in and out of Level 1 and Level 2, as well as activity in Level 3 fair value measurements, and provides clarification to existing disclosures. This standard is effective for interim periods and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements as these disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Our adoption of the guidance related to new disclosures and clarifications on January 1, 2010 did not have any effect on our consolidated financial condition, results of operations or cash flows. Our adoption of the guidance related to disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements will occur during the first quarter of 2011. We do not anticipate that the adoption of this part of the pronouncement will materially impact the Company.

In February 2010, the FASB issued a pronouncement to amend the subsequent events guidance. The amendment states that SEC filers are no longer required to disclose the date through which subsequent events have been evaluated in originally issued and revised financial statements. This standard is effective immediately. The adoption of this pronouncement did not materially impact the Company.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

To the extent that we incur debt with variable interest rates, our future income, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. At December 31, 2010, none of our outstanding debt was subject to variable interest rates.

Item 8. Financial Statements and Supplementary Data

See index to financial statements included in this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Principal Executive Officer and Chief Financial Officer (CFO) has concluded that as of the end of the period covered by this Annual Report on Form 10-K our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the SEC and is accumulated and communicated to management, including the Principal Executive Officer and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Principal Executive Officer and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework. Based on its evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

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Ernst & Young LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report on Form 10-K and, as part of its audit, has issued its report, included herein at page 50, on the effectiveness of our internal control over financial reporting.

(c) Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Sunstone Hotel Investors, Inc.

We have audited Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Sunstone Hotel Investors, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sunstone Hotel Investors, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sunstone Hotel Investors, Inc. as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the period ended December 31, 2010 of Sunstone Hotel Investors, Inc. and our report

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dated February 17, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Irvine, California
February 17, 2011

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Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this Item is set forth under the caption "Election of Directors" in our definitive Proxy Statement, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this Item is set forth under the caption "Executive Officer Compensation" in our definitive Proxy Statement, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Except as set forth below, the information required by this Item is set forth under the caption "Security Ownership by Directors, Executive Officers and Five Percent Stockholders" in our definitive Proxy Statement, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act and is incorporated herein by reference. The following table sets forth certain information with respect to securities authorized for issuance under the equity compensation plan as of December 31, 2010:

Equity Compensation Plan Information

Number of securities to be issued upon exercise of outstanding awards (a)	Weighted-average exercise price of outstanding awards (b)	Number of securities remaining available for future issuance under the Long-term Incentive Plan (excluding securities reflected in column a)
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(c)

Equity compensation plans
approved by the Company's
stockholders:

- 2004 Long-Term Incentive Plan	200,000	\$	17.71(1)	3,828,573
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(1) The weighted-average exercise price is for the 200,000 options outstanding as of December 31, 2010.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is set forth under the caption "Certain Relationships and Related Transactions" and "Corporate Governance" in our definitive Proxy Statement, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item is set forth under the caption "Ratification of the Audit Committee's Appointment of Independent Registered Public Accounting Firm" in our definitive Proxy Statement, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act and is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

- (a)(1) Financial Statements. See Index to Financial Statements and Schedules on page F-1.
- (a)(2) Financial Statement Schedules. See Index to Financial Statements and Schedules on page F-1.
- (a)(3) Exhibits. The following exhibits are filed (or incorporated by reference herein) as a part of this Annual Report on Form 10-K:

Exhibit Number	Description
3.1	Articles of Amendment and Restatement of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 3.1 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
3.2	Amended and Restated Bylaws of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q filed by the Company on August 5, 2008).
3.3	Articles Supplementary for Series A preferred stock (incorporated by reference to Exhibit 3.3 to Form 10-K filed by the Company on February 12, 2009).
3.4	Form of Articles Supplementary for Series C preferred stock (incorporated by reference to Exhibit 3 to Form 8-K filed by the Company on July 13, 2005).
3.5	Articles Supplementary increasing the authorized number of shares of Series A preferred stock (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed by the Company on April 11, 2006).
4.1	Specimen Certificate of Common Stock of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 4.1 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
4.2	Letter furnished to Securities and Exchange Commission agreeing to furnish certain debt instruments (incorporated by reference to Exhibit 4.2 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
4.3	Form of Specimen Certificate of Series A preferred stock of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 4.1 to the registration statement on Form S-11 (File No. 333-123102) filed by the Company).
4.4	Form of Specimen Certificate of Series C preferred stock of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 4.5 to Form 10-Q filed by the Company on June 30, 2005).
4.5	Indenture, dated as of June 18, 2007, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., certain subsidiaries of Sunstone Hotel Investors, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to Form 10-Q filed by the Company on August 8, 2007).
4.6	First Supplemental Indenture, dated as of June 18, 2007, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., certain subsidiaries of Sunstone Hotel Investors, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to Form 10-Q filed by the Company on August 8, 2007).
4.7	

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Second Supplemental Indenture, dated as of June 27, 2007, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., certain subsidiaries of Sunstone Hotel Investors, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.3 to Form 10-Q filed by the Company on August 8, 2007).

- 4.8 Third Supplemental Indenture, dated as of July 29, 2008, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., certain subsidiaries of Sunstone Hotel Investors, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to Form 10-Q filed by the Company on May 7, 2009).
- 4.9 Fourth Supplemental Indenture, dated as of May 20, 2009, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., certain subsidiaries of Sunstone Hotel Investors, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to Form 8-K filed by the Company on May 22, 2009).
- 10.1 Registration Rights Agreement between Security Capital Preferred Growth Incorporated and Sunstone Hotel Investors, Inc., dated June 28, 2005 (incorporated by reference to Exhibit 10.23 to the registration statement on Form S-11 (File No. 333-127975) filed by the Company).

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Exhibit Number	Description
10.2	Form of Master Agreement with Management Company (incorporated by reference to Exhibit 10.2 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.3	Form of Hotel Management Agreement (incorporated by reference to Exhibit 10.3 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.3.1	Management Agreement Amendment dated as of July 1, 2005 (incorporated by reference to Exhibit 10.10.1 to Form 10-K filed by the Company on February 15, 2006).
10.3.2	Management Agreement Amendment dated as of January 1, 2006 (incorporated by reference to Exhibit 10.3.2 to Form 10-K filed by the Company on February 12, 2009).
10.3.3	Management Agreement Letter Amendment dated as of June 1, 2006 (incorporated by reference to Exhibit 10.3.3 to Form 10-K filed by the Company on February 23, 2010).
10.4	Amended and Restated Loan Agreement, dated January 31, 2003, between the borrowers named therein and Bear Stearns Commercial Mortgage, Inc., as Lender (incorporated by reference to Exhibit 10.5 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.4.1	First Amendment to Amended and Restated Loan Agreement, dated February 25, 2003, between the borrowers named therein and LaSalle Bank National Association, as Trustee, in trust for the Holders of Bear Stearns Commercial Mortgage Securities Inc. Commercial Mortgage Pass-Through Certificates, Series 2003-West, as Lender (incorporated by reference to Exhibit 10.5.1 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.5	2004 Long-Term Incentive Plan of Sunstone Hotel Investors, Inc., as amended effective May 5, 2010 (incorporated by reference to Exhibit 4.3 to Form S-8 filed by the Company on November 4, 2010).
10.5.1	Amendment to the 2004 Long-Term Incentive Plan of Sunstone Hotel Investors, Inc., effective as of December 31, 2008 (incorporated by reference to Exhibit 10.6.1 to Form 10-K filed by the Company on February 12, 2009).
10.5.2	Second Amendment to the 2004 Long-Term Incentive Plan of Sunstone Hotel Investors, Inc., effective as of May 5, 2010 (incorporated by reference to Exhibit 10.1 to Form 8-K filed by the Company on May 7, 2010).
10.6	Sunstone Hotel Investors, Inc. Executive Incentive Plan (incorporated by reference to Exhibit 10.3 to Form 10-Q filed by the Company on August 5, 2008).
10.7	Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.1 to Form 8-K filed by the Company on February 23, 2005).
10.8	Form of Restricted Stock Award Certificate (Directors) (incorporated by reference to Exhibit 10.2 to Form 8-K filed by the Company on February 23, 2005).
10.9	Form of TRS Lease (incorporated by reference to Exhibit 10.10 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.10	Credit Agreement, dated November 1, 2010, among Sunstone Hotel Partnership, LLC, Sunstone Hotel Investors, Inc., each lender from time to time party thereto and Bank of America, N.A., as administrative agent and L/C issuer (incorporated by reference to Exhibit 10.1 to Form 8-K filed by the Company on November 5, 2010).
10.11	Form of Senior Management Incentive Plan of Sunstone Hotel Investors, Inc. (incorporated by reference to Exhibit 10.14 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).
10.12	Form of Employment Agreement with Robert A. Alter (incorporated by reference to Exhibit 10.15 to the registration statement on Form S-11 (File No. 333-117141) filed by the Company).

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- 10.12.1 Amendment to Employment Arrangements, dated as of March 19, 2007, between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.2 to Form 10-Q filed by the Company on May 2, 2007).
- 10.12.2 Amendment No. 2 to Employment Agreement, effective as of July 21, 2008, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Robert A. Alter (incorporated by reference to Exhibit 10.1 to Form 10-Q filed by the Company on August 5, 2008).

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Exhibit Number	Description
10.12.3	Amendment No. 3 to Employment Agreement, effective as of December 31, 2008, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Robert A. Alter (incorporated by reference to Exhibit 10.13.3 to Form 10-K filed by the Company on February 12, 2009).
10.12.4	Retirement Benefit Agreement, dated November 15, 1997, by and between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.1 to Form 10-Q filed by the Company on November 5, 2008).
10.12.5	Amendment No. 1 to Retirement Benefit Agreement, dated December 27, 2006, by and between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.2 to Form 10-Q filed by the Company on November 5, 2008).
10.12.6	Amendment No. 2 to Retirement Benefit Agreement, dated July 31, 2008, by and between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.3 to Form 10-Q filed by the Company on November 5, 2008).
10.12.7	Amendment No. 3 to Retirement Benefit Agreement, effective as of December 31, 2008, by and between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.13.17 to Form 10-K filed by the Company on February 12, 2009).
10.12.8	Waiver Agreement, dated as of February 19, 2010, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Robert A. Alter (incorporated by reference to Exhibit 10.13.8 to Form 10-K filed by the Company on February 23, 2010).
10.12.9	Trust Under Retirement Benefit Agreement, dated July 31, 2008, Related to The Retirement Benefit Agreement with Robert A. Alter (incorporated by reference to Exhibit 10.4 to Form 10-Q filed by the Company on November 5, 2008).
10.12.10	Split-Dollar Agreement, dated November 15, 1997, by and between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.5 to Form 10-Q filed by the Company on November 5, 2008).
10.12.11	Stock Option Award Agreement, dated as of April 28, 2008, between Sunstone Hotel Investors, Inc. and Robert A. Alter (incorporated by reference to Exhibit 10.1 to Form 10-Q filed by the Company on May 8, 2008).
10.13	Employment Agreement, dated as of June 19, 2008, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Arthur L. Buser, Jr. (incorporated by reference to Exhibit 10.2 to Form 10-Q filed by the Company on August 5, 2008).
10.13.1	Amendment No. 1 to Employment Agreement, dated as of January 22, 2009, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Arthur L. Buser, Jr. (incorporated by reference to Exhibit 10.1 to Form 10-Q filed by the Company on May 7, 2009).
10.13.2	Waiver Agreement, dated as of February 19, 2010, between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Arthur L. Buser, Jr. (incorporated by reference to Exhibit 10.14.2 to Form 10-K filed by the Company on February 23, 2010).
10.13.3	Separation Agreement and General Release of All Claims, dated December 17, 2010, by and between Arthur L. Buser, Jr., Sunstone Hotel Investors, Inc. and Sunstone Hotel Partnership, LLC (incorporated by reference to Exhibit 99.2 to Form 8-K filed by the Company on December 20, 2010).
10.14	Second Amended and Restated Limited Liability Company Agreement of Sunstone Hotel Partnership, LLC (incorporated by reference to Exhibit 10 to Form 8-K filed by the Company on July 17, 2005).
10.15	Employment Agreement (including the Indemnification Agreement), dated as of August 4, 2010, by and between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Kenneth E. Cruse (incorporated by reference to Exhibit 10.2 to Form 10-Q filed by the Company on August 6, 2010).

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10.16 Form of Indemnification Agreement for Directors (incorporated by reference to Exhibit 10.23 to Form 10-K filed by the Company on February 15, 2006).

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Exhibit Number	Description
10.16.1	Form of Indemnification Agreement for Executive Officers (incorporated by reference to Exhibit 10.24 to Form 10-K filed by the Company on February 15, 2006).
10.17	Employment Agreement (including the Indemnification Agreement), dated as of August 4, 2010, by and between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and Marc A. Hoffman (incorporated by reference to Exhibit 10.3 to Form 10-Q filed by the Company on August 6, 2010).
10.18	Employment Agreement (including the Indemnification Agreement), dated as of February 14, 2011, by and between Sunstone Hotel Investors, Inc., Sunstone Hotel Partnership, LLC and John Arabia.
12	Computation of Ratios of Earnings to Fixed Charges and Preferred Stock Dividends
14.1	Sunstone Hotel Investors, Inc. Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14.1 of Form 8-K filed by the Company on November 10, 2008).
21.1	List of subsidiaries.
23.1	Consent of Ernst & Young LLP.
31.1	Certification of Principal Executive Officer (Section 302 Certification).
31.2	Certification of Principal Financial Officer (Section 302 Certification).
32.1	Certification of Chief Executive Officer and Chief Financial Officer (Section 906 Certification).

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Sunstone Hotel Investors, Inc.

Date: February 17, 2011

/S/ Kenneth E. Cruse
Kenneth E. Cruse
President and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/S/ ROBERT A. ALTER Robert A. Alter	Executive Chairman	February 17, 2011
/S/ LEWIS N. WOLFF Lewis N. Wolff	Co-Chairman	February 17, 2011
/S/ KENNETH E. CRUSE Kenneth E. Cruse	President and Chief Financial Officer (Principal Executive, Financial and Accounting Officer)	February 17, 2011
/S/ Z. JAMIE BEHAR Z. Jamie Behar	Director	February 17, 2011
/S/ THOMAS A. LEWIS, JR. Thomas A. Lewis, Jr.	Director	February 17, 2011
/S/ KEITH M. LOCKER Keith M. Locker	Director	February 17, 2011
/S/ KEITH P. RUSSELL Keith P. Russell	Director	February 17, 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Sunstone Hotel Investors, Inc.

We have audited the accompanying consolidated balance sheets of Sunstone Hotel Investors, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sunstone Hotel Investors, Inc. and subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sunstone Hotel Investors, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 17, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Irvine, California
February 17, 2011

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands, except share data)**

	December 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents (\$1,365 and \$1,471 related to VIEs)	\$ 277,976	\$ 353,255
Restricted cash (\$3,581 and \$4,711 related to VIEs)	55,972	36,858
Accounts receivable, net (\$1,885 and \$2,758 related to VIEs)	18,498	22,624
Due from affiliates	44	62
Inventories (\$159 and \$92 related to VIEs)	2,614	2,446
Prepaid expenses	8,126	7,423
Investment in hotel properties of discontinued operations, net		118,814
Other current assets of discontinued operations, net		15,879
Total current assets	363,230	557,361
Investment in hotel properties, net	2,034,223	1,923,392
Other real estate, net	12,012	14,044
Investments in unconsolidated joint ventures	246	542
Deferred financing costs, net	8,907	7,300
Goodwill	4,673	4,673
Other assets, net (\$3 and \$0 related to VIEs)	12,815	6,218
Total assets	\$ 2,436,106	\$ 2,513,530
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses (\$713 and \$523 related to VIEs)	\$ 21,530	\$ 12,425
Accrued payroll and employee benefits (\$1,123 and \$1,121 related to VIEs)	12,938	9,092
Due to Third Party Managers	7,852	9,817
Dividends payable	5,137	5,137
Other current liabilities (\$1,439 and \$1,316 related to VIEs)	17,692	21,910
Current portion of notes payable	16,486	153,778
Notes payable of discontinued operations		209,620
Other current liabilities of discontinued operations, net	19,613	47,813
Total current liabilities	101,248	469,592
Notes payable, less current portion	1,126,817	1,050,019
Other liabilities (\$30 and \$12 related to VIEs)	8,742	7,256
Total liabilities	1,236,807	1,526,867
Commitments and contingencies (<i>Note 14</i>)		
Preferred stock, Series C Cumulative Convertible Redeemable Preferred Stock, \$0.01 par value, 4,102,564 shares authorized, issued and outstanding at December 31, 2010 and 2009, liquidation preference of \$24.375 per share	100,000	99,896
Stockholders equity:		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized. 8.0% Series A Cumulative Redeemable Preferred Stock, 7,050,000 shares issued and outstanding at December 31, 2010 and 2009, stated at liquidation preference of \$25.00 per share	176,250	176,250
Common stock, \$0.01 par value, 500,000,000 shares authorized, 116,950,504 shares issued and outstanding at December 31, 2010 and 96,904,075 shares issued and outstanding at December 31, 2009	1,170	969
Additional paid in capital	1,313,498	1,119,005
Retained earnings (deficit)	29,593	(8,949)

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Cumulative dividends	(418,075)	(397,527)
Accumulated other comprehensive loss	(3,137)	(2,981)
Total stockholders' equity	1,099,299	886,767
Total liabilities and stockholders' equity	\$ 2,436,106	\$ 2,513,530

The abbreviation VIEs above refers to Variable Interest Entities.

See accompanying notes to consolidated financial statements.

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Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)**

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
REVENUES			
Room	\$ 428,412	\$ 408,150	\$ 504,104
Food and beverage	164,378	161,963	201,952
Other operating	50,300	53,744	59,140
Total revenues	643,090	623,857	765,196
OPERATING EXPENSES			
Room	109,935	101,780	113,987
Food and beverage	120,650	118,629	145,576
Other operating	26,871	26,916	29,823
Advertising and promotion	33,182	32,295	35,676
Repairs and maintenance	28,049	27,360	29,579
Utilities	25,232	24,895	28,731
Franchise costs	21,474	20,656	24,658
Property tax, ground lease and insurance	42,349	43,352	44,993
Property general and administrative	77,101	72,823	86,797
Corporate overhead	28,803	25,242	21,511
Depreciation and amortization	95,500	93,795	93,759
Property and goodwill impairment losses	1,943	30,852	57
Total operating expenses	611,089	618,595	655,147
Operating income	32,001	5,262	110,049
Equity in net earnings (losses) of unconsolidated joint ventures	555	(27,801)	(1,445)
Interest and other income	111	1,388	3,639
Interest expense	(70,830)	(76,539)	(83,176)
Gain on extinguishment of debt		54,506	
Income (loss) from continuing operations	(38,163)	(43,184)	29,067
Income (loss) from discontinued operations	76,705	(226,424)	42,171
NET INCOME (LOSS)	38,542	(269,608)	71,238
Dividends paid on unvested restricted stock compensation		(447)	(814)
Preferred stock dividends and accretion	(20,652)	(20,749)	(20,884)
Undistributed income allocated to unvested restricted stock compensation	(102)		
INCOME AVAILABLE (LOSS ATTRIBUTABLE) TO COMMON STOCKHOLDERS	\$ 17,788	\$ (290,804)	\$ 49,540
Basic per share amounts:			
Income (loss) from continuing operations available (attributable) to common stockholders	\$ (0.59)	\$ (0.92)	\$ 0.14
Income (loss) from discontinued operations	0.77	(3.25)	0.78
Basic income available (loss attributable) to common stockholders per common share	\$ 0.18	\$ (4.17)	\$ 0.92
Diluted per share amounts:			
Income (loss) from continuing operations available (attributable) to common stockholders	\$ (0.59)	\$ (0.92)	\$ 0.14
Income (loss) from discontinued operations	0.77	(3.25)	0.78
Diluted income available (loss attributable) to common stockholders per common share	\$ 0.18	\$ (4.17)	\$ 0.92
Weighted average common shares outstanding:			

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Basic	99,709	69,820	53,633
Diluted	99,709	69,820	53,662

See accompanying notes to consolidated financial statements.

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Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY****(In thousands, except per share data)**

	Preferred Stock		Common Stock		Additional	Retained		Accumulated	
	Number of	Amount	Number of	Amount	Paid in	Earnings	Cumulative	Other	Total
	Shares		Shares		Capital	(Deficit)	Dividends	Comprehensive	
								Loss	
Balance at									
December 31, 2007	7,050,000	\$ 176,250	58,815,271	\$ 588	\$ 1,009,353	\$ 189,421	\$ (261,665)	\$ (1,185)	\$ 1,112,762
Vesting of restricted common stock			157,869	2	4,477				4,479
Repurchase of outstanding common stock			(11,108,486)	(111)	(184,356)				(184,467)
Common dividends and dividends payable at \$1.20 per share							(65,573)		(65,573)
Series A preferred dividends and dividends payable at \$2.00 per share							(14,100)		(14,100)
Series C preferred dividends and dividends payable at \$1.605 per share							(6,584)		(6,584)
Accretion of discount on Series C preferred stock					(200)				(200)
Net income						71,238			71,238
Pension liability adjustment								(2,743)	(2,743)
Comprehensive income									68,495

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	Preferred Stock		Common Stock		Additional Paid in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive		Total
	Number of Shares	Amount	Number of Shares	Amount			Dividends	Loss	
Balance at December 31, 2008	7,050,000	\$ 176,250	47,864,654	\$ 479	\$ 829,274	\$ 260,659	\$ (347,922)	\$ (3,928)	\$ 914,812
Net proceeds from sale of common stock			43,700,000	437	256,638				257,075
Vesting of restricted common stock			290,264	3	4,287				4,290
Common dividends at \$0.60 per share			5,049,157	50	29,006		(29,056)		
Series A preferred dividends and dividends payable at \$2.00 per share							(14,100)		(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share							(6,449)		(6,449)
Accretion of discount on Series C preferred stock					(200)				(200)
Net loss						(269,608)			(269,608)
Pension liability adjustment								947	947
Comprehensive loss									(268,661)
Balance at December 31, 2009	7,050,000	176,250	96,904,075	969	1,119,005	(8,949)	(397,527)	(2,981)	886,767
Net proceeds from sale of common stock			19,500,000	195	190,447				190,642
Vesting of restricted common stock			546,429	6	4,150				4,156
Series A preferred dividends and dividends payable at \$2.00 per share							(14,100)		(14,100)
Series C preferred dividends and dividends payable at \$1.572 per share							(6,448)		(6,448)
Accretion of discount on Series C preferred stock					(104)				(104)
Net income						38,542			38,542
Pension liability adjustment								(156)	(156)
Comprehensive income									38,386
Balance at December 31, 2010	7,050,000	\$ 176,250	116,950,504	\$ 1,170	\$ 1,313,498	\$ 29,593	\$ (418,075)	\$ (3,137)	\$ 1,099,299

See accompanying notes to consolidated financial statements

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	\$ 38,542	\$ (269,608)	\$ 71,238
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Bad debt expense	89	5,976	671
(Gain) loss on sales of hotel properties and other assets, net	382	12,677	(26,013)
Gain on extinguishment of debt	(86,235)	(54,506)	
Depreciation	100,670	110,642	117,137
Amortization of franchise fees and other intangibles	543	418	2,277
Amortization and write-off of deferred financing fees	3,623	2,673	1,702
Amortization of loan discounts	996	1,813	3,505
Amortization of deferred stock compensation	3,942	4,055	3,975
Property and goodwill impairment losses	1,943	226,145	2,904
Equity in net (earnings) losses of unconsolidated joint ventures	(555)	27,801	1,445
Changes in operating assets and liabilities:			
Restricted cash	(19,234)	(879)	372
Accounts receivable	4,269	9,903	604
Due from affiliates	18	47	823
Inventories	(163)	290	7
Prepaid expenses and other assets	(4,494)	2,008	1,555
Accounts payable and other liabilities	(1,301)	(4,537)	(12,249)
Accrued payroll and employee benefits	3,829	712	(9,281)
Due to Third Party Managers	(2,449)	(3,942)	(2,891)
Discontinued operations	987	(6,948)	2,221
Net cash provided by operating activities	45,402	64,740	160,002
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of hotel properties and other assets	63	64,073	360,395
Cash received from unconsolidated joint ventures	900	500	5,675
Restricted cash replacement reserve	(931)	(1,823)	5,136
Acquisitions of notes receivable	(3,950)		
Acquisitions of hotel properties and land	(142,410)		(30,695)
Renovations and additions to hotel properties and other real estate	(56,984)	(44,105)	(94,697)
Net cash provided by (used in) investing activities	(203,312)	18,645	245,814
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from common stock offering	199,875	269,100	
Payment of common stock offering costs	(9,233)	(12,025)	
Payments for repurchases of outstanding common stock			(184,467)
Proceeds from notes payable	92,500	60,000	181,000
Payments on notes payable	(175,175)	(74,406)	(190,386)
Payments for repurchases of notes payable and related costs		(117,450)	
Payments of deferred financing costs	(4,788)	(3,540)	(117)
Dividends paid	(20,548)	(27,911)	(99,753)
Net cash provided by (used in) financing activities	82,631	93,768	(293,723)
Net increase (decrease) in cash and cash equivalents	(75,279)	177,153	112,093
Cash and cash equivalents, beginning of year	353,255	176,102	64,009
Cash and cash equivalents, end of year	\$ 277,976	\$ 353,255	\$ 176,102

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)****(In thousands)**

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid for interest	\$ 65,780	\$ 91,407	\$ 97,431
NONCASH INVESTING ACTIVITY			
Accounts payable related to renovations and additions to hotel properties and other real estate	\$ 8,669	\$ 1,568	\$ 2,796
Deconsolidation of assets of hotels placed into receivership	\$	\$ 60,770	\$
Deconsolidation of liabilities of hotels placed into receivership	\$	\$ 101,221	\$
Amortization of deferred stock compensation construction activities	\$ 182	\$ 188	\$ 457
Amortization of deferred stock compensation unconsolidated joint venture	\$ 32	\$ 47	\$ 47
Forgiveness of interest on note receivable	\$	\$ (1,050)	\$
Receipt of note receivable	\$	\$	\$ 2,000
NONCASH FINANCING ACTIVITY			
Issuance of stock dividend	\$	\$ 29,056	\$
Dividends payable	\$ 5,137	\$ 5,137	\$ 12,499

See accompanying notes to consolidated financial statements.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Sunstone Hotel Investors, Inc. (the Company) was incorporated in Maryland on June 28, 2004 in anticipation of an initial public offering of common stock, which was consummated on October 26, 2004. The Company, through its 100% controlling interest in Sunstone Hotel Partnership, LLC (the Operating Partnership), of which the Company is the sole managing member, and the subsidiaries of the Operating Partnership, including Sunstone Hotel TRS Lessee, Inc. (the TRS Lessee) and its subsidiaries, is currently engaged in acquiring, owning, asset managing and renovating hotel properties. The Company may also sell certain hotel properties from time to time. The Company operates as a real estate investment trust (REIT) for federal income tax purposes.

As a REIT, certain tax laws limit the amount of non-qualifying income the Company can earn, including income derived directly from the operation of hotels. As a result, the Company leases all of its hotels to its TRS Lessee, which in turn enters into long-term management agreements with third parties to manage the operations of the Company's hotels. As of December 31, 2010, the Company owned 31 hotels (the 31 hotels). The Company's third party managers included a subsidiary of Interstate Hotels & Resorts, Inc. (IHR), manager of 13 of the Company's hotels; subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively, Marriott), managers of 12 of the Company's hotels; and Davidson Hotel Company (Davidson), a subsidiary of Denihan Hospitality Group (Denihan), Fairmont Hotels & Resorts (U.S.) (Fairmont), Hilton Worldwide (Hilton), Hyatt Corporation (Hyatt) and Sage Hospitality Resources (Sage), each managers of one of the Company's hotels. In addition to its wholly owned hotels, as of December 31, 2010, the Company had a 38% equity interest in a joint venture that owns one hotel.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements as of December 31, 2010 and 2009, and for the years ended December 31, 2010, 2009 and 2008, include the accounts of the Company, the Operating Partnership, the TRS Lessee and their subsidiaries. All significant intercompany balances and transactions have been eliminated.

Certain prior year amounts have been reclassified in the consolidated financial statements in order to conform to the current year presentation.

The Company has evaluated subsequent events through the date of issuance of these financial statements.

Use of Estimates

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

Reporting Periods

The results the Company reports in its consolidated statements of operations are based on results reported to the Company by its hotel managers. These hotel managers use different reporting periods. Marriott uses a fiscal year ending on the Friday closest to December 31, and reports twelve weeks of operations each for the first three quarters of the year, and sixteen or seventeen weeks of operations for the fourth quarter of the year. The Company's other hotel managers report operations on a standard monthly calendar. The Company has elected to adopt quarterly close periods of March 31, June 30 and September 30, and an annual year end of December 31. As a result, the Company's 2010 results of operations for the Marriott-managed hotels include results from January 2 through March 26 for the first quarter, March 27 through June 18 for the second quarter, June 19 through September 10 for the third quarter, and September 11 through December 31 for the fourth quarter. The Company's 2009 results of operations for the Marriott-managed hotels include results from January 3 through March 27 for the first quarter, March 28 through June 19 for the second quarter, June 20 through September 11 for the third quarter, and September 12 through January 1 for the fourth quarter. The Company's 2008 results of operations for the Marriott-managed hotels include results from December 29 through March 21 for the first quarter, March 22 through June 13 for the second quarter, June 14 through September 5 for the third quarter, and September 6 through January 2 for the fourth quarter.

Due to the one less day included in Marriott's 2010 results of operations, the Company estimates it recorded \$0.5 million less in revenue and approximately \$0.1 million less in net income based on the average daily revenues and income generated by its Marriott managed hotels during 2010. Due to the one less day included in Marriott's 2009 results of operations, the Company estimates it recorded \$0.2 million less in revenue and approximately \$41,000 less in net income

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

based on the average daily revenues and income generated by its Marriott managed hotels during 2009. Due to the five extra days included in Marriott's 2008 results of operations, the Company estimates it recorded an additional \$3.1 million in revenue and approximately \$0.8 million in additional net income based on the average daily revenues and income generated by its Marriott managed hotels during 2008.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and in various bank accounts plus all short-term investments with an original maturity of three months or less.

The Company maintains cash and cash equivalents and certain other financial instruments with various financial institutions. These financial institutions are located throughout the country and the Company's policy is designed to limit exposure to any one institution. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company's investment strategy. At December 31, 2010 and 2009, the Company had amounts in banks that were in excess of federally insured amounts.

Restricted Cash

Restricted cash is comprised of reserve accounts for debt service, interest reserves, capital replacements, ground leases, and property taxes. These restricted funds are subject to supervision and disbursement approval by certain of the Company's lenders and/or hotel managers.

Accounts Receivable

Accounts receivable primarily represents receivables from hotel guests who occupy hotel rooms and utilize hotel services. Accounts receivable also includes, among other things, receivables from customers who utilize the Company's commercial laundry facilities in Salt Lake City, Utah, and Rochester, Minnesota, as well as tenants who lease space in the Company's hotels. The Company maintains an allowance for doubtful accounts sufficient to cover potential credit losses. The Company's accounts receivable at both December 31, 2010 and 2009 includes an allowance for doubtful accounts of \$0.1 million. At December 31, 2010 and 2009, the Company had approximately \$0.3 million and \$2.6 million, respectively, in accounts receivable with one customer who is operating under a contract with the United States government. No amounts have been reserved for this receivable as of either December 31, 2010 or 2009 as all amounts have been deemed to be collectible.

Inventories

Inventories, consisting primarily of food and beverages at the hotels, are stated at the lower of cost or market, with cost determined on a method that approximates first-in, first-out basis. In addition, inventories include linens leased to customers of our commercial laundry facilities, which are carried at their historical cost basis, less accumulated amortization.

Investments In Hotel Properties, Other Real Estate and Franchise Fees

Hotel properties and other real estate assets are recorded at cost, less accumulated depreciation. Hotel properties and other completed real estate investments are depreciated using the straight-line method over estimated useful lives ranging from five to 35 years for buildings and improvements and three to 12 years for furniture, fixtures and equipment.

Intangible assets consist of two easement agreements, one ground lease with use rights agreement and contractual advance hotel bookings through August 2013 related to the purchase of the Royal Palm Miami Beach. The two easement agreements and one ground lease with use rights agreement are all recorded at fair value. The contractual advance hotel bookings are recorded at a discounted present value based on estimated collectibility. The ground lease with use rights agreement and one of the easement agreements are amortized using the straight-line method over the remaining non-cancelable term of the related agreement, 81 and 88 years, respectively. The contractual advance hotel bookings are amortized using the straight-line method based on the periods the amounts are expected to be collected through August 2013. The cost basis of these three intangible assets totaled \$24.7 million and \$24.4 million at December 31, 2010 and 2009, respectively. Accumulated amortization amounted to \$1.5 million and \$1.1 million at December 31, 2010 and 2009, respectively. Amortization expense for these three intangible assets amounted to \$0.4 million for the year ended December 31, 2010 and \$0.3 million for both of the years ended December 31, 2009 and 2008. Amortization expense will be \$0.5 million in 2011, and will be \$0.3 million every year thereafter until the agreements expire. The second easement agreement, recorded at fair value of \$9.7 million, has an indefinite useful life, and, therefore, is not amortized. This non-amortizable intangible asset is reviewed annually for impairment and more frequently if events or circumstances indicate that the asset may be impaired. If a non-amortizable intangible asset is subsequently determined to have a finite useful life, the intangible asset will be written down to the lower of its fair value or carrying amount and then amortized prospectively, based on the remaining useful life of the intangible asset.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Initial franchise fees are recorded at cost and amortized using the straight-line method over the lives of the franchise agreements ranging from six to 20 years. All other franchise fees that are based on the Company's results of operations are expensed as incurred.

The Company follows the requirements of the Property, Plant and Equipment Topic of the FASB ASC, which requires impairment losses to be recorded on long-lived assets to be held and used by the Company when indicators of impairment are present and the future undiscounted net cash flows expected to be generated by those assets are less than the assets' carrying amount. If such assets are considered to be impaired, the related assets are adjusted to their estimated fair value and an impairment is recognized. The impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. In computing fair value, the Company uses a discounted cash flow analysis to estimate the fair value of its hotel properties, taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of disposition and terminal capitalization rate. In 2010, the Company recognized a \$1.9 million impairment on an office building and land adjacent to one of its hotels based on estimated proceeds expected to be received from the possible sale of this property. In conjunction with its 2009 review, the Company recorded hotel property impairment losses totaling \$217.7 million, including \$25.4 million to property and goodwill impairment losses and \$192.3 million to discontinued operations to reduce the carrying values of 11 hotels on its balance sheet to their fair values. In addition, in 2009 the Company recorded an impairment loss of \$1.4 million to property and goodwill impairment losses related to the write-off of deferred costs associated with a potential time share development, and an impairment loss of \$0.1 million to property and goodwill impairment losses related to a parcel of land adjacent to one of its hotels, which was sold in June 2009. In 2008, the Company recorded an impairment loss to property and goodwill impairment losses of \$0.1 million on a vacant parcel of land, which was sold in January 2009. Based on the Company's review, management believes that there were no other impairments on its long-lived assets, and that the carrying values of its hotel properties and other real estate are recoverable at December 31, 2010.

When an impairment loss is required for assets held for sale, the related assets are adjusted to their estimated fair values, less costs to sell. Operating results of any long-lived assets with their own identifiable cash flows that are disposed of or held for sale are removed from income from continuing operations and reported as discontinued operations. Depreciation ceases when a property is held for sale. The operating results for any such assets for any prior periods presented must also be reclassified as discontinued operations.

Fair value represents the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than a forced or liquidation sale. The estimation process involved in determining if assets have been impaired and in the determination of fair value is inherently uncertain because it requires estimates of current market yields as well as future events and conditions. Such future events and conditions include economic and market conditions, as well as the availability of suitable financing. The realization of the Company's investment in hotel properties and other real estate is dependent upon future uncertain events and conditions and, accordingly, the actual timing and amounts realized by the Company may be materially different from their estimated fair values.

Deferred Financing Fees

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Deferred financing fees consist of loan fees and other financing costs related to the Company's outstanding indebtedness and are amortized to interest expense over the terms of the related debt. Upon repayment or refinancing of the underlying debt, any related unamortized deferred financing fee is charged to interest expense. Upon any loan modification, any related unamortized deferred financing fee is amortized over the remaining terms of the modified loan.

During 2010 and 2009, approximately \$4.8 million and \$3.5 million, respectively, were incurred and paid, related to new debt and debt refinancings. Such costs are being amortized over the related terms of the loans. Unamortized deferred financing costs written off and charged to interest expense due to the repayment or modification of the underlying debt totaled \$1.6 million for 2010, \$0.3 million for 2009 and zero for 2008. During 2010, the Company wrote off \$1.5 million in deferred financing fees related to the termination of its credit facility, and \$0.1 million in deferred financing fees related to the release of three hotels from the Mass Mutual loan. During 2009, the Company wrote off \$0.3 million in deferred financing fees associated with the amendment of its credit facility.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total amortization and write-off of deferred financing fees for 2010, 2009 and 2008 was as follows (in thousands):

	2010		2009		2008
Continuing operations:					
Amortization of deferred financing fees	\$ 1,597	\$	1,823	\$	1,133
Write-off of deferred financing fees	1,585		284		
Total deferred financing fees continuing operations	3,182		2,107		1,133
Discontinued operations:					
Amortization of deferred financing fees	441		566		569
Total amortization and write-off of deferred financing fees	\$ 3,623	\$	2,673	\$	1,702

Goodwill

The Company follows the requirements of the Intangibles Goodwill and Other Topic of the FASB ASC, which states that goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests. As a result, the carrying value of goodwill allocated to the hotel properties is reviewed at least annually for impairment. In addition, when facts and circumstances suggest that the Company's goodwill may be impaired, an interim evaluation of goodwill is prepared. Such review entails comparing the carrying value of the individual hotel property (the reporting unit) including the allocated goodwill to the fair value determined for that hotel property. If the aggregate carrying value of the hotel property exceeds the fair value, the goodwill of the hotel property is impaired to the extent of the difference between the fair value and the aggregate carrying value, not to exceed the carrying amount of the allocated goodwill. The Company's annual impairment evaluation is performed each year as of December 31.

Based on its annual impairment evaluation for 2010, the Company determined that no adjustment to its goodwill was required. During 2009, in light of the continuing decline in the economic environment, the Company determined that the goodwill associated with six of its hotels was impaired, and, accordingly, the Company recorded impairment losses of \$6.9 million in 2009, of which \$3.9 million is included in property and goodwill impairment losses and \$3.0 million is included in discontinued operations. As part of its 2008 annual impairment evaluation, the Company determined that the goodwill associated with one of its hotels should be written off, and, accordingly, the Company recorded an impairment loss of \$2.8 million in 2008, which is included in discontinued operations.

As of December 31, 2010 and 2009, goodwill consisted of the following (in thousands):

	2010		2009
Balance at beginning of year	\$ 4,673	\$	8,621
Goodwill impairment loss			(3,948)
Balance at end of year	\$ 4,673	\$	4,673

Property and Equipment

Property and equipment is stated on the cost basis and includes computer equipment and other corporate office equipment and furniture. Property and equipment is depreciated on a straight-line basis over the estimated useful lives ranging from three to 12 years. The cost basis of property and equipment amounted to \$8.2 million at both December 31, 2010 and 2009. Accumulated depreciation amounted to \$6.5 million and \$7.1 million at December 31, 2010 and 2009, respectively. Property and equipment net of related accumulated depreciation is included in other assets, net in the accompanying consolidated balance sheets.

Investments in Unconsolidated Joint Ventures

In December 2007, the Company entered into a joint venture agreement with Strategic Hotels & Resorts, Inc. (Strategic) to own and operate BuyEfficient, LLC (BuyEfficient), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment. Under the terms of the agreement, Strategic acquired a 50% interest in BuyEfficient from the Company. In December 2006, the Company entered into a joint venture agreement to obtain a 38% interest in the 460-room Doubletree Guest Suites Times Square in New York City, New York. The Company accounts for both of these ownership interests using the equity method. The Company's accounting policies are consistent with those of the unconsolidated joint ventures.

In January 2011, the Company purchased the outside 50% share in the BuyEfficient joint venture for \$8.6 million, and the outside 62% equity interests in the Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million. The Company is still evaluating the accounting for these transactions. Beginning in 2011, the Company is the sole owner of both BuyEfficient and the 460-room Doubletree Guest Suites Times Square, and will present both of these investments on a consolidated basis.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value of Financial Instruments

As of December 31, 2010 and 2009, the carrying amount of certain financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued expenses were representative of their fair values due to the short-term maturity of these instruments.

The Company follows the requirements of the Fair Value Measurements and Disclosures Topic of the FASB ASC, which establishes a framework for measuring fair value and disclosing fair value measurements by establishing a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the asset or the liability; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Unobservable inputs reflecting the Company's own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

The Company currently pays the premiums for a \$5,000,000 split life insurance policy for its former Chief Executive Officer and current Executive Chairman, Robert A. Alter. Under the terms of the policy, the Company is entitled to receive the greater of the cash surrender value of the policy or the premiums paid by the Company following the termination of Mr. Alter's employment with the Company. Within 60 days following the date of the termination of the split dollar policy during Mr. Alter's lifetime, Mr. Alter may obtain a release of such obligation by paying the Company the greater of the total amount of the premiums paid by the Company or the then-current cash surrender value. The Company has valued this policy using Level 2 measurements at \$1.9 million and \$1.8 million as of December 31, 2010 and 2009, respectively. These amounts are included in other assets, net in the accompanying consolidated balance sheets.

The Company also has a Retirement Benefit Agreement with Mr. Alter. Pursuant to the Retirement Benefit Agreement, Mr. Alter may defer a portion of his compensation. Mr. Alter may amend the amount of his compensation to be deferred from time to time; provided, however, that any such amendment must be in compliance with Section 409A of the Internal Revenue Code. The Company will match 50% of Mr. Alter's deferrals for each year, up to a maximum of \$1,500 for that year. Earnings on Mr. Alter's deferrals and the Company's matching contributions are

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an amount equal to the amount which would have been earned on such deferrals and matching contributions had they been paid as premiums on the life insurance policy noted above in accordance with the investment designations made by Mr. Alter. The balance in Mr. Alter's deferred compensation account is payable over a period of time following the termination of his employment with the Company, regardless of the reason for such termination. The Company has valued this agreement using Level 2 measurements at \$1.9 million and \$1.8 million as of December 31, 2010 and 2009, respectively. These amounts are included in accrued payroll and employee benefits in the accompanying consolidated balance sheets.

The Company has analyzed the carrying values of its hotel properties using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its hotel properties taking into account each property's expected cash flow from operations, holding period and estimated proceeds from the disposition of the property. The factors addressed in determining estimated proceeds from disposition included anticipated operating cash flow in the year of disposition and terminal capitalization rate. In June 2010, the Company recognized a \$1.9 million impairment on an office building and land adjacent to one of its hotels based on estimated proceeds expected to be received from the possible sale of this property. When indicators of impairment existed in 2009 and the undiscounted cash flows were less than the carrying value of the asset, the Company used terminal capitalization rates in its 2009 analyses ranging between 8.1% and 9.6%, based on the Company's weighted average cost of capital, a hurdle rate assigned to each hotel to account for a hotel's individual characteristics including, but not limited to, size, age and market supply, and an estimated average annual growth rate.

On an annual basis and periodically when indicators of impairment exist, the Company has analyzed the carrying value of its goodwill using Level 3 measurements, including a discounted cash flow analysis to estimate the fair value of its reporting units. In 2010, the Company did not identify any properties with indicators of goodwill impairment. When indicators of goodwill impairment existed in 2009 and the discounted cash flows were less than the carrying value of the reporting unit, the Company used discount rates ranging between 13.0% and 13.8% in its 2009 analyses, taking into account each related reporting unit's expected cash flow from operations, holding period and proceeds from the potential disposition of the property. The factors addressed in determining estimated proceeds from disposition include anticipated operating cash flow in the year of potential disposition and terminal capitalization rate. The Company used terminal capitalization rates in its

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2009 analyses ranging between 8.1% and 9.6%, based on the Company's weighted average cost of capital, a hurdle rate assigned to each hotel to account for a hotel's individual characteristics including, but not limited to, size, age and market supply, and an estimated average annual growth rate. The Company's judgment is required in determining the discount rate applied to estimated cash flows, the terminal capitalization rate, the growth rate of each property's projected revenues and expenses, the need for capital expenditures, as well as specific market and economic conditions.

As of December 31, 2010 and 2009, all of the Company's outstanding debt had fixed interest rates. The Company's carrying value of its debt secured by properties not classified as discontinued operations totaled \$1.1 billion and \$1.2 billion as of December 31, 2010 and 2009, respectively. Using Level 3 measurements, including the Company's weighted average cost of capital ranging between 6.0% and 9.6%, the Company estimates that the fair market value of its debt as of December 31, 2010 and 2009 totaled \$1.1 billion and \$1.0 billion, respectively.

The following table presents the impairment charges recorded as a result of applying Level 3 measurements included in earnings for the years ended December 31, 2010, 2009 and 2008 (in thousands):

	2010	2009	2008
Investment in hotel properties, net	\$	\$ 25,488	\$
Investment in hotel properties of discontinued operations, net		192,286	
Goodwill		3,948	
Other real estate, net	1,943		57
Other assets, net		1,416	
Investment in unconsolidated joint ventures		26,007	
Other current assets of discontinued operations, net (1)		3,007	2,847
Total Level 3 measurement impairment losses included in earnings	\$ 1,943	\$ 252,152	\$ 2,904

(1) Includes goodwill impairment losses recorded on discontinued operations.

The following tables present our assets and liabilities measured at fair value on a recurring and non-recurring basis at December 31, 2010 and 2009 (in thousands):

	Total December 31, 2010	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
Assets:				

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Other real estate, net (1)	\$	2,506	\$	\$	2,506
Life insurance policy		1,868		1,868	
Goodwill		4,673			4,673
Total assets	\$	9,047	\$	1,868	\$ 7,179
Liabilities:					
Retirement benefit agreement	\$	1,868	\$	1,868	\$
Total liabilities	\$	1,868	\$	1,868	\$

(1) Includes the office building and land adjacent to one of the Company's hotels that was impaired and recorded at fair value during 2010.

	Total December 31, 2009	Fair Value Measurements at Reporting Date		
		Level 1	Level 2	Level 3
Assets:				
Investment in hotel properties of discontinued operations, net (1)	\$ 69,272	\$	\$	\$ 69,272
Life insurance policy	1,814		1,814	
Goodwill	4,673			4,673
Goodwill of discontinued operations (2)	1,174			1,174
Total assets	\$ 76,933	\$	\$ 1,814	\$ 75,119
Liabilities:				
Retirement benefit agreement	\$ 1,814	\$	\$ 1,814	\$
Total liabilities	\$ 1,814	\$	\$ 1,814	\$

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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- (1) Includes the six hotel properties that were impaired and recorded at fair value as of December 31, 2009.
- (2) Goodwill of discontinued operations is included in other current assets of discontinued operations, net in the accompanying consolidated 2009 balance sheet.

Revenue Recognition

Room revenue and food and beverage revenue are recognized as earned, which is generally defined as the date upon which a guest occupies a room and/or utilizes the hotel's services. Additionally, some of the Company's hotel rooms are booked through independent internet travel intermediaries. Revenue for these rooms is booked at the price the Company sold the room to the independent internet travel intermediary less any discount or commission paid.

Other operating revenues consist of revenues derived from incidental hotel services such as concessions, movie rentals, retail sales, fitness services, internet access, telephone, and sublease revenues relating to the restaurants and retail shops, along with any performance guaranties. During 2009 and 2008, the Company recognized \$2.5 million and \$3.5 million, respectively, of a \$6.0 million performance guaranty received from Fairmont. As of December 31, 2009, the Company had fully utilized the \$6.0 million performance guaranty. Also, the Company operates two commercial laundries located in Rochester, Minnesota and Salt Lake City, Utah, which provide laundry services to the Company's hotels and other third parties in the respective locations. Revenues from incidental hotel services, management agreements, and laundry services are recognized in the period the related services are provided or the revenue is earned.

Advertising and Promotion Costs

Advertising and promotion costs are expensed when incurred. Advertising and promotion costs represent the expense for advertising and reservation systems under the terms of the hotel franchise and brand management agreements and general and administrative expenses that are directly attributable to advertising and promotions.

Income Taxes

The Company has elected to be treated as a REIT pursuant to the Internal Revenue Code, as amended (the "Code"). Management believes that the Company has qualified and intends to continue to qualify as a REIT. Therefore, the Company is permitted to deduct distributions paid to our

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stockholders, eliminating the federal taxation of income represented by such distributions at the company level. REITs are subject to a number of organizational and operational requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) on taxable income at regular corporate tax rates.

With respect to taxable subsidiaries, the Company accounts for income taxes in accordance with the Income Taxes Topic of the FASB ASC. Accordingly, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse.

Dividends

The Company pays quarterly dividends to its Series A Cumulative Redeemable and Series C Cumulative Convertible Redeemable preferred stockholders as declared by the Board of Directors. The Company may also pay dividends on its common stock to the extent declared by the Board of Directors. The Company's ability to pay dividends is dependent on the receipt of distributions from the Operating Partnership.

Earnings Per Share

The Company applies the two-class method when computing its earnings per share as required by the Earnings Per Share Topic of the FASB ASC, which requires the net income per share for each class of stock (common stock and convertible preferred stock) to be calculated assuming 100% of the Company's net income is distributed as dividends to each class of stock based on their contractual rights. To the extent the Company has undistributed earnings in any calendar quarter, the Company will follow the two-class method of computing earnings per share.

The Company follows the requirements of ASC 260-10, which states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Distributed earnings

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representing nonforfeitable dividends of zero, \$0.4 million and \$0.8 million were allocated to the participating securities for the years ended December 31, 2010, 2009 and 2008, respectively. Undistributed earnings representing nonforfeitable dividends of \$0.1 million were allocated to the participating securities for the year ended December 31, 2010, and zero for both the years ended December 31, 2009 and 2008.

In accordance with the Earnings Per Share Topic of the FASB ASC, basic earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period. Diluted earnings available (loss attributable) to common stockholders per common share is computed based on the weighted average number of shares of common stock outstanding during each period, plus potential common shares considered outstanding during the period, as long as the inclusion of such awards is not anti-dilutive. Potential common shares consist of unvested restricted stock awards (using the treasury stock method), the incremental common shares issuable upon the exercise of stock options (using the treasury stock method) and the conversion of the Company's Series C Cumulative Convertible Redeemable Preferred Stock (Series C preferred stock).

The following table sets forth the computation of basic and diluted earnings (loss) per common share (in thousands, except per share data):

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
Numerator:			
Net income (loss)	\$ 38,542	\$ (269,608)	\$ 71,238
Less dividends paid on unvested restricted stock compensation		(447)	(814)
Less preferred stock dividends and accretion	(20,652)	(20,749)	(20,884)
Less undistributed income allocated to unvested restricted stock compensation	(102)		
Numerator for basic and diluted earnings available (loss attributable) to common stockholders	\$ 17,788	\$ (290,804)	\$ 49,540
Denominator:			
Weighted average basic common shares outstanding	99,709	69,820	53,633
Unvested restricted stock awards			29
Weighted average diluted common shares outstanding	99,709	69,820	53,662
Basic earnings available (loss attributable) to common stockholders per common share	\$ 0.18	\$ (4.17)	\$ 0.92
Diluted earnings available (loss attributable) to common stockholders per common share	\$ 0.18	\$ (4.17)	\$ 0.92

The Company's unvested restricted stock units and shares associated with its long-term incentive plan have been excluded from the above calculation of earnings (loss) per share for the years ended December 31, 2010 and 2009, as their inclusion would have been anti-dilutive. The Company's common stock options and shares of its Series C preferred stock have been excluded from the above calculation of earnings (loss) per share for the years ended December 31, 2010, 2009 and 2008, as their inclusion would have been anti-dilutive.

Segment Reporting

The Company reports its consolidated financial statements in accordance with the Segment Reporting Topic of the FASB ASC. Currently, the Company operates in one segment, operations held for investment. Previously, the Company operated in an additional segment, operations held for non-sale disposition. As a result of deed backs and title transfers, the Company has disposed of all assets and liabilities from its operations held for non-sale disposition segment. Accordingly, all assets, liabilities and the operations from its non-sale disposition segment have been reclassified to discontinued operations.

Recent Accounting Pronouncements

In June 2009, the FASB issued a pronouncement which amends GAAP to require more information about transfers of financial assets, eliminates the qualifying special purpose entity (QSPE) concept, changes the requirements for derecognizing financial assets and requires additional disclosures. The FASB issued a second pronouncement in June 2009, which amends GAAP regarding certain guidance for determining whether an entity is a variable interest entity and modifies the methods allowed for determining the primary beneficiary of a variable interest entity. This second pronouncement requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and enhanced disclosures

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

related to an enterprise's involvement in a variable interest entity. Both of these pronouncements are effective for the first annual reporting period that begins after November 15, 2009. The adoption of these two pronouncements did not materially impact the Company.

In January 2010, the FASB issued a pronouncement to further update the fair value measurement guidance to improve fair value measurement disclosures. This update requires new disclosures related to transfers in and out of Level 1 and Level 2, as well as activity in Level 3 fair value measurements, and provides clarification to existing disclosures. This standard is effective for interim periods and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements as these disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company's adoption of the guidance related to new disclosures and clarifications on January 1, 2010 did not have any effect on its consolidated financial condition, results of operations or cash flows. The Company's adoption of the guidance related to disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements will occur during the first quarter of 2011. The Company does not anticipate that the adoption of this part of the pronouncement will materially impact the Company.

In February 2010, the FASB issued a pronouncement to amend the subsequent events guidance. The amendment states that SEC filers are no longer required to disclose the date through which subsequent events have been evaluated in originally issued and revised financial statements. This standard is effective immediately. The adoption of this pronouncement did not materially impact the Company.

3. Investment in Hotel Properties

Investment in hotel properties, net consisted of the following (in thousands):

	December 31,	
	2010	2009
Land	\$ 274,590	\$ 233,812
Buildings and improvements	1,964,535	1,848,435
Furniture, fixtures and equipment	258,962	243,415
Intangibles	34,454	34,081
Franchise fees	983	1,133
Construction in process	38,462	6,182
	2,571,986	2,367,058
Accumulated depreciation and amortization	(537,763)	(443,666)
	\$ 2,034,223	\$ 1,923,392

In August 2009, pursuant to the 2009 secured debt restructuring program, the Company elected to cease the subsidization of debt service on the \$29.2 million non-recourse mortgage secured by the 347-room Renaissance Westchester. In December 2009, a stipulation for the appointment of a receiver for the entity that owns the Renaissance Westchester was filed in the New York Superior Court, County of Westchester, and the Company transferred possession and control of the Renaissance Westchester to a receiver, who was operating the property for the benefit of the

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lender of the non-recourse loan. As such, and in conjunction with the Consolidation Topic of the FASB ASC, the Company effectively transferred control of the asset to the receiver in December 2009, and accordingly deconsolidated the Renaissance Westchester. The Company had no rights to the profit or loss associated with the Renaissance Westchester upon the hotel's appointment to the receiver; however, since the Company was still not released from the non-recourse mortgage, the net liability was still recorded on the Company's balance sheet. On June 14, 2010, the Company reacquired the Renaissance Westchester for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled. The Company recorded a \$6.7 million gain on the extinguishment of this debt, which is included in discontinued operations. Operating results for the Renaissance Westchester for 2009, therefore, are included in discontinued operations, whereas operating results from June 14, 2010 forward are included in the Company's continuing operations.

In August 2010, the Company acquired the Royal Palm hotel in Miami Beach, Florida at a foreclosure auction for a gross purchase price of \$126.1 million excluding transaction costs. Prior to the auction, the Company purchased a portion of the hotel's outstanding debt at a discount to par resulting in a net purchase price of approximately \$117.6 million, excluding transaction costs. The results of operations for the Royal Palm Miami Beach have been included in the Company's statement of operations from the title transfer date of August 27, 2010 through the fourth quarter ended December 31, 2010.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2009, the Company recorded an impairment loss of \$0.1 million to property and goodwill impairment losses on a parcel of land adjacent to one of its hotels which was sold in June 2009. The Company received net proceeds of \$0.1 million, and recorded a net loss of \$0.1 million on this sale, which is included in interest and other income on the consolidated statements of operations.

In June 2009, the Company performed a review of each property for possible impairment in accordance with the Property, Plant and Equipment Topic of the FASB ASC. In conjunction with this review, the Company recorded an impairment loss on its Marriott Del Mar of \$25.4 million to property and goodwill impairment losses.

In September 2008, the Company acquired 32.6 acres of land underlying its Renaissance Orlando at SeaWorld® for \$30.7 million, including costs of the acquisition, using its available cash on hand.

Acquired properties are included in the Company's results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the Company's results as if the reacquisition of the Renaissance Westchester in June 2010, the acquisition of the Royal Palm Miami Beach in August 2010, as well as the acquisition of the land underlying the Renaissance Orlando at SeaWorld® that occurred during the third quarter of 2008, had all occurred on January 1, 2008. In the Company's opinion, all significant adjustments necessary to reflect the effects of the acquisitions have been made (in thousands, except per share data):

	2010 (unaudited)	2009 (unaudited)	2008 (unaudited)
Revenues	\$ 663,448	\$ 658,561	\$ 812,244
Income available (loss attributable) to common stockholders from continuing operations	\$ (38,868)	\$ (45,604)	\$ 34,685
Income (loss) per diluted share available (attributable) to common stockholders from continuing operations	\$ (0.60)	\$ (0.97)	\$ 0.27

4. Discontinued Operations

The Company sold the Hyatt Regency Century Plaza during the second quarter of 2008, the Crowne Plaza Grand Rapids during the fourth quarter of 2008, the Marriott Napa Valley and the Marriott Riverside during the second quarter of 2009, and the Hyatt Suites Atlanta Northwest during the third quarter of 2009. These five hotel properties met the held for sale and discontinued operations criteria in accordance with the Property, Plant and Equipment Topic of the FASB ASC.

The sale of the Hyatt Regency Century Plaza in 2008 generated net proceeds of \$358.8 million and a net gain of \$42.1 million. The Crowne Plaza Grand Rapids sale in 2008 generated net proceeds of \$3.6 million, including a \$2.0 million note receivable which was paid by the buyer in

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January 2009, and a net loss of \$16.1 million. The sales of the Marriott Napa Valley and the Marriott Riverside during the second quarter of 2009 generated net proceeds of \$53.5 million and a net loss of \$10.8 million. During the second quarter of 2009, the Company also recorded a net loss of \$2.3 million due to additional expenses incurred related to hotels sold in prior years, including \$1.5 million accrued by the Company in regards to a lawsuit brought against the Company by the buyer of 13 hotels sold by the Company in 2006, and \$0.8 million accrued for various tax audits covering prior years. The Company recorded an impairment loss of \$4.9 million in June 2009 in anticipation of the Hyatt Suites Atlanta Northwest sale in the third quarter of 2009. The sale of the Hyatt Suites Atlanta Northwest generated net proceeds of \$7.8 million and a net gain of \$18,000 during the third quarter of 2009.

In June 2009, the Company elected to cease the subsidization of debt service on the non-recourse mortgage secured by the 258-room W San Diego. In September 2009, a stipulation for the appointment of a receiver for the entity that owns the W San Diego was filed in the California Superior Court, County of San Diego, and the Company transferred possession and control of the W San Diego to the receiver, who operated the property for the benefit of the lender of the non-recourse loan. As such, and in conjunction with the Consolidation Topic of the FASB ASC, the Company concluded that it lost control of the asset, and accordingly deconsolidated the W San Diego. The Company reclassified the net assets and the net liabilities, including the hotel's \$65.0 million mortgage indebtedness to other current liabilities of discontinued operations, net on the Company's December 31, 2009 balance sheet. Additionally, the Company reclassified the W San Diego's results of operations and cash flows to discontinued operations on the Company's statements of operations and cash flows. In conjunction with its quarterly impairment analysis, the Company recorded an impairment loss of \$60.0 million in June 2009 to reduce the carrying value of the W San Diego to its book value, which is included in discontinued operations. In July 2010, the Company completed the deed back of the W San Diego, and title to the hotel was transferred to the lender. The Company recorded a gain on extinguishment of debt of \$35.4 million to discontinued operations in July 2010, and removed the hotel's net assets and liabilities from its 2010 balance sheet.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2009, the Company commenced restructuring negotiations with Massachusetts Mutual Life Insurance Company, or Mass Mutual, the lender's representative for a \$246.0 million, 5.95% non-recourse mortgage loan secured by 11 hotels comprised of 2,587 rooms. In November 2009, the Company elected to cease the subsidization of debt service on the loan. In December 2009, the Company began the process to either transfer possession and control of eight of the hotels (the Mass Mutual eight) to a court-appointed receiver or to deed back the hotels to the lender. The Mass Mutual eight hotels include: Renaissance Atlanta Concourse; Hilton Huntington; Residence Inn by Marriott Manhattan Beach; Marriott Provo; Courtyard by Marriott San Diego (Old Town); Holiday Inn Downtown San Diego; Holiday Inn Express San Diego (Old Town); and Marriott Salt Lake City (University Park). Upon deed back of the hotels, the Company reclassified the assets, liabilities and results of operations of the Mass Mutual eight hotels to discontinued operations on its balance sheets, statements of operations and statements of cash flows. In conjunction with the Company's 2009 impairment evaluations, the Company recorded \$3.0 million in goodwill impairment losses on four of the Mass Mutual eight hotels, and an impairment charge of \$88.2 million in order to reduce the value of six of the Mass Mutual eight hotels on its balance sheet to their fair value, all of which is included in discontinued operations.

During the first quarter of 2010, the Company reached an agreement in principle with Mass Mutual to secure the release of the three remaining hotels comprising the collateral pool for the Mass Mutual loan. Also pursuant to this agreement, in November 2010, the Company completed the deed back of the Mass Mutual eight hotels, and titles to the hotels were transferred to the lender. In connection with such transfer, Mass Mutual delivered to the Company a covenant and agreement pursuant to which Mass Mutual agreed to not sue the Company for any matter or claim which Mass Mutual may ever have relating to the hotels, the loan or the loan documents. There are certain customary carveouts from this covenant not to sue, including fraud, a breach of the deed in lieu agreement itself and the environmental indemnity agreement delivered at the time the loan was originated. Additionally, the Company made certain customary representations and warranties, all of which survive the closing for a period of six months. Five of the Mass Mutual eight hotels remain subject to franchise agreements which contain corporate guaranties. If the franchise agreements on these remaining five hotels were to be terminated, the Company may be liable for up to \$19.6 million in termination fees. The Company recorded a gain on extinguishment of debt of \$39.0 million to discontinued operations in the fourth quarter of 2010, and the net assets and liabilities were removed from its 2010 balance sheet. Additional gain of \$19.6 million will be deferred until all significant contingencies are resolved.

In August 2009, the Company elected to cease the subsidization of debt service on the non-recourse mortgage secured by the 347-room Renaissance Westchester. In December 2009, a stipulation for the appointment of a receiver for the entity that owns the Renaissance Westchester was filed in the New York Superior Court, County of Westchester, and the Company transferred possession and control of the Renaissance Westchester to the receiver, who operated the property for the benefit of the lender of the non-recourse loan. As such, and in conjunction with the Consolidation Topic of the FASB ASC, the Company concluded that it lost control of the asset, and accordingly deconsolidated the Renaissance Westchester. The Company reclassified the net assets and the net liabilities, including the hotel's \$29.2 million mortgage indebtedness to other current liabilities of discontinued operations, net on the Company's December 31, 2009 balance sheet. Additionally, the Company reclassified the Renaissance Westchester's results of operations and cash flows to discontinued operations on its statements of operations and cash flows. In conjunction with its quarterly impairment analysis, the Company recorded an impairment loss of \$30.2 million in June 2009 to reduce the carrying value of the Renaissance Westchester to its book value, which is included in discontinued operations. In June 2010, the Company reacquired the Renaissance Westchester for \$26.0 million, including \$1.2 million of restricted cash and related costs for a net purchase price of \$24.8 million. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled, and the Company recorded a gain on extinguishment of debt of \$6.7 million to discontinued operations in June 2010.

In September 2009, the Company elected to cease the subsidization of debt service on the \$25.5 million 5.34% non-recourse mortgage secured by the 299-room Marriott Ontario Airport, and commenced restructuring negotiations with the loan's special servicer. In March 2010, possession

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and control of the Marriott Ontario Airport was transferred to a court-appointed receiver, and the Company deconsolidated the hotel. The Company reclassified the assets, liabilities and results of operations (including an impairment loss of \$8.9 million recorded in June 2009 to reduce the carrying value of the hotel to its fair value) of the Marriott Ontario Airport to discontinued operations on its balance sheets, statements of operations and statements of cash flows. In August 2010, the Marriott Ontario Airport was sold by the receiver, and title to the hotel was transferred to the hotel's new owner. In connection with this sale, the Company recorded a \$5.1 million gain on extinguishment of debt to discontinued operations in August 2010, and removed the net assets and liabilities from its 2010 balance sheet.

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Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following sets forth the discontinued operations for the years ended December 31, 2010, 2009 and 2008, related to hotel properties that have been disposed through non-sale disposition or sold (in thousands):

	2010	2009	2008
Operating revenues	\$ 71,105	\$ 136,777	\$ 250,584
Operating expenses	(58,031)	(114,893)	(187,306)
Interest expense	(17,172)	(22,698)	(18,618)
Depreciation and amortization	(5,432)	(17,265)	(25,655)
Property and goodwill impairment losses		(195,293)	(2,847)
Gain on extinguishment of debt	86,235		
Gain (loss) on sale of hotels, net		(13,052)	26,013

5. Other Real Estate

Other real estate, net consisted of the following (in thousands):

	December 31,	
	2010	2009
Land	\$ 2,768	\$ 3,824
Buildings and improvements	9,297	10,179
Furniture, fixtures and equipment	6,687	6,058
Construction in progress	116	27
	18,868	20,088
Accumulated depreciation	(7,044)	(6,232)
	11,824	13,856
Land held for investment	188	188
	\$ 12,012	\$ 14,044

In June 2010, the Company recorded an impairment loss of \$1.9 million on an office building and land adjacent to one of its hotels in anticipation of a possible sale.

In December 2008, the Company recorded an impairment loss of \$57,000 on a vacant parcel of land which was sold in January 2009 for net proceeds of \$0.3 million. No gain or loss was recognized on the sale.

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As of December 31, 2010, other real estate, net included the Company's two commercial laundry facilities, an office building and one vacant parcel of land.

6. Investments in Unconsolidated Joint Ventures

In December 2007, the Company entered into a joint venture agreement with Strategic to own and operate BuyEfficient. Under the terms of the agreement, Strategic acquired a 50% interest in BuyEfficient from the Company. As part of the Company's agreement with Strategic, the cost of BuyEfficient's participation in the Company's Long-Term Incentive Plan continues to be borne solely by the Company. In accordance with the Investments - Equity Method and Joint Ventures Topic of the FASB ASC, the Company expenses the cost of stock-based compensation granted to employees of BuyEfficient as incurred to the extent the Company's claim on BuyEfficient's book value has not been increased. The Company recognizes this stock-based compensation expense based on fair value in accordance with the Compensation - Stock Compensation Topic and the Equity Topic of the FASB ASC. The Company recognized stock-based compensation expense for BuyEfficient for the years ended December 31, 2010, 2009 and 2008, all of which was included in equity in net earnings (losses) of unconsolidated joint ventures, as follows (in thousands):

	2010		2009		2008	
Stock-based compensation expense	\$	49	\$	74	\$	72

The Company received \$0.9 million in distributions from BuyEfficient in 2010, \$0.5 million in 2009 and no distributions in 2008.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In January 2011, the Company repurchased Strategic's 50% share in BuyEfficient for \$8.6 million. The Company is still evaluating the accounting for the transaction. In accordance with the Consolidation Topic of the FASB ASC, the Company will consolidate BuyEfficient with its continuing operations in 2011 as it will be the sole owner of BuyEfficient.

In December 2006, the Company entered into a joint venture agreement with Whitehall Street Global Real Estate Limited Partnership 2005 and Highgate Holdings to acquire the 460-room Doubletree Guest Suites Times Square located in New York City, New York. Annual dividends on the Company's equity investment in the Doubletree Guest Suites Times Square are senior to the returns on equity to both Whitehall and Highgate. The annual dividends, which are calculated as a percentage of the Company's original \$40.0 million investment, were initially 8.0%, increased to 8.5% for 2008 through 2010, and will increase to 9.25% over a nine-year period. In addition, the Company's equity investment is entitled to receive a pro-rata share of any excess equity distributions to the joint venture. The Company received no distributions in either 2010 or 2009, and \$5.7 million during 2008.

During the fourth quarter of 2009, the Doubletree Guest Suites Times Square recorded an impairment loss in accordance with the Property, Plant and Equipment Topic of the FASB ASC, reducing the partners' equity in the joint venture to a deficit. The Company had no guaranteed obligations to fund any losses of the partnership; therefore, in accordance with the Investments - Equity Method and Joint Ventures Topic of the FASB ASC, the Company's impairment loss was limited to its remaining \$26.0 million investment in the partnership. The impairment charge was taken against equity in net losses of unconsolidated joint ventures, effectively reducing the Company's investment in the partnership to zero on its balance sheet as of December 31, 2009.

In January 2011, the Company purchased the remaining outside 62% equity interests in its Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The Company is still evaluating the accounting for the transaction. In accordance with the Consolidation Topic of the FASB ASC, the Company will consolidate the hotel with its continuing operations in 2011 as it will be the sole owner of the hotel.

7. Other Assets

Other assets, net consisted of the following (in thousands):

	December 31,	
	2010	2009
Property and equipment, net	\$ 1,758	\$ 1,125
Notes receivable	3,950	
Other receivables	4,403	2,567
Other	2,704	2,526
	\$ 12,815	\$ 6,218

Prior to its acquisition of the Royal Palm Miami Beach in August 2010, the Company purchased a portion of the hotel's debt with a principal amount of \$17.1 million for \$3.0 million. In conjunction with the purchase of the hotel, the Company received \$5.4 million, net of related costs, as a partial payment of this debt, and will receive an additional \$3.1 million no later than February 2012. The Company has included the additional \$3.1 million receivable in other assets, net in the accompanying consolidated 2010 balance sheet.

In April 2010, the Company purchased two hotel loans with a combined principal amount of \$32.5 million for a total purchase price of \$3.7 million. The loans included (i) a \$30.0 million, 8.5% mezzanine loan maturing in January 2017 secured by the equity interests in the Company's Doubletree Guest Suites Times Square joint venture (see Footnote 6), and (ii) one-half of a \$5.0 million, 8.075% subordinate note maturing in November 2010 secured by the 101-room boutique hotel known as Twelve Atlantic Station in Atlanta, Georgia. The Company purchased the mezzanine loan for \$3.45 million and the subordinate note for \$250,000. In November 2010, the Company purchased the remaining half of the Twelve Atlantic Station subordinate note for an additional \$250,000. In November 2010, the subordinate note was modified to provide for monthly interest only payments of 3.5%, with the remaining interest due at maturity, and the maturity date was extended to November 2012. As the subordinate note was in default, the borrower was required to bring the subordinate note current. As of December 31, 2010, the subordinate note secured by the Twelve Atlantic Station was not in default, however, the Company is accounting for the Twelve Atlantic Station loan using the cost recovery method until such time as the expected cash flows from the loan are reasonably probable and estimable. No amounts were received for the subordinate note during 2010. As of December 31, 2010, the debt on the Doubletree Guest Suites Times Square was not in default, however interest on the mezzanine loan was being deferred in accordance with the provisions of the loan, and the Company was accounting for the loan using the cost recovery method until such time as the expected cash flows from the loan were reasonably probable and estimable. No amounts were received for the mezzanine loan during 2010. In January 2011, the Company purchased the

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outside 62% equity interests in its Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. After the Company's acquisition of the remaining interests in the hotel, the mezzanine loan will remain in effect for tax purposes, but will be eliminated in consolidation on the Company's financial statements.

In 2006, the Company sold 13 hotels for gross proceeds of \$144.1 million. As a condition of the transaction, the Company currently holds a promissory note from the buyer of the 13 hotels (the Buyer) for \$5.6 million, with interest accruing at 8% per annum. The note is interest only and is secured by an equity pledge in the Buyer's legal investment entity. In December 2009, the Company received notice that the Buyer requested a loan modification from the Senior Note Lender, indicating that the Company's \$5.6 million mezzanine loan along with the accrued interest may not be collectible. As such, the Company recorded an allowance for bad debt of \$5.6 million to other assets, net in December 2009, which reserved both the discounted note and the related interest receivable in full at December 31, 2009. The Company suspended recording interest receivable on the note, and any amounts received from the Buyer in the future will be applied first towards the principal amount of the note. During 2010, the Company received \$0.1 million from the Buyer, and applied these receipts towards the principal amount of the note as recoveries of bad debt which were included in corporate overhead. In October 2010, the Company received notice that the Buyer had filed a deed in lieu of foreclosure in bankruptcy court, and the Company removed the note receivable and related reserve from its balance sheet.

8. Due to Third Party Managers and Other Current Liabilities*Due to Third Party Managers*

IHR manages 13 of the Company's 31 hotels as of December 31, 2010. The following amounts make up the net liability owed to IHR in regards to these 13 hotels (in thousands):

	December 31,		
	2010		2009
Accrued payroll and employee benefits	\$ 4,015	\$	5,839
Workers' compensation	1,280		1,637
Accrued pension liability	2,315		2,141
Management and accounting fees payable	262		354
Reimbursements from IHR	(20)		(154)
	\$ 7,852	\$	9,817

Other current liabilities of discontinued operations, net includes \$1.4 million due to IHR as of December 31, 2009.

Other Current Liabilities

Other current liabilities consisted of the following (in thousands):

	December 31,	
	2010	2009
Property, sales, and use taxes payable	\$ 6,527	\$ 7,925
Accrued interest	5,315	7,618
Advanced deposits	3,109	3,292
Other	2,741	3,075
	\$ 17,692	\$ 21,910

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Notes payable consisted of the following at December 31 (in thousands):

	2010	2009
Notes payable requiring payments of interest and principal, with fixed rates ranging from 4.97% to 9.88%; maturing at dates ranging from July 2012 through May 2021. The notes are collateralized by first deeds of trust on 19 hotel properties and one laundry facility at December 31, 2010, and 22 hotel properties and one laundry facility at December 31, 2009.	\$ 1,083,000	\$ 1,144,490
Senior Notes, with a fixed interest rate of 4.60%, maturing in July 2027. The notes are guaranteed by the Company and certain of its subsidiaries.	62,500	62,500
	1,145,500	1,206,990
Less: discount on Senior Notes	(2,197)	(3,193)
	1,143,303	1,203,797
Less: current portion	(16,486)	(153,778)
	\$ 1,126,817	\$ 1,050,019

In November 2010, the Company entered into a new \$150.0 million senior corporate credit facility. The interest rate for the facility ranges from 325 to 425 basis points over LIBOR, depending on the overall leverage of the Company. The initial term of the facility is three years with an option to extend for an additional one year. Subject to approval by the lender group, the facility may be increased to up to \$250.0 million. The facility contains customary events of default relating to payments and breaches of representations and warranties. As of December 31, 2010, the Company had no outstanding indebtedness under its credit facility.

In November 2010, the Company entered into a new \$92.5 million non-recourse mortgage on its Hilton Times Square. The mortgage matures in 2020 and bears a fixed interest rate of 4.97%, with scheduled monthly principal and interest amounts based on a thirty-year amortization. The proceeds from the mortgage were used in part to repay the maturing \$81.0 million mortgage secured by the Company's Hilton Times Square, which bore an interest rate of 5.915%. Excess proceeds were retained for general corporate purposes. The mortgage contains customary events of default relating to payments and breaches of representations and warranties.

In January 2011, the Company purchased the outside 62% equity interests in its Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The Company is still evaluating the accounting for the transaction. The hotel is encumbered by approximately \$270.0 million of non-recourse senior mortgage and mezzanine debt that matures in January 2012 and bears a blended interest rate of LIBOR + 115 basis points. The Company expects to refinance this debt during 2011 and intends to fund any refinancing shortfall with existing cash.

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During 2009, the Company initiated a secured debt restructuring program aimed at addressing cash flow and value deficits among certain of its hotels securing non-recourse mortgage debt. The Company concluded the program in the fourth quarter of 2009. The primary goal of the program was to amend the terms of mortgage debt to eliminate existing cash flow and/or value deficits. In certain cases, however, where acceptable restructuring terms could not be reached, rather than employing corporate resources to subsidize debt service, the Company elected to deed-back the collateral hotels in satisfaction of the associated debt. The loans secured by such hotels, subject to customary exceptions, were non-recourse to the Company. During 2009, five of the Company's loans totaling \$470.9 million were subject to the Company's secured debt restructuring program. The status of each of these five loans is discussed further below.

W San Diego. Effective September 30, 2009, possession and control of the 258-room W San Diego was transferred to a court-appointed receiver. In connection with this transfer, the Company deconsolidated this hotel and reclassified the assets and liabilities, including the \$29.0 million hotel net asset and the hotel's \$65.0 million 6.14% non-recourse mortgage, to discontinued operations on its balance sheets. Additionally, the Company reclassified the W San Diego's results of operations and cash flows to discontinued operations on its statements of operations and cash flows. In July 2010, the Company completed the deed back of the W San Diego, and title to the hotel was transferred to the lender. The Company recorded a gain on extinguishment of debt of \$35.4 million to discontinued operations in July 2010, and removed the hotel's net assets and liabilities from its 2010 balance sheet.

Renaissance Westchester. Effective December 28, 2009, possession and control of the 347-room Renaissance Westchester was transferred to a court-appointed receiver. In connection with this transfer, the Company deconsolidated this hotel and reclassified the assets and liabilities, including the \$25.2 million hotel net asset and the hotel's \$29.2 million 4.98% non-recourse mortgage, to discontinued operations on its balance sheets. Additionally, the Company reclassified the Renaissance Westchester's results of operations and cash flows to discontinued operations on its statements of operations and cash flows. In connection with the repurchase of the Renaissance Westchester, the \$29.2 million non-recourse mortgage was cancelled, and the Company recorded a gain on extinguishment of debt of \$6.7 million to discontinued operations in June 2010.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Marriott Ontario Airport. In September 2009, the Company elected to cease the subsidization of debt service on the \$25.5 million 5.34% non-recourse mortgage secured by the 299-room Marriott Ontario Airport, and commenced restructuring negotiations with the loan's special servicer. In March 2010, possession and control of the Marriott Ontario Airport was transferred to a court-appointed receiver, and the Company deconsolidated the hotel. The Company reclassified the assets, liabilities and results of operations of the Marriott Ontario Airport to discontinued operations on its balance sheets, statements of operations and statements of cash flows. In August 2010, the Marriott Ontario Airport was sold by the receiver, and title to the hotel was transferred to the hotel's new owner. In connection with this sale, the Company recorded a \$5.1 million gain on extinguishment of debt to discontinued operations in August 2010, and removed the net assets and liabilities from its 2010 balance sheet.

Massachusetts Mutual Life Insurance Company. In July 2009, the Company commenced restructuring negotiations with Mass Mutual, the lender's representative for a \$246.0 million, 5.95% non-recourse mortgage loan secured by 11 of the Company's hotels. In November 2009, the Company elected to cease the subsidization of debt service on the loan. In December 2009, the Company began the process to either transfer possession and control of the Mass Mutual eight hotels to a court-appointed receiver or to deed back the hotels to the lender in lieu of repayment of the debt. Upon deed back of the hotels, the Company reclassified the assets, liabilities and results of operations of the Mass Mutual eight hotels to discontinued operations on its balance sheets, statements of operations and statements of cash flows. During the first quarter of 2010, the Company reached an agreement in principle with Mass Mutual to secure the release of the three remaining hotels comprising the collateral pool for the Mass Mutual loan. Also pursuant to this agreement, in November 2010, the Company completed the deed back of the Mass Mutual eight hotels and titles to the hotels were transferred to the lender. In connection with such transfer, Mass Mutual delivered to the Company a covenant and agreement pursuant to which Mass Mutual agreed to not sue the Company for any matter or claim which Mass Mutual may ever have relating to the hotels, the loan or the loan documents. There are certain customary carveouts from this covenant not to sue, including fraud, a breach of the deed in lieu agreement itself and the environmental indemnity agreement delivered at the time the loan was originated. Additionally, the Company made certain customary representations and warranties, all of which survive the closing for a period of six months. Five of the Mass Mutual eight hotels remain subject to franchise agreements which contain corporate guaranties. If the franchise agreements on these five hotels were to be terminated, the Company may be liable for up to \$19.6 million in termination fees. The Company recorded a gain on extinguishment of debt of \$39.0 million to discontinued operations in the fourth quarter of 2010, and the net assets and liabilities were removed from its 2010 balance sheet. Additional gain of \$19.6 million will be deferred until all significant contingencies are resolved.

Renaissance Baltimore. During the fourth quarter of 2009, the Company finalized an amendment to the \$105.2 million 5.13% non-recourse mortgage secured by the 622-room Renaissance Baltimore. The amendment results in the elimination of amortization on this loan for a period of up to 30 months.

The Operating Partnership issued an aggregate of \$250.0 million of Senior Notes in June 2007. The Senior Notes have a maturity date of July 2027 and a stated interest rate of 4.60%. The Company follows the requirements of ASC 470-20 which states that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer's non-convertible debt borrowing rate at the time of issuance. As a result, the liability component is recorded at a discount reflecting its below market interest rate. The liability component is subsequently accreted to its par value over its expected life based on a rate of interest that reflects the issuer's non-convertible debt borrowing rate at the time of issuance, and is reflected in the results of operations as interest expense. Under the guidelines of ASC 470-20, the implicit interest rate for the Senior Notes is 6.5% based on the Company's non-convertible debt borrowing rate at the time of issuance. Interest expense for the years ended December 31, 2010, 2009 and 2008 includes \$1.0 million, \$1.8 million and \$3.5 million, respectively, in accretion of the Senior Notes. Interest on the notes is payable semi-annually in arrears on January 15 and July 15 of each year. The notes, subject to specified events and other conditions, are exchangeable into, at the Company's option, cash, the Company's common stock, or a combination of cash and the Company's common stock. The initial exchange rate for each \$1,000 principal amount of notes was 28.9855 shares of the Company's common stock, representing an exchange price of approximately

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\$34.50 per common share. The initial exchange rate is subject to adjustment under certain circumstances, and was adjusted in 2008 as a result of the Company's modified Dutch Auction tender offer, as well as its 2008 year-end dividend consisting of both cash and stock. Currently, the exchange rate for each \$1,000 principal amount of notes is 32.9179 shares of the Company's common stock, representing an exchange price of approximately \$30.38 per common share. The Operating Partnership does not have the right to redeem the notes, except to preserve the Company's REIT status, before January 20, 2013, and may redeem the notes, in whole or in part, thereafter at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus any accrued and unpaid interest. Upon specified change in control events

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

as well as on specified dates, holders of the notes may require the Operating Partnership to repurchase their notes, in whole or in part, for cash equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest. The notes are the senior unsecured obligations of the Operating Partnership. The Company and several of its subsidiaries have guaranteed the Operating Partnership's obligations under the notes. The notes do not qualify as a derivative or an equity instrument.

During the first quarter of 2009, the Company repurchased \$64.0 million in aggregate principal amount of the Senior Notes for \$30.8 million, including \$0.4 million in interest, using its available cash on hand. After the repurchase, such Senior Notes were cancelled. The Company wrote off \$1.4 million in deferred financing fees and \$4.2 million of the Senior Notes discount, and recognized a net gain of \$28.0 million on this early extinguishment of debt. In May 2009, in accordance with the terms and conditions of a tender offer (the "Senior Notes Tender Offer"), the Company purchased a total of \$123.5 million in principal amount of Senior Notes for \$89.0 million, including \$2.0 million in interest, \$1.9 million in related consents solicited from the registered holders of the Senior Notes to adopt a proposed amendment to the indenture governing the Senior Notes and \$0.6 million in fees and costs. After the repurchase, such Senior Notes were cancelled. In addition, the Company paid \$1.2 million, including \$0.3 million in fees and costs, for consents related to non-tendered Senior Notes. The Company wrote off \$2.7 million in deferred financing fees and \$7.3 million of the Senior Notes discount, and recognized a net gain of \$26.6 million on this early extinguishment of debt. The Company initially used its credit facility in existence at the time to fund this repurchase of the Senior Notes, and subsequently replaced such cash with proceeds from its equity offering completed in May 2009. The Company incurred an additional \$20,000 and \$53,000 in fees and costs during the third and fourth quarters of 2009, respectively, related to the repurchases of the Senior Notes.

In April 2009, the Company drew down \$60.0 million on its credit facility in existence at the time in connection with its Senior Notes Tender Offer. The Company repaid the \$60.0 million in May 2009 using available cash. In June 2009, the Company amended its credit facility (the "amended credit facility"), reducing the facility's size from \$200.0 million to \$85.0 million. In addition, the amendment reduced the facility's minimum fixed charge coverage covenant from 1.50:1.00 to 1.00:1.00, with added flexibility to drop to 0.90:1.00 for up to four quarters, and eliminated the facility's 65% maximum total leverage covenant, replacing it with a 9.50:1.00 maximum net debt to EBITDA covenant, which could be increased to 10.50:1.00 for up to four quarters. The amended credit facility was secured by five of the Company's hotels (Fairmont Newport Beach, Hyatt Regency Newport Beach, Renaissance Los Angeles Airport, Residence Inn Rochester, and Sheraton Cerritos), had an interest rate based on grid pricing ranging from 375-525 basis points over LIBOR, and matured in 2012, assuming the exercise of a one-year extension option. In February 2010, in view of its strong liquidity position, the restrictive terms of the amended credit facility and the Company's expectation that the amended credit facility would not be accessed in 2010, the Company elected to terminate its amended credit facility.

Total interest incurred and expensed on the notes payable is as follows (in thousands):

	2010		2009		2008	
Interest expense	\$	65,457	\$	71,940	\$	78,538
Interest expense - default rate (1)		884		472		
Accretion of Senior Notes		996		1,813		3,505
Amortization of deferred financing fees		1,597		1,823		1,133
Write-off of deferred financing fees		1,585		284		
Loan penalties and fees (1)		311		207		

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\$	70,830	\$	76,539	\$	83,176
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(1) The default rate interest expense and the loan penalties and fees were incurred due to the Company's elective default on the Mass Mutual loan.

Aggregate future principal maturities of notes payable at December 31, 2010, are as follows (in thousands):

2011	\$	16,486
2012		50,523
2013		81,069
2014		19,111
2015		219,595
Thereafter		758,716
Total	\$	1,145,500

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Income Taxes

The Company has elected to be taxed as a REIT under the Code. As a REIT the Company generally will not be subject to corporate level federal income taxes on net income it distributes to its stockholders. The Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. Taxable income from non-REIT activities managed through taxable REIT subsidiaries is subject to federal, state and local taxes.

The Company leases its hotels to wholly owned TRSs that are subject to federal and state income taxes. The Company accounts for income taxes in accordance with the provisions of the Income Taxes Topic of the FASB ASC, which requires the Company to account for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between GAAP carrying amounts and their respective tax bases.

The income tax benefit (provision) included in the consolidated financial statements is as follows (in thousands):

	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008
Current:			
Federal	\$	\$	\$
State			
Deferred:			
Federal	4,187	5,177	1,530
State	1,069	1,317	371
	5,256	6,494	1,901
Valuation allowance	(5,256)	(6,494)	(1,901)
Provision for income taxes	\$	\$	\$

The tax effects of temporary differences giving rise to the deferred tax assets (liabilities) are as follows (in thousands):

	December 31, 2010	December 31, 2009
NOL carryover	\$ 36,636	\$ 29,945
Other reserves	1,848	3,210
State taxes and other	1,582	1,619
Current deferred tax asset before valuation allowance	40,066	34,774

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Depreciation	(151)	(115)
Current deferred tax liability before valuation allowance	(151)	(115)
Net deferred tax asset	39,915	34,659
Valuation allowance	(39,915)	(34,659)
	\$	\$

The Company has provided a valuation allowance against its deferred tax asset at December 31, 2010 and 2009. The valuation allowance is due to the uncertainty of realizing the Company's historical operating losses. Accordingly, no provision or benefit for income taxes is reflected in the accompanying consolidated statements of operations.

At December 31, 2010 and 2009, net operating loss carryforwards for federal income tax purposes total approximately \$93.0 million and \$76.0 million, respectively. These losses, which begin to expire in 2019, are available to offset future income through 2029.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Characterization of Distributions*

For income tax purposes, distributions paid consist of ordinary income, capital gains, return of capital or a combination thereof. For the years ended December 31, 2010, 2009 and 2008, distributions paid per share were characterized as follows (unaudited):

	2010		2009		2008	
	Amount	%	Amount	%	Amount	%
Common Stock:						
Ordinary income	\$				1.341	74.479%
Capital gain					0.459	25.521
Return of capital						
Total	\$				1.800	100.000%
Preferred Stock Series A						
Ordinary income	\$	1.010	67.321%	\$	2.000	100.000%
Capital gain					0.510	25.521
Return of capital		0.490	32.679			
Total	\$	1.500	100.000%	\$	2.000	100.000%
Preferred Stock Series C						
Ordinary income	\$	0.794	67.321%	\$	1.572	100.000%
Capital gain					0.410	25.521
Return of capital		0.385	32.679			
Total	\$	1.179	100.000%	\$	1.572	100.000%

11. Series C Cumulative Convertible Redeemable Preferred Stock

In July 2005, the Company sold 4,102,564 shares of Series C preferred stock with a liquidation preference of \$24.375 per share to Security Capital Preferred Growth, Incorporated, an investment vehicle advised by Security Capital Research & Management Incorporated, for gross proceeds of \$99.0 million, or \$24.13 per share, which included a 1% discount to the conversion price/liquidation preference. Other costs of the offering totaled \$130,000. Net proceeds of \$99.0 million were contributed to the Operating Partnership in exchange for preferred membership units with economic terms substantially identical to the Series C preferred stock. The net proceeds were used to partially finance the Company's acquisition of six Renaissance hotels. As a result of the Company's stock dividend paid in January 2009, the Series C conversion price was adjusted to \$22.23 per share. Each share of the Series C preferred stock is convertible into 1.096 shares of the Company's common stock at the option of the holder, subject to customary antidilution provisions, including stock splits, stock dividends, non-cash distributions and above-market issuer self-tender or exchange offers. As of July 8, 2010, the Series C preferred stock is redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$24.375 per share, plus accrued and unpaid dividends up to and including the redemption date. The holders of the Series C preferred stock have the right to require the Company to redeem the Series C preferred stock in the event of any of the following: (1) a change in control of the Company, if certain conditions are not met; (2) a REIT termination event; or, (3) a termination of the Company's listing on either the New York Stock Exchange or NASDAQ. In general, holders of Series C preferred stock vote on an as-converted basis as a single class with holders of the Company's common stock. The holders are eligible to

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receive a participating dividend to the extent the Company's dividend on its common stock exceeds \$0.339 per share per quarter. The quarterly dividend on the Series C preferred stock is currently \$0.393 per share. If the Company fails to meet certain financial ratios for four consecutive quarters a financial ratio violation will occur with respect to the Company's Series C preferred stock. During the continuation of a financial ratio violation, among other things, the Company would be restricted from paying dividends on its common stock, and may incur a 50 basis point per quarter dividend increase on the Series C preferred stock. Additionally, the Series C preferred stockholders would gain the right to appoint one board member. Should operations deteriorate from current levels, the Company may fail to meet its financial ratios with respect to its Series C preferred stock for four consecutive quarters, which would cause the Company to incur a financial ratio violation. The Series C preferred stock has no maturity date and, except as set forth above, the Company is not required to redeem the Series C preferred stock at any time. As the Series C preferred stockholders may redeem their shares in certain circumstances outside of the control of the Company, the Series C preferred stock has not been classified as permanent equity.

The initial carrying value of the Series C preferred stock was recorded at its sales price less costs to issue on the date of issuance. This carrying value is periodically adjusted so that the carrying value will equal the redemption value on the redemption date, which is the earliest date available for the Company to redeem the Series C preferred stock. The carrying value will also be periodically adjusted for any accrued and unpaid dividends. At December 31, 2010 and 2009, the Series C preferred stock carrying value consisted of the following (in thousands):

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	December 31,			
	2010		2009	
Initial fair value, sales price of \$99.0 million	\$	99,000	\$	99,000
Redemption value accretion		1,000		896
	\$	100,000	\$	99,896

12. Stockholders' Equity***Series A Cumulative Redeemable Preferred Stock***

In March 2005, the Company sold an aggregate of 4,850,000 shares of 8.0% Series A and B Cumulative Redeemable Preferred Stock (Series A preferred stock and Series B preferred stock, respectively) with a liquidation preference of \$25.00 per share for gross proceeds of \$121.3 million. Underwriting and other costs of the offering totaled \$3.8 million. Net proceeds of \$117.5 million were contributed to the Operating Partnership in exchange for preferred membership units with economic terms substantially identical to the Series A and B preferred stock. Subsequent to this offering, the shares of Series B preferred stock were exchanged for an equivalent number of shares of Series A preferred stock. The net proceeds were used to reduce borrowings under the Company's credit facility in existence at the time and for acquisitions. As of March 17, 2010, the Series A preferred stock is redeemable at the Company's option, in whole or in part, at any time or from time to time, for cash at a redemption price of \$25.00 per share, plus accrued and unpaid dividends up to and including the redemption date. Holders of Series A preferred stock generally have no voting rights. However, if the Company is in arrears on dividends on the Series A preferred stock for six or more quarterly periods, whether or not consecutive, holders of the Series A preferred stock will be entitled to vote at its next annual meeting and each subsequent annual meeting of stockholders for the election of two additional directors to serve on the Company's board of directors until all unpaid dividends and the dividend for the then-current period with respect to the Series A preferred stock have been paid or declared and a sum sufficient for the payment thereof set aside for payment. As of December 31, 2010, the Company is in compliance with the dividend requirements for the Series A preferred stock. The Series A preferred stock has no maturity date and the Company is not required to redeem the Series A preferred stock at any time.

In April 2006, the Company sold an additional 2,200,000 shares of Series A preferred stock with a liquidation preference of \$25.00 per share for gross proceeds of \$55.0 million. The proceeds to the Company, net of offering costs, were \$54.2 million, and were used together with proceeds of certain debt refinancings to repay the Company's term loan facility.

Common Stock

In February 2008, the Company's board of directors authorized the Company to repurchase up to \$150.0 million of the Company's common stock on or prior to December 31, 2008 (the 2008 Repurchase Program). During the first quarter of 2008, the Company repurchased 734,307 shares of its common stock at a cost of \$11.8 million under the 2008 Repurchase Program. In June 2008, the Company conducted a modified Dutch Auction tender offer (the Common Stock Tender Offer) through which it purchased 7,374,179 shares of its common stock at a cost of \$129.0 million. In August 2008, the Company's board of directors authorized an increase of \$100.0 million to the 2008 Repurchase Program. During the

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third quarter of 2008, the Company repurchased 3,000,000 shares of its common stock at a cost of \$42.1 million. On December 11, 2008, the Company's board of directors terminated the 2008 Repurchase Program. Through the termination of the 2008 Repurchase Program, the Company incurred \$1.6 million in fees and commissions related to the 2008 stock repurchases, and repurchased 11,108,486 shares of its common stock at a cost of \$182.9 million.

On December 11, 2008 the Company's board of directors declared a dividend of \$0.75 per share of common stock. The dividend was payable in cash and/or shares of common stock at the election of the stockholder, and was subject to a cash limitation of 20% of the total value of the dividend. This fourth quarter dividend was paid on January 15, 2009 to stockholders of record at the close of business on December 19, 2008. Based on stockholder elections, the dividend consisted of approximately \$7.3 million in cash and 5,049,157 shares of the Company's common stock. The number of shares included in the distribution was calculated based on the \$5.74 average closing price per share of the Company's common stock on the New York Stock Exchange on January 8 and 9, 2009.

In May 2009, the Company issued 20,700,000 shares of its common stock, including the underwriters' over-allotment of 2,700,000 shares, for net proceeds of \$98.7 million. The Company used the net proceeds from this equity offering for working capital and other general corporate purposes, including the replacement of cash used in the repurchase of the Senior Notes and the repayment of \$60.0 million outstanding on its credit facility in existence at the time.

In October 2009, the Company issued 23,000,000 shares of its common stock, including the underwriters' over-allotment of 3,000,000 shares, for net proceeds of approximately \$158.4 million. The Company used a portion of the net proceeds from this equity offering for working capital and other general corporate purposes, as well as the reacquisition of the Renaissance Westchester in June 2010 and the acquisition of the Royal Palm Miami Beach in August 2010.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In November 2010, the Company issued 19,500,000 shares of its common stock for net proceeds of approximately \$190.6 million. The Company plans to use the net proceeds from this equity offering for growth capital expenditures, future acquisitions and other general corporate purposes, including working capital.

Dividends

The Company declared dividends per share during 2010, 2009 and 2008 as follows:

	2010		2009		2008	
Series A preferred stock	\$	2.00	\$	2.00	\$	2.00
Common stock - cash						1.20
Common stock - stock						0.60
	\$	2.00	\$	2.00	\$	3.80

2009 Repurchase Program and Senior Notes Tender Offer

On December 11, 2008, the Company's board of directors authorized a \$200.0 million program (the 2009 Repurchase Program) to repurchase common stock, Series A preferred stock, Series C preferred stock, or Senior Notes, or to repay secured debt on or prior to December 31, 2009. As of the expiration of the 2009 Repurchase Program on December 31, 2009, the Company had repurchased \$187.5 million in aggregate principal amount of the Senior Notes for \$119.8 million through open market purchases and the Senior Notes Tender Offer, including \$2.4 million in interest, \$1.9 million in related consents and \$0.6 million in fees and costs of the Senior Notes Tender Offer and consent solicitation discussed above.

Operating Partnership Units

As of December 31, 2010, the Operating Partnership had 116,950,504 units outstanding, all of which are held by the Company.

13. Long-Term Incentive Plan

Stock Grants

The Company has a Long-Term Incentive Plan (LTIP) which provides for the granting to directors, officers and eligible employees of incentive or nonqualified share options, restricted shares, deferred shares, share purchase rights and share appreciation rights in tandem with options, or any combination thereof. The Company has reserved 6,050,000 common shares for issuance under the LTIP, and 3,828,573 shares remain available for future issuance as of December 31, 2010.

Restricted shares and restricted share units granted pursuant to the Company's LTIP generally vest over periods from one to five years from the date of grant. The value of shares granted has been calculated based on the share price on the date of grant and is being amortized as compensation expense in accordance with the Company's policy on a straight-line basis over the vesting periods for the entire award. The Company's compensation expense and forfeitures related to these restricted shares and restricted share units for the years ended December 31, 2010, 2009 and 2008 were as follows (in thousands):

	2010		2009		2008	
Compensation expense	\$	5,811	\$	5,621	\$	5,345
Forfeiture expense (credit) adjustments	\$	(48)	\$	43	\$	(273)

In December 2010, the Company recorded \$1.7 million in stock compensation and amortization expense related to the departure of its former Chief Executive Officer, Arthur L. Buser.

The following is a summary of non-vested stock grant activity:

	2010		2009		2008	
	Shares	Weighted Average Price	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at beginning of year	1,301,451	\$ 7.68	692,767	\$ 17.93	650,546	\$ 26.33
Granted	438,665	9.06	1,073,084	4.58	684,846	15.32
Vested	(767,052)	8.84	(400,647)	17.15	(237,062)	25.66
Forfeited	(304,130)	6.71	(63,753)	7.36	(405,563)	22.48
Outstanding at end of year	668,934	7.70	1,301,451	7.68	692,767	17.93

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2010, there were no deferred shares, share purchase rights, or share appreciation rights issued or outstanding under the LTIP.

Stock Options

In April 2008, the Compensation Committee of the Company's board of directors approved a grant of 200,000 non-qualified stock options (the Options) to Robert A. Alter, the Company's former Chief Executive Officer and current Executive Chairman. The Options fully vested in April 2009, and will expire in April 2018. The exercise price of the Options is \$17.71 per share.

The initial fair value of the Options was \$0.7 million, and was estimated using a binomial option pricing model with the following assumptions:

Expected dividend yield	7.90%
Risk-free interest rate	3.29%
Expected volatility	26.90%
Expected life (in years)	5.5

The expected life was calculated using the simplified method as outlined in the Securities and Exchange Commission's Staff Accounting Bulletin No. 107.

14. Commitments and Contingencies

Management Agreements

Management agreements with the Company's third party hotel managers require the Company to pay between 1% and 3.5% of total revenue of the managed hotels to the third party managers each month as a basic management fee. Total basic management fees incurred by the Company during the years ended December 31, 2010, 2009 and 2008 were included in the Company's statements of operations as follows (in thousands):

	2010	2009	2008
Continuing operations property general and administrative expense	\$ 16,112	\$ 15,451	\$ 19,992

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Discontinued operations	1,606	3,317	6,274
	\$ 17,718	\$ 18,768	\$ 26,266

In addition to basic management fees, provided that certain operating thresholds are met, the Company may also be required to pay certain of its third party managers incentive management fees. Total incentive management fees incurred by the Company were \$3.0 million, \$2.9 million and \$4.1 million for the years ended December 31, 2010, 2009 and 2008, respectively, all of which were included in property general and administrative expense.

License and Franchise Agreements

The Company has entered into license and franchise agreements related to certain of its hotel properties. The license and franchise agreements require the Company to, among other things, pay monthly fees that are calculated based on specified percentages of certain revenues. The license and franchise agreements generally contain specific standards for, and restrictions and limitations on, the operation and maintenance of the hotels which are established by the franchisors to maintain uniformity in the system created by each such franchisor. Such standards generally regulate the appearance of the hotel, quality and type of goods and services offered, signage and protection of trademarks. Compliance with such standards may from time to time require the Company to make significant expenditures for capital improvements.

Total license and franchise costs incurred by the Company during the years ended December 31, 2010, 2009 and 2008 totaled \$26.1 million, \$28.7 million, and \$37.5 million, respectively, of which royalties totaled \$9.2 million, \$10.4 million, and \$13.8 million for the years ended December 31, 2010, 2009 and 2008, respectively. The remaining costs included advertising, reservation and priority club assessments. Total license and franchise costs incurred by the Company during the years ended December 31, 2010, 2009 and 2008 were included in the Company's statements of operations as follows (in thousands):

	2010	2009	2008
Continuing operations franchise costs	\$ 21,474	\$ 20,656	\$ 24,658
Discontinued operations	4,665	7,997	12,799
	\$ 26,139	\$ 28,653	\$ 37,457

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Several of the Company's franchise agreements contain corporate guaranties. In the event of a default under any of these franchise agreements, the Company may be liable for termination fees. During the third quarter of 2010, the Company paid \$3.4 million in franchise termination fees for the Marriott Ontario Airport as this hotel's franchise agreement was terminated in connection with the receiver's sale of the hotel. The \$3.4 million is included in discontinued operations in the Company's statement of operations. Currently, five of the Mass Mutual eight hotels remain subject to franchise agreements which contain corporate guaranties. If the franchise agreements on these five hotels were to be terminated, the Company may be liable for up to \$19.6 million in termination fees, which is included in other current liabilities of discontinued operations, net in the accompanying 2010 consolidated balance sheet.

Renovation and Construction Commitments

At December 31, 2010, the Company had various contracts outstanding with third parties in connection with the renovation of certain of its hotel properties aimed at maintaining the appearance and quality of its hotels. The remaining commitments under these contracts at December 31, 2010 totaled \$33.0 million.

Ground and Operating Leases

At December 31, 2010, the Company was obligated to unaffiliated parties under the terms of five ground leases, one air lease and a lease on the corporate facility, which mature from dates ranging from 2018 through 2096, excluding renewal options. The air lease requires a payment of \$1.00 annually, which the Company has paid in full for the life of the lease. Total rent expense incurred pursuant to ground lease agreements for the years ended December 31, 2010, 2009 and 2008 was included in the Company's statements of operations as follows (in thousands):

	2010		2009		2008
Continuing operations – property tax, ground lease and insurance (1)	\$ 5,246	\$	4,615	\$	7,028
Discontinued operations	491		608		683
	\$ 5,737	\$	5,223	\$	7,711

(1) Beginning in 2010, ground lease expense also includes amortization of lease intangibles on a ground lease with use rights and an easement at two of the Company's 31 hotels.

Rent expense incurred pursuant to the lease on the corporate facility totaled \$0.3 million for the year ended December 31, 2010, and \$0.4 million for both the years ended December 31, 2009 and 2008, and was included in corporate overhead expense.

Future minimum payments under the terms of the five ground leases and the lease on the corporate facility in effect at December 31, 2010 are as follows (in thousands):

2011	\$	4,423
2012		4,464
2013		4,504
2014		4,547
2015		4,590
Thereafter		286,424
Total	\$	308,952

Employment Agreements

As of December 31, 2010, the Company has employment agreements with certain executive employees, which expire through August 2013. The terms of the agreements stipulate payments of base salaries and bonuses.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Approximate minimum future obligations under employment agreements are as follows as of December 31, 2010 (in thousands):

2011	\$	938
2012		700
2013		409
	\$	2,047

Litigation

The Company is involved from time to time in various claims and other legal actions in the ordinary course of business. Management does not believe that the resolution of such matters will have a material adverse effect on the Company's financial position or results of operations when resolved.

In September 2009, the Company settled a lawsuit brought against the Company by the buyer (the Buyer) of 13 of the Company's hotels which were sold in 2006. The Company had estimated that the ultimate liability would range from between \$2.0 million and \$2.5 million, and in accordance with the Contingencies Topic of the FASB ASC, the Company had previously recorded a liability for this lawsuit of \$2.2 million. The lawsuit was settled in September 2009 for \$2.2 million, including \$1.15 million in cash and \$1.05 million of interest forgiveness on the Company's \$5.6 million note receivable from the Buyer. In December 2009, the Company determined that this note receivable may not be collectible, and the Company recorded an allowance for bad debt of \$5.6 million to fully reserve this note and related interest receivable. In October 2010, the Company received notice that the Buyer had filed a deed in lieu of foreclosure in bankruptcy court, and the Company removed this note receivable and related reserve from its balance sheet.

Collective Bargaining Agreements

The Company is subject to exposure to collective bargaining agreements at certain hotels operated by our management companies. At December 31, 2010, approximately 12.1% of workers employed by the Company's third party managers were covered by such collective bargaining agreements.

Defined Benefit Retirement Plan Obligation

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In connection with the Company's formation and structuring transactions, certain predecessor companies sold their property management company to IHR, who assumed certain liabilities of the property management company including the defined benefit retirement plan. In accordance with the management agreement with IHR, the Company is still responsible for the costs of the defined benefit retirement plan.

The benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter as of December 31, 2010 are as follows (in thousands):

2011	\$	384
2012		388
2013		399
2014		414
2015		431
Thereafter		2,524
	\$	4,540

401(k) Savings and Retirement Plan

The Company's employees may participate, subject to eligibility, in the Company's 401(k) Savings and Retirement Plan (the "401(k) Plan"). Employees are eligible to participate in the 401(k) Plan after attaining 21 years of age and after the first of the month following the performance of six months of service. Three percent of eligible employee annual base earnings is contributed by the Company as a Safe Harbor elective contribution. Safe Harbor contributions made by the Company totaled \$0.2 million for each of the years ended December 31, 2010, 2009 and 2008, and were included in corporate overhead expense.

The Company is also responsible for funding various retirement plans at certain hotels operated by its management companies. Matching contributions into these various retirement plans totaled \$0.9 million for both the years ended December 31, 2010 and 2009, all of which was included in property general and administrative expense. For the year ended December 31, 2008, the Company contributed \$1.3 million into the hotels' various retirement plans, of which \$1.2 million was included in property general and administrative expense and \$0.1 million was included in discontinued operations.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Concentration of Risk

As of December 31, 2010, nine of the 31 hotels were located in California, the largest concentration of the Company's hotels in any state, representing approximately 25% of the Company's rooms and approximately 24% of the revenue generated by the Company's 31 hotels during the year ended December 31, 2010. The concentration of the Company's hotels in California exposes the Company's business to economic conditions, competition and real and personal property tax rates unique to California.

Other

The Company has provided unsecured environmental indemnities to certain lenders. The Company has performed due diligence on the potential environmental risks, including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate the Company to reimburse the indemnified parties for damages related to certain environmental matters. There is no term or damage limitation on these indemnities; however, if an environmental matter arises, the Company could have recourse against other previous owners or a claim against its environmental insurance policies.

At December 31, 2010, the Company had \$2.1 million of outstanding irrevocable letters of credit to guaranty the Company's financial obligations related to workers' compensation insurance programs from prior policy years. The beneficiaries of these letters of credit may draw upon these letters of credit in the event of a contractual default by the Company relating to each respective obligation. No draws have been made through December 31, 2010.

An audit for the tax years 2006, 2007 and 2008 of the Company's five hotels and one laundry facility located in Minnesota was completed by the State of Minnesota during the third quarter of 2009. The Company had previously estimated that the ultimate liability, including penalties and interest, would range from between \$0.5 million and \$1.0 million, and, accordingly, the Company recorded a liability of \$0.5 million in December 2008 in accordance with the Contingencies Topic of the FASB ASC, which requires a liability be recorded based on the Company's estimate of the probable cost of the resolution of a contingency. The actual audit liability totaled \$0.6 million, including penalties and fees, causing the Company to record additional expense of \$0.1 million in the third quarter of 2009.

15. Transactions With Affiliates

Other Reimbursements

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From time to time, the Company pays for certain expenses such as payroll, insurance and other costs on behalf of certain affiliates. The affiliates generally reimburse such amounts on a monthly basis. At December 31, 2010 and 2009, amounts owed to the Company by its affiliates amounted to \$44,000 and \$62,000, respectively, and are included in due from affiliates in the accompanying consolidated balance sheets.

Transactions With Others

The Company purchases telecommunications equipment from Gemini Telemanagement Systems, (GTS), a telecommunications equipment provider based in Redwood City, California. The Company's former Chief Executive Officer and current Executive Chairman, Robert A. Alter, was a 5.2% stockholder in GTS, and his brother, Richard Alter, was the majority stockholder in GTS, until they both divested their interests in April 2009. The Company paid GTS nominal amounts in 2010, and \$0.6 million and \$1.5 million, respectively, for the years ended December 31, 2009 and 2008.

16. Variable Interest Entities

The Company adopted Accounting Standards Update (ASU) No. 2009-17 codified in the Consolidation Topic of the FASB ASC on January 1, 2010, which changes the consolidation guidance applicable to variable interest entities (VIEs). It also amends the guidance governing the determination of whether an enterprise is the primary beneficiary of a VIE, and is, therefore, required to consolidate an entity, by requiring a qualitative analysis rather than a quantitative analysis. The qualitative analysis includes, among other things, consideration of who has the power to direct the activities of the entity that most significantly impact the entity's economic performance and who has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. This topic also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE. Previously, the applicable standard required reconsideration of whether an enterprise was the primary beneficiary of a VIE only when specific events had occurred. The topic also requires additional disclosures about an enterprise's involvement with a VIE.

Upon adoption of ASU No. 2009-17, the Company evaluated its variable interests, including the management agreements it has with its third party hotel managers and its interest in the Doubletree Guest Suites Times Square joint venture, to determine whether or not these variable interests are VIEs. The Company's analysis included both quantitative and qualitative reviews. In arriving at the VIE determination for its third party management agreements, the Company

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

followed the guidance in ASC 810-10-55-37, *Fees Paid to Decision Makers or Service Providers*, which states that fees paid to a legal entity's decision makers or service providers are not variable interests if six conditions are met: 1) the fees are compensation for services provided and are commensurate with the level of effort required to provide those services; 2) substantially all of the fees are at or above the same level of seniority as other operating liabilities of the VIE that arise in the normal course of the VIE's activities, such as trade payables; 3) the decision maker or service provider does not hold other interests in the VIE that individually, or in the aggregate, would absorb more than an insignificant amount of the VIE's expected losses or receive more than an insignificant amount of the VIE's expected residual returns; 4) the service arrangement includes only terms, conditions, or amounts that are customarily present in arrangements for similar services negotiated at arm's length; 5) the total amount of anticipated fees are insignificant relative to the total amount of the VIE's anticipated economic performance; and 6) the anticipated fees are expected to absorb an insignificant amount of the variability associated with the VIE's anticipated economic performance, which includes any carried interests, promotes or incentive fees. Based on the six conditions stated in ASC 810-10-55-37, the Company has determined that the management agreements for all but three of its hotels are not variable interest entities. The three hotels do not meet conditions (5) and (6) as each of the three hotels' incentive management fees are significant relative to the total amount of each hotel's economic performance, and these fees are expected to absorb a significant amount of the variability associated with each hotel's anticipated economic performance. The Company has determined that it is the primary beneficiary of these three VIEs because it has the power to direct the activities that most significantly impact the hotels' economic performance, such as developing budgets and renovation programs as well as making the decision to sell the hotels, and it is obligated to absorb the losses or to receive the benefits from the hotels that could potentially be significant to the hotels. The Company has, therefore, consolidated these three VIEs.

Though the Company concluded its interest in the Doubletree Guest Suites Times Square joint venture is a VIE, the Company has determined that it is not the primary beneficiary because it does not have the power to direct the activities that most significantly impact the economic performance of the Doubletree Guest Suites Times Square. The Company, therefore, accounted for this investment using the equity method. In January 2011, the Company purchased the outside 62% equity interests in the Doubletree Guest Suites Times Square for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The Company is still evaluating the accounting for the transaction. Beginning in 2011, the Company will consolidate this hotel into its continuing operations.

17. Quarterly Results (Unaudited)

The consolidated quarterly results for the years ended December 31, 2010 and 2009, of the Company are as follows (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues				
Continuing Operations				
2010	\$ 140,899	\$ 160,874	\$ 157,064	\$ 184,253
2009	\$ 150,045	\$ 154,520	\$ 149,277	\$ 170,015
Operating income (loss)				
Continuing Operations				
2010	\$ 2,462	\$ 13,167	\$ 1,943	\$ 14,429

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2009	\$	5,201	\$	(14,727)	\$	6,382	\$	8,406
Net income (loss)								
2010	\$	(21,091)	\$	308	\$	23,653	\$	35,672
2009	\$	6,510	\$	(130,205)	\$	(17,948)	\$	(127,965)
Income available (loss attributable) to common stockholders per share basic								
2010	\$	(0.27)	\$	(0.05)	\$	0.19	\$	0.28
2009	\$	0.02	\$	(2.23)	\$	(0.31)	\$	(1.45)
Income available (loss attributable) to common stockholders per share diluted								
2010	\$	(0.27)	\$	(0.05)	\$	0.19	\$	0.28
2009	\$	0.02	\$	(2.23)	\$	(0.31)	\$	(1.45)

Income available (loss attributable) to common stockholders per share is computed independently for each of the quarters presented and therefore may not sum to the annual amount for the year. Previously reported revenues and operating income have been adjusted to account for current discontinued operations in accordance with the Property, Plant and Equipment Topic of the FASB ASC.

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SUNSTONE HOTEL INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In November 2010, the Company purchased the remaining half of the Twelve Atlantic Station subordinate note for an additional \$250,000, increasing its investment in the \$5.0 million subordinate note to \$0.5 million. In November 2010, the subordinate note was modified to provide for monthly interest only payments of 3.5%, with the remaining interest due at maturity, and the maturity date was extended to November 2012. As the subordinate note was in default, the borrower was required to bring the subordinate note current. As of December 31, 2010, the subordinate note secured by the Twelve Atlantic Station was not in default, however, the Company is accounting for the Twelve Atlantic Station loan using the cost recovery method until such time as the expected cash flows from the loan are reasonably probable and estimable. No amounts were received for the subordinate note during 2010.

In November 2010, the Company entered into a new \$150.0 million senior corporate credit facility. The interest rate for the facility ranges from 325 to 425 basis points over LIBOR, depending on the overall leverage of the Company. The initial term of the facility is three years with an option to extend for an additional one year. Subject to approval by the lender group, the facility may be increased to up to \$250.0 million. The facility contains customary events of default relating to payments and breaches of representations and warranties. As of December 31, 2010, the Company had no outstanding indebtedness under its credit facility.

In November 2010, the Company entered into a new \$92.5 million non-recourse mortgage on its Hilton Times Square. The mortgage matures in 2020 and bears a fixed interest rate of 4.97%, with scheduled monthly principal and interest amounts based on a thirty-year amortization. The proceeds from the mortgage were used in part to repay the maturing \$81.0 million mortgage secured by the Company's Hilton Times Square, which bore an interest rate of 5.915%. Excess proceeds were retained for general corporate purposes. The mortgage contains customary events of default relating to payments and breaches of representations and warranties.

In November 2010, the Company issued 19,500,000 shares of its common stock for net proceeds of approximately \$190.6 million. The Company plans to use the net proceeds from this equity offering for growth capital expenditures, future acquisitions and other general corporate purposes, including working capital.

18. Subsequent Events

In January 2011, the Company purchased the outside 62% equity interests in its Doubletree Guest Suites Times Square joint venture for approximately \$37.5 million and, as a result, became the sole owner of the entity that owns the 460-room Doubletree Guest Suites Times Square hotel in New York City. The Company is still evaluating the accounting for the transaction. The hotel is encumbered by approximately \$270.0 million of non-recourse senior mortgage and mezzanine debt that matures in January 2012 and bears a blended interest rate of LIBOR + 115 basis points. The Company expects to refinance this debt during 2011 and intends to fund any refinancing shortfall with existing cash. In accordance with the Consolidation Topic of the FASB ASC, the Company will consolidate the hotel with its continuing operations in 2011 as it will be the sole owner of the hotel.

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In January 2011, the Company repurchased Strategic's 50% share in BuyEfficient for \$8.6 million. The Company is still evaluating the accounting for the transaction. In accordance with the Consolidation Topic of the FASB ASC, the Company will consolidate BuyEfficient with its continuing operations in 2011 as it will be the sole owner of BuyEfficient.

In February 2011, the Company purchased the 494-room JW Marriott New Orleans for approximately \$94.3 million. The Company is still evaluating the accounting for the transaction. The acquisition included the assumption of a \$42.2 million floating-rate, non-recourse senior mortgage. The mortgage, which matures in September 2015, has been swapped to a fixed rate of 5.45%, and is subject to a 25-year amortization schedule.

Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS****DECEMBER 31, 2010****(In Thousands)**

	Balance at Beginning of Year (1)	Additions Charged to Operations (1)	Uncollectible Accounts Written Off (1)	Balance at End of Year (1)
Year ended December 31, 2010				
Allowance for doubtful accounts	\$ 116	\$ 83	\$ (85)	\$ 114
Reserve for loan losses	\$ 5,557	\$	\$ (5,557)	\$
Year ended December 31, 2009				
Allowance for doubtful accounts	\$ 256	\$ 132	\$ (272)	\$ 116
Reserve for loan losses	\$	\$ 5,557	\$	\$ 5,557
Year ended December 31, 2008				
Allowance for doubtful accounts	\$ 143	\$ 184	\$ (71)	\$ 256

(1) Includes all hotel properties owned on December 31, 2010.

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SUNSTONE HOTEL INVESTORS, INC.

SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION

DECEMBER 31, 2010

(In Thousands)

	Enmbr	Cost Capitalized			Gross Amount at		Totals	Accum. Depr.	Date Acq./Constr.	Depr. Life
		Land	Bldg. and Impr	Land	Bldg. and Impr.	Land				
Courtyard by										
Marriott Los Angeles		(b) \$	\$ 8,446	\$	\$ 8,508	\$	\$ 16,954	\$ 6,291	1999	5-35
Doubletree Minneapolis		(a) 150	9,953		4,780	1,150	14,733	3,697	2002	5-35
Embassy Suites Chicago	75,000	79	46,886	6,348	11,492	6,427	58,378	15,064	2002	5-35
Embassy Suites La Jolla	70,000	7,900	70,450		7,241	27,900	77,691	12,736	2006	5-35
Fairmont Newport										
Beach		(b)	65,769		30,949		96,718	17,591	2005	5-35
Hilton Del Mar		(a) 106	22,353		5,985	4,106	28,338	7,583	2002	5-35
Hilton Houston	33,261	16,184	35,628		17,463	6,184	53,091	11,943	2002	5-35
Hilton Times Square	92,288		221,488		7,756		229,244	39,593	2006	5-35
Hyatt Regency Newport										
Beach		(b)	30,549		12,041		42,590	10,683	2002	5-35
Kahler Grand										
Hotel Rochester		(a) 11	45,349		18,623	3,411	63,972	20,281	1999	5-35
Kahler Inn &										
Suites Rochester		(b) 666	21,582	(173)	2,362	1,493	23,944	8,625	1999	5-35
Marriott Boston	176,000	1,598	170,238		18,434	51,598	188,672	25,117	2007	5-35
Marriott Del Mar	48,000	5,125	58,548	(2,026)	(19,277)	3,099	39,271	42,370	2006	5-35
Marriott Houston		(a) 167	19,155		7,227	4,167	26,382	6,309	2002	5-35
Marriott Park City		(a) 260	17,778		7,088	2,260	24,866	8,046	1999	5-35
Marriott Philadelphia		(a) 297	29,710		5,985	3,297	35,695	9,415	2002	5-35
Marriott Portland		(b) 341	20,705		3,267	5,341	23,972	8,018	2000	5-35
Marriott Quincy	14,375		97,875		1,905	14,375	99,780	13,187	2007	5-35
Marriott Rochester		(b) 851	39,714		4,966	1,851	44,680	16,399	1999	5-35
Marriott Troy		(a) 701	45,814		7,205	2,701	53,019	14,222	2002	5-35
Marriott Tysons Corner		(a) 897	43,528	(250)	10,982	3,647	54,510	14,193	2002	5-35
Renaissance										
Harborplace	105,242	25,085	102,707		17,052	25,085	119,759	22,208	2005	5-35
Renaissance Los										
Angeles Airport		(b) 800	52,506		1,324	7,800	53,830	7,763	2007	5-35
Renaissance Long										
Beach	33,251	10,437	37,300		11,848	10,437	49,148	8,862	2005	5-35
Renaissance Orlando at										
SeaWorld®	83,954		119,733	30,716	23,122	30,716	142,855	26,651	2005	5-35
Renaissance										
Washington D.C.	132,304	44,563	132,800		15,045	14,563	147,845	27,366	2005	5-35
Renaissance										
Westchester (2)		(b) 751	17,069		26	5,751	17,095	354	2010	5-35
		(b) 225	9,652	173	1,001	398	10,653	2,473	2004	5-35

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Residence Inn by Marriott Rochester									
Royal Palm Miami Beach	36,027	79,864	69	35,027	79,933	114,960	1,054	2010	5-35
Sheraton Cerritos	(b)	24,737	5,364		30,101	30,101	5,356	2005	5-35
Valley River Inn Eugene	(a)	14,113	2,703	1,806	16,816	18,622	4,416	2002	5-35
	\$ 849,299,802	\$ 1,711,999	\$ 34,788	\$ 252,536	\$ 274,590	\$ 1,964,535	\$ 2,239,125	\$ 384,931	

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Table of Contents**SUNSTONE HOTEL INVESTORS, INC.****SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION****DECEMBER 31, 2010****(In Thousands)**

	Encmbr.	Initial costs Land	Bldg. and Impr.	Cost Capitalized Subsequent to Acquisition Land	Bldg. and Impr.	Gross Amount at December 31, 2010 (1) Land	Bldg. and Impr.	Totals	Accum. Depr.	Date Acq./Constr.	Depr. Life
Investments in Other Real Estate											
TCS Rochester	\$ 2,474	\$ 1,600	\$	\$	\$ 7,959	\$ 1,600	\$ 7,959	\$ 9,559	\$ 2,191	1999	5-35
Office Building Troy		2,224	2,140	(1,056)	(802)	1,168	1,338	2,506	370	2006	5-35
Land held for future development or sale		4,500		(4,312)		188		188		1999	NA
	\$ 2,474	\$ 8,324	\$ 2,140	\$ (5,368)	\$ 7,157	\$ 2,956	\$ 9,297	\$ 12,253	\$ 2,561		

(1) The aggregate cost of properties for federal income tax purposes is approximately \$2.5 billion (unaudited) at December 31, 2010.

(2) Hotel originally acquired in 2005. Possession and control of the hotel transferred to a receiver in December 2009, and the Company reacquired the hotel in June 2010.

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	2010	Hotel Properties 2009	2008	Other Real Estate Investments		
				2010	2009	2008
(1) Reconciliation of land and buildings and improvements:						
Balance at the beginning of the year	\$ 2,082,247	\$ 2,079,896	\$ 2,001,620	\$ 14,191	\$ 14,436	\$ 13,899
Additions during year:						
Acquisitions	137,711		30,716			
Improvements	19,167	29,760	65,781	5	20	594
Impairment loss		(202,453)		(1,943)		(57)
Changes in reporting presentation		263,961	312,550			
Disposals during the year		(88,917)	(330,771)		(265)	
Balance at the end of the year	\$ 2,239,125	\$ 2,082,247	\$ 2,079,896	\$ 12,253	\$ 14,191	\$ 14,436
(2) Reconciliation of accumulated depreciation:						
Balance at the beginning of the year	\$ 318,583	\$ 253,135	\$ 188,468	\$ 2,233	\$ 1,874	\$ 1,530
Depreciation for the year	66,348	77,137	81,731	328	359	344
Changes in reporting presentation		10,721	(1,880)			
Retirement		(22,410)	(15,184)			
Balance at the end of the year	\$ 384,931	\$ 318,583	\$ 253,135	\$ 2,561	\$ 2,233	\$ 1,874

(a) Hotel is pledged as collateral by the non-recourse mortgage secured by deed of trust dated April 29, 2005 with a balance at December 31, 2010 of \$231,227,000.

(b) Hotel is pledged as collateral by the credit facility entered into in November 2010. As of December 31, 2010, the Company has no outstanding indebtedness under its credit facility.