Sunstone Hotel Investors, Inc.
Form 10-K
February 23, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2009

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	**20-1296886**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
903 Calle Amanecer, Suite 100	
San Clemente, California	**92673**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (949) 369-4000

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 x

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 x

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 x 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 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 x	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 x

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, 2009 as reported on the New York Stock Exchange (NYSE) was approximately $392.9 million. The registrant had no non-voting common equity outstanding on such date. This amount excludes 1,728,119 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 16, 2010 was 98,102,440.

Documents Incorporated by Reference

Part III of this Report incorporates by reference information from the definitive Proxy Statement for the registrant s 2010 Annual Meeting of Stockholders.

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SUNSTONE HOTEL INVESTORS, INC.

ANNUAL REPORT ON

FORM 10-K

For the Year Ended December 31, 2009

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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, 2009, we owned 38 hotels (the 38 hotels), excluding the W San Diego and the Renaissance Westchester both of which are held in receivership and included in discontinued operations. We are currently in the process of transferring ownership and control of nine additional hotels to court-appointed receivers, leaving 29 hotels (the 29 hotels) currently held for investment. The 29 hotels are comprised of 10,966 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. The following discussion focuses on the 29 hotels. Our financial results for the periods presented, however, include all 38 hotels, and our financial results will continue to include all 38 hotels until the disposition process is complete, which is expected to occur in the first half of 2010. The two hotels in discontinued operations and the nine hotels that are currently in the process of being transferred to receivers represented 16.2% of our revenues during the year ended December 31, 2009, and 5.1% of our assets as of December 31, 2009.

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, and Hyatt. Our portfolio primarily consists of upper upscale and upscale full-service hotels. We also own luxury and midscale hotels. The classifications luxury, upper upscale, upscale and 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; midscale with food and beverage; midscale without food and beverage; 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, 2009, Sunstone Hotel Properties, Inc. (Interstate SHP), a division of Interstate Hotels & Resorts, Inc. (Interstate), managed 15 of the 29 hotels. Additionally, subsidiaries of Marriott International, Inc. or Marriott Services, Inc. (collectively Marriott) managed 11 of the 29 hotels, and Fairmont Hotels & Resorts (U.S.) (Fairmont), Hilton Worldwide (Hilton) and Hyatt Corporation (Hyatt), each managed one of the 29 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.

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Strong Cash Position. During 2009, we increased our cash and cash equivalents by $182.5 million, from $176.1 million to $358.6 million. We believe our higher than historical cash balance provides added security in uncertain economic times as well as funds for hotel acquisitions.

Flexible Capital Structure. We believe our capital structure provides us with adequate financial flexibility to execute our strategy. As of December 31, 2009, our indebtedness bore fixed interest at a weighted average rate of 5.6%, and had a weighted average term to maturity of 7.2 years. Eighty-one million of our debt matures in 2010, and we have no debt maturing in 2011. All of our debt is in the form of senior unsecured notes or single asset loans rather than cross-collateralized multi-property pools. 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.

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 2009, approximately 75% of the revenues generated by the 29 hotels were earned by hotels located in key gateway markets such as Boston, New York, Washington, D.C./Baltimore, Chicago, Orlando, 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 29 hotels during 2009, 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 and Hyatt. We believe that affiliations with strong brands help to drive business to our hotels.

Recently Renovated Hotels. From January 1, 2005 through December 31, 2009, we invested $323.7 million in capital renovations throughout the 29 hotels. We believe that these capital renovations will improve the competitiveness of our hotels and 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 January 1, 2005 through December 31, 2009, we acquired interests in 17 hotels and sold 30 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, our focus shifted to the selective acquisition of upper upscale hotels as we believe we are approaching a recovery phase in the lodging cycle. This focus will continue into 2010 as we seek to take advantage of the ongoing dysfunction in the commercial mortgage markets, which we believe has created opportunities for well-capitalized companies to acquire individual hotel assets at discounts to warranted 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 revenues of our hotel portfolio and maximize operational efficiency by leveraging best practices and innovations across our various hotels and by providing our managers with operational insights from our extensive experience.

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 upper upscale hotels, well located within key markets. We seek to maximize total returns to our stockholders through a cycle-appropriate capital allocation 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 cyclical declines. 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 luxury hotels with nationally recognized brands in markets with high barriers to entry;

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

Optimizing the performance of our portfolio through proactive asset management;

Recycling capital through opportunistic dispositions of non-core assets; and

Minimizing our cost of capital through disciplined balance sheet management.

By leveraging our management s relationships and expertise in redeveloping and upgrading hotel properties as well as our financial structuring capabilities, strong balance sheet, liquidity position and REIT structure we believe it is possible to grow our business as the hotel market recovers. In addition to straight property acquisitions, we are aware of opportunities to: purchase defaulted and/or distressed debt positions in loan-to-own hotel transactions; utilize our REIT structure to effect strategic combinations with select property owners; effect purchases from institutional and other owners seeking portfolio liquidity; and employ capital in situations where the owner is illiquid and faces debt maturities or capital requirements that it cannot meet.

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 require us to provide additional amenities or make capital improvements that we otherwise would not have to make, which may reduce our profitability.

We believe that competition for the acquisition of hotels is highly 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. At times when we seek to acquire hotels, competition generally may increase the bargaining power of property owners seeking to sell and reduce the number of suitable investment opportunities available to us. Similarly, during times when we seek to sell hotels, competition from other sellers may increase the bargaining power of the potential property buyers.

Twenty-six of the 29 hotels are operated under nationally recognized brands as of December 31, 2009. 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

As of December 31, 2009, 15 of the 29 hotels were managed and operated by Interstate SHP pursuant to management agreements with our TRS Lessee or its subsidiaries, and the other 14 hotels were managed by Marriott, Fairmont, Hilton or Hyatt pursuant to management agreements with our TRS Lessee or its subsidiaries. The following is a general description of these agreements.

Interstate SHP. Our management agreements with Interstate SHP require us to pay, on a monthly basis, a management fee ranging from 1.0% to 2.1% of gross revenues; plus an accounting fee of $10-$11 per room per month, subject to an annual increase based on consumer price index; 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 Interstate SHP for any fiscal year. Our TRS Lessee has guaranteed all fees payable to Interstate SHP.

The Interstate SHP management agreements expire in 2024, and we have the right to renew each management agreement for up to two additional terms of five years each, absent a prior termination by either party. During December

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2009, we issued a request for proposal (RFP) to hotel management companies interested in managing certain of our hotels currently managed by Interstate SHP. The purpose of the RFP was to ensure that we have the most highly qualified management companies operating our hotels in order to consistently deliver best in class results. We anticipate completing the RFP process during the first half of 2010.

Marriott. Of the 29 hotels, six of the Marriott hotels and five of the Renaissance hotels are operated under management agreements with Marriott. These management agreements require us to pay Marriott a base management fee between 2.25% and 3.0% of total revenue from these hotels. These management agreements expire between 2014 and 2050. Additionally, seven 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; 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. 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.

Fairmont. Our Fairmont Newport Beach, California hotel is operated under a management agreement with a subsidiary of Fairmont. The agreement requires us to pay 3.0% of total revenue as a base management fee and expires in 2015, with two options to extend the agreement for an additional 30 years in the aggregate. The agreement includes incentive fees ranging from between 15.0% and 25.0% of the hotel s net profit above certain net profit thresholds. In addition, we entered into an agreement with Fairmont whereby Fairmont will provide us with a limited performance guaranty to ensure, subject to certain limitations, a return on equity to us. Under the terms of this agreement, should the net cash flow generated by the hotel be insufficient to cover a 9.0% return on our equity investment in the hotel in 2008 and a 10.0% return on our equity investment in subsequent years, Fairmont is required to pay us the shortfall, up to $6.0 million over the term of the agreement. We used a total of $3.5 million of the $6.0 million performance guaranty during 2008, and a total of $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, and requires us to pay a base management fee as follows: 1.5% of gross revenues in 2006 and 2007; 1.75% of gross revenues in 2008; 2.0% of gross revenues in 2009; and 2.25% of gross revenues 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 2039 and 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. This management agreement may be terminated earlier than the contract term if certain events occur, including the failure of Hyatt to satisfy certain performance standards, a condemnation of, a casualty to, or a force majeure event involving the hotel, and upon a default by Hyatt or us that is not cured prior to the expiration of any applicable cure period.

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, 2009, 14 of the 29 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.

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

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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 guaranties certain obligations under the franchise agreements.

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.

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 a percentage rent. 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.

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, 2009, six of the 29 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, 2009, the remaining terms of these ground and air leases (including renewal options) range from approximately 39 to 87 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.

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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 903 Calle Amanecer, Suite 100, San Clemente, California 92673 from an unaffiliated third party. We occupy our headquarters under a lease that terminates on June 30, 2010, with an option to extend for an additional five years. We are in the process of evaluating whether to renew the lease or to move our headquarters to another location.

Employees

At February 1, 2010, we had 30 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

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.

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.

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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.

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, recently the capital markets have experienced 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. The recent dislocations in the debt markets have reduced 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.

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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 hotel mortgages have increased by several percentage points since we entered into our last mortgage financing in April 2007 and amended our credit facility in June 2009. Equity investor return expectations have also risen during the same time period. If capital costs remain at current levels or increase, 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, 2009, we had approximately $1,145 million of outstanding debt, excluding debt in our secured debt restructuring program, 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 $180.8 million matures over the next four years ($81.0 million in 2010, zero in 2011, $34.0 million in 2012, and $65.8 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). In addition, we continue to negotiate with Massachusetts Mutual Life Insurance Company, or Mass Mutual, the lender s representative for a $246.0 million, 5.95% non-recourse mortgage loan which matures in 2011, and which is secured by 11 hotels comprised of 2,587 rooms. We have offered to deed back eight of the 11 hotels, and we have offered to make a partial payment on the mortgage loan in an effort to secure the release of three of the 11 hotels. As such, we expect to pay a release price in 2010. The $180.8 million does not include $61.9 million in mortgage debt associated with the three hotels, or $10.9 million of normal loan amortization payments due in 2010, $15.3 million due in 2011, $15.2 million due in 2012, or $17.1 million due in 2013. 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.

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, 2009, we had $2.9 million in outstanding letters of credit.

During 2009, pursuant to a secured debt restructuring program, we voluntarily elected to cease the subsidization of debt service on mortgages securing some of our hotels. 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. We ultimately determined that it was in our best interest to voluntarily cease the subsidization of debt service shortfalls under certain of our mortgages. As of December 31, 2009, we have elected to cease the subsidization of debt service on four non-recourse mortgages, and have either transferred, or are in the process of transferring, three hotels securing three of these loans to court-appointed receivers. The fourth non-recourse mortgage is secured by 11 hotels. We have offered to make a partial payment on the fourth non-recourse mortgage loan in an effort to secure the release of three of the hotels. If we and Mass Mutual reach agreement on this proposal, we have offered to deed back the remaining eight hotels to Mass Mutual in satisfaction of the debt balance that will remain after the payment of the release price. If we and Mass Mutual are unable to reach agreement on this proposal, we have offered to deed back all 11 hotels in satisfaction of the entire debt balance and without making a cash payment to Mass Mutual. We expect and intend to release the three hotels, and have, therefore, included these three hotels in operations held for investment. If, however, we are unsuccessful in our negotiations with Mass Mutual, and we deed back the three hotels along with the Mass Mutual eight hotels, we may be unable to recover certain hotel investments that secure the loan. Accordingly, the hotels would become impaired and we would record an impairment charge equal to the amount by which the book values exceed their fair values. We hope to resolve these issues in the first quarter of 2010, but no assurance can be given that either the partial release or the deed-in-lieu transaction will be consummated, or upon their timing or terms. These transfers reduce our assets and 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 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. In addition, because of various cross-collateralization provisions in our notes payable, our default under some of our mortgage debt obligations may result in a default on our other indebtedness. If this occurs, our financial condition, cash flow and ability to satisfy our other debt obligations or ability to pay dividends may be harmed.

Defaulting on our secured debt obligations may negatively impact our relationships with lenders.

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 may negatively impact our ability to secure favorable financing in the future. If we are unable to secure new financing, we may be unable to refinance existing debt when it comes due, which could result in a default, make financing transactions more difficult or costly in the future or otherwise have an adverse effect on our business, results of operations or financial condition.

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.

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. If we are unable to refinance our indebtedness on acceptable terms, or at all, we may be forced to sell one or more of our properties on potentially disadvantageous terms, which might 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 existing notes payable and those notes we may assume may restrict our operating or acquisition activities.

Some of our existing notes payable contain, and other 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. If we need to obtain consents or waivers from compliance with these covenants, it may take time or cause us to incur additional expenses.

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, or 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. Unless operations improve, we may fail to meet our financial covenants with respect to our Series C preferred stock during 2010. If we were to fail to meet certain financial covenants under the Series C preferred stock for each quarter of 2010, a financial ratio violation would occur during the first quarter of 2011.

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.

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 prices we must pay to acquire them, which, although beneficial to dispositions of hotels, may materially impact our ability to acquire new properties. 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.

If we are delayed or unable to find suitable investments, we may not be able to achieve our investment objectives.

Delays in selecting, acquiring and developing 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. We are currently in the process of identifying real properties and other real estate-related assets that we will purchase with our available cash; however, we may suffer from delays in deploying the capital into suitable investments.

Changes in supply of or demand for similar real properties in a particular area may increase the price of real properties we seek to purchase or decrease the price of real properties when we seek to sell them.

The real estate industry is subject to market forces. We are unable to predict certain market changes including changes in supply of, or demand for, similar real properties in a particular area. Any potential purchase of an overpriced asset could decrease our rate of return on these investments and result in lower operating results and overall returns to our stockholders.

Delays in the acquisition, 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 and development of real properties could adversely affect investor returns. 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. Therefore, stockholders may suffer delays in receiving cash distributions attributable to those particular real properties. Delays in completion of construction could give tenants the right to terminate preconstruction leases for space at a newly developed project. 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. In addition, we will be subject to normal lease-up risks relating to newly constructed projects. 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 geographically dispersed 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.

If we make or invest in mortgage loans, our mortgage loans may be affected by unfavorable real estate market conditions, which could decrease the value of those loans and the return on your investment.

If we make or invest in mortgage loans, we will 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 will not know whether the values of the properties securing any potential mortgage loans 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.

If we make or invest in mortgage loans, our mortgage loans would 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; accordingly, the value of your investment would be subject to fluctuations in interest rates.

If we invest in fixed-rate, long-term mortgage loans and interest rates rise, the mortgage loans could yield a return that is lower than then-current market rates. 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, if we invest in mortgage loans, 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 may invest would involve greater risks of loss than senior loans secured by income-producing real properties.

We may 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.

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. During 2009, we determined that intra-year impairment analyses should be performed for the quarters ended March 31, 2009, June 30, 2009 and September 30, 2009 in addition to our annual impairment analysis performed at December 31, 2009. Based on the results of these analyses, we wrote off $217.7 million, including $25.4 million to property and goodwill impairment losses, $97.1 million to impairment loss of operations held for non-sale disposition, and $95.2 million to discontinued operations to reduce the carrying values of 11 hotels on our balance sheet to their fair values. The 11 hotels and their respective impairment losses for the year ended December 31, 2009 were: Marriott Del Mar $25.4 million; Marriott Ontario Airport $8.9 million; Marriott Provo $11.2 million; Holiday Inn Downtown San Diego $7.2 million; Holiday Inn Express San Diego (Old Town) $1.4 million; Marriott Salt Lake City (University Park) $6.8 million; Hilton Huntington $41.1 million, Renaissance Atlanta Concourse $20.5 million; Hyatt Suites Atlanta Northwest $4.9 million; W San Diego $60.0 million; and Renaissance Westchester $30.3 million. In addition, we wrote off $6.9 million of goodwill associated with six of our hotels: Marriott Provo $0.7 million; Holiday Inn Downtown San Diego $1.4 million; Holiday Inn Express San Diego (Old Town) $0.2 million; Marriott Salt Lake City (University Park) $0.7 million; Marriott Rochester $2.6 million; and Marriott Park City $1.3 million. During 2009, we also 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 our hotels which was sold in 2009. In addition, we recorded an impairment loss of $26.0 million in 2009 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 as of December 31, 2009. 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 generally 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 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.

We use non-GAAP financial measures such as EBITDA, Adjusted EBITDA, FFO and Adjusted FFO when evaluating our business performance. Our presentation of these non-GAAP financial measures may not be comparable to similar measures disclosed by other companies. In addition, the non-GAAP financial measures we present should not be considered as alternatives to GAAP financial measures.

We believe EBITDA, Adjusted EBITDA, FFO and Adjusted FFO 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, Adjusted EBITDA, FFO and Adjusted FFO as measures in determining the value of hotel acquisitions and dispositions. We caution investors that amounts presented in accordance with our definitions of EBITDA, Adjusted EBITDA, 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. EBITDA, Adjusted EBITDA, FFO and Adjusted FFO should not be considered as an alternative measure of our net income (loss), operating performance, cash flow or liquidity. EBITDA, Adjusted EBITDA, FFO and Adjusted FFO may include funds that may not be available for our discretionary use due to functional requirements to conserve funds for capital expenditures and property acquisitions and other commitments and uncertainties. Although we believe that EBITDA, Adjusted EBITDA, 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.

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, 2009, nine of the 29 hotels, the largest concentration of our hotels in any state, representing approximately 27% of our rooms and approximately 25% of our 2009 revenues generated by the 29 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 other large customers, and the loss of such customers for any reason could harm our operating results.

Group contract business and other large customers, or large events, 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 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, 2009, 26 of the 29 hotels, representing approximately 89% 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 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. See also Because we are a REIT, we depend on third parties to operate our hotels, which could harm our results of operations below.

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 Interstate SHP, Marriott, Fairmont, Hilton and Hyatt, control the daily operations of our hotels.

As of December 31, 2009, Interstate SHP operated 15 of the 29 hotels. Additionally, subsidiaries of Marriott operated 11 of our hotels, and Fairmont, Hilton and Hyatt 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.

We have entered into management agreements with Interstate SHP, Marriott, Fairmont, Hilton and Hyatt to manage the daily operations of our hotels. Should we terminate any of these agreements and enter into new agreements with different management companies, the day to day operations of our hotels may be disrupted. In addition, the new management agreements may contain terms that are unfavorable to us, and any new management company may not be successful in managing our hotels.

As of December 31, 2009, 15 of the 29 hotels are managed and operated by Interstate SHP pursuant to management agreements with the TRS Lessee or its subsidiaries. In addition, 14 of the 29 hotels are managed by Marriott, Fairmont, Hilton or Hyatt under management agreements with the TRS Lessee or its subsidiaries. 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.

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.

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Because six of the 29 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 29 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, 2009, the terms of these ground or air leases (including renewal options) range from approximately 39 to 87 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 God, occurs and the cost thereof exceeds available insurance proceeds.

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 depress 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. 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.

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 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 an experienced substitute, such person s departure could harm our operations and financial condition.

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. To the extent that cash flow from operations is insufficient during any quarter due to temporary or seasonal fluctuations in revenue, we may determine not to make distributions to our stockholders or have to enter into short-term borrowings to make distributions.

In the past, the threat of terrorism has harmed the hotel industry generally, including our results of operations and these harmful effects may continue or worsen, particularly if there are further terrorist events.

The threat of terrorism has had a negative impact on hotel operations and caused a significant decrease in hotel occupancy and ADRs due to disruptions in business and leisure travel patterns and concerns about travel safety. Hotels in major metropolitan areas and near airports, such as many of our hotels, have been harmed due to concerns about air travel safety and a significant overall decrease in the amount of air travel, particularly transient business travel, which includes the corporate and premium business segments that generally pay the highest average room rates. Future terrorist acts, terrorism alerts or outbreaks of hostilities could have a negative effect on travel and, correspondingly, on our business.

The attacks of September 11, 2001 had a dramatic adverse impact on business and leisure travel, hotel occupancy and RevPAR. While there have been improvements, the uncertainty associated with the continuing war on terrorism and the possibility of future attacks may continue to hamper business and leisure travel patterns and, accordingly, the performance of our business.

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 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 readily be 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.

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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 29 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.

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.

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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.

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.

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.

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

The terms of our management agreements with Interstate SHP were negotiated by us and Sunstone Hotel Investors, LLC, which had a conflict of interest because of the payment it received from Interstate SHP for its interests in the subsidiary that managed our hotels prior to the formation and structuring transactions consummated at the time of our initial public offering.

The initial terms of the management agreements with Interstate SHP were the result of negotiations among us, Sunstone Hotel Investors, LLC and Interstate SHP. At the time of the formation and structuring transactions, Interstate SHP paid $8.0 million in cash to Sunstone Hotel Investors, LLC to purchase the corporate subsidiary that managed certain of our hotels and employed the employees of such hotels. This payment was not contributed to us in the formation and structuring transactions that took place at the time of our initial public offering. As a result of this payment, Sunstone Hotel Investors, LLC had a conflict of interest with us in negotiating the management agreements with Interstate SHP. We expect to either terminate or renegotiate these agreements in 2010, but cannot provide any assurances as to either the terms or which hotels the agreements will cover. We may also engage other managers on different terms.

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 Interstate SHP 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, Interstate SHP 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 Interstate SHP. 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.

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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 2009, our stock price fluctuated from a low of $1.99 to a high of $9.03. 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 dividend of $0.75 per share of common stock comprised of cash and stock in January 2009. 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 2009. In October 2009, 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 2010. 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.

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 recently 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. A reduction in the cash yield on our common stock 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

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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, 2009, 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 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 purchasers of REIT shares may expect a higher dividend rate. Thus, higher market interest rates or reductions in our dividend rate could cause the market price of our shares to decrease.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

The following table sets forth additional summary information with respect to our hotels as of December 31, 2009:

Hotel	City	State	Chain Scale Segment(1)	Service Category	Rooms	Manager
Hotel Properties Held for Investment (29 hotels):						
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	Interstate SHP
Marriott	Park City	Utah	Upper Upscale	Full Service	199	Interstate SHP
Marriott	Philadelphia	Pennsylvania	Upper Upscale	Full Service	289	Marriott
Marriott	Portland	Oregon	Upper Upscale	Full Service	249	Interstate SHP
Marriott	Quincy	Massachusetts	Upper Upscale	Full Service	464	Marriott
Marriott	Rochester	Minnesota	Upper Upscale	Full Service	203	Interstate SHP
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	Interstate SHP
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
Residence Inn by Marriott	Rochester	Minnesota	Upscale	Extended Stay	89	Interstate SHP
Fairmont(2)	Newport Beach	California	Luxury	Full Service	444	Fairmont
Hilton	Del Mar	California	Upper Upscale	Full Service	257	Interstate SHP
Hilton	Houston	Texas	Upper Upscale	Full Service	480	Interstate SHP
Hilton(2)	Times Square	New York	Upper Upscale	Full Service	460	Interstate SHP
Doubletree	Minneapolis	Minnesota	Upscale	Full Service	229	Interstate SHP
Embassy Suites	Chicago	Illinois	Upper Upscale	Extended Stay	367	Interstate SHP
Embassy Suites	La Jolla	California	Upper Upscale	Extended Stay	340	Hilton
Hyatt Regency(2)	Newport Beach	California	Upper Upscale	Full Service	403	Hyatt
Sheraton(2)	Cerritos	California	Upper Upscale	Full Service	203	Interstate SHP
Independent Valley River Inn	Eugene	Oregon	Upscale	Full Service	257	Interstate SHP
Independent Kahler Inn & Suites	Rochester	Minnesota	Midscale with F/B	Extended Stay	271	Interstate SHP
Independent The Kahler Grand	Rochester	Minnesota	Upscale	Full Service	668	Interstate SHP
Total number of rooms of hotel properties held for investment					10,966	
Hotel Properties Held for Non-Sale Disposition (9 hotels):						
Marriott	Ontario	California	Upper Upscale	Full Service	299	Interstate SHP
Marriott	Provo	Utah	Upper Upscale	Full Service	330	Interstate SHP
Marriott(2)	Salt Lake City	Utah	Upper Upscale	Full Service	218	Interstate SHP
Courtyard by Marriott	San Diego (Old Town)	California	Upscale	Select Service	176	Interstate SHP
Renaissance Concourse(2)	Atlanta	Georgia	Upper Upscale	Full Service	387	Marriott
Residence Inn by Marriott	Manhattan Beach	California	Upscale	Extended Stay	176	Interstate SHP
Hilton	Huntington	New York	Upper Upscale	Full Service	302	Interstate SHP

Holiday Inn	San Diego (Harborview)	California	Midscale with F/B	Full Service	220	Interstate SHP
Holiday Inn Express	San Diego (Old Town)	California	Midscale without F/B	Select Service	125	Interstate SHP
Total number of rooms of hotel properties held for non-sale disposition					2,233	
Hotel Properties Held in Receivership (2 hotels):						
Renaissance Westchester	White Plains	New York	Upper Upscale	Full Service	347	Marriott
W Hotel	San Diego	California	Luxury	Full-Service	258	Starwood
Total number of rooms of hotel properties held in receivership					605	

(1) As defined by Smith Travel Research. F/B refers to food and beverage facilities.
(2) Subject to a ground or air lease with an unaffiliated third party.
(3) 85% ownership interest.

In addition to the hotel properties listed above, as of December 31, 2009, 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 laundry facility in Rochester, Minnesota and lease a 65,000 square foot laundry facility in Salt Lake City, Utah. The facility in Rochester, Minnesota services our hotels in the area, as well as the Mayo Clinic and other surrounding hospitals and businesses. The 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.

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Geographic Diversity

We own a geographically diverse portfolio of hotels located in 13 states and in Washington, D.C. The following table summarizes the 29 hotels by region as of December 31, 2009:

Region	Number of Hotels	Number of Rooms	Percentage of 2009 Revenues
California(1)	9	2,983	24.8%
Other West(2)	5	1,575	11.5%
Midwest(3)	7	2,177	14.4%
East(4)	8	4,231	49.3%
Total	29	10,966	100.0%

The following table presents our occupancy, ADR and RevPAR by geographic region for the 29 hotels for 2007, 2008 and 2009, and may include periods prior to when we acquired our interest in the hotels:

	2007			2008			2009		
Region	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR
California(1)	78.3%	$ 151.06	$ 118.28	78.6%	$ 148.12	$ 116.42	72.5%	$ 125.45	$ 90.95
Other West(2)	82.5%	$ 111.84	$ 92.27	78.2%	$ 123.34	$ 96.45	66.7%	$ 115.58	$ 77.09
Midwest(3)	69.7%	$ 143.72	$ 100.17	67.0%	$ 146.80	$ 98.36	64.7%	$ 126.54	$ 81.87
East(4)	75.6%	$ 207.85	$ 157.13	74.1%	$ 208.85	$ 154.76	70.5%	$ 184.25	$ 129.90
Weighted Average	76.1%	$ 165.21	$ 125.72	74.5%	$ 167.58	$ 124.85	69.3%	$ 147.32	$ 102.09
Year-over-year change	NA	NA	NA	(160) bps	1.4%	(0.7)%	(520) bps	(12.1)%	(18.2)%

(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. As discussed under Item 1, we have transferred, or are in the process of transferring, 11 hotels to court-appointed receivers.

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

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchasers of Equity Securities

Our common stock is traded on the NYSE under the symbol SHO. On January 29, 2010, the last reported price per share of common stock on the NYSE was $8.59. 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
2008:			
First Quarter	$ 18.20	$ 14.97	$ 0.35
Second Quarter	$ 20.94	$ 16.60	$ 0.35
Third Quarter	$ 16.38	$ 10.84	$ 0.35
Fourth Quarter	$ 13.07	$ 3.03	$ 0.75(1)
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

(1) Paid in a combination of cash and shares of our common stock, pursuant to elections by individual stockholders.

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 January 29, 2010, we had approximately 43 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 2009 Purchases of Equity Securities:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 1, 2009 October 31, 2009		$		$
November 1, 2009 November 30, 2009		$		$
December 1, 2009 December 31, 2009		$		$
Total				

(1) On December 11, 2008, the Company s board of directors authorized the repurchase of the Company s common stock, Series A preferred stock, Series C preferred stock and the Senior Notes or repayment of secured debt for an aggregate purchase price and/or payment of up to

$200.0 million on or prior to December 31, 2009 (the 2009 Repurchase Program). As of the expiration of the 2009 Repurchase Program on December 31, 2009, the Company had repurchased $187.5 million of the Senior Notes for $119.8 million, incurring related interest and fees of $5.0 million under the 2009 Repurchase Program.

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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.

	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
Operating Data ($ in thousands):					
Revenues:					
Room	$ 408,150	$ 504,104	$ 492,240	$ 380,839	$ 234,796
Food and beverage	161,963	201,952	199,831	156,117	105,208
Other operating	53,744	59,140	53,686	42,284	33,898
Revenues of operations held for non-sale disposition	93,966	116,298	120,353	110,578	91,155
Total revenues	717,823	881,494	866,110	689,818	465,057
Operating expenses:					
Room	98,382	110,444	106,589	84,218	51,850
Food and beverage	118,629	145,576	144,518	111,204	74,428
Other operating	26,916	29,823	29,755	26,545	21,718
Advertising and promotion	35,693	39,219	37,932	30,280	22,700
Repairs and maintenance	27,360	29,579	27,769	23,372	15,559
Utilities	24,895	28,731	25,840	21,858	14,803
Franchise costs	20,656	24,658	23,770	19,051	9,620
Property tax, ground lease and insurance	43,352	44,993	43,791	39,858	23,113
Property general and administrative	72,823	86,797	86,055	69,395	44,199
Corporate overhead	25,242	21,511	27,849	18,640	14,384
Depreciation and amortization	93,795	93,759	89,925	65,238	41,810
Operating expenses of operations held for non-sale disposition	87,007	96,548	96,433	88,896	73,104
Property and goodwill impairment losses	30,852	57			
Property and goodwill impairment losses of operations held for non-sale disposition	100,143				
Total operating expenses	805,745	751,695	740,226	598,555	407,288
Operating income (loss)	(87,922)	129,799	125,884	91,263	57,769
Equity in net earnings (losses) of unconsolidated joint ventures	(27,801)	(1,445)	(3,588)	140	
Interest and other income	1,388	3,639	8,880	4,074	3,060
Interest and other income of operations held for non-sale disposition	9	69	103	49	7
Interest expense	(76,539)	(83,176)	(77,463)	(54,702)	(36,948)
Interest expense of operations held for non-sale disposition	(15,036)	(13,016)	(10,750)	(9,230)	(6,100)
Gain (loss) on extinguishment of debt	54,506		(417)	(9,976)	(2,667)
Income (loss) from continuing operations	(151,395)	35,870	42,649	21,618	15,121
Income (loss) from discontinued operations	(118,213)	35,368	81,227	31,619	16,845
Net income (loss)	(269,608)	71,238	123,876	53,237	31,966
Non-controlling interest					(1,761)
Dividends paid on unvested restricted stock compensation	(447)	(814)	(1,007)	(856)	(537)
Preferred stock dividends and accretion	(20,749)	(20,884)	(20,795)	(19,616)	(10,973)

Undistributed income allocated to unvested restricted stock compensation			(222)		
Undistributed income allocated to Series C preferred stock			(1,397)		
Income available (loss attributable) to common stockholders	$ (290,804)	$ 49,540	$ 100,455	$ 32,765	$ 18,695
Income (loss) from continuing operations available (attributable) to common stockholders per diluted common share	$ (2.47)	$ 0.26	$ 0.33	$ 0.02	$ 0.05
Cash flows provided by operating activities	$ 70,095	$ 160,002	$ 214,862	$ 161,940	$ 111,713
Cash dividends declared per common share [1]	$ 0.00	$ 1.20	$ 1.31	$ 1.22	$ 1.155

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	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006	Year Ended December 31, 2005
Balance sheet data ($ in thousands):					
Investment in hotel properties, net (2)	$ 1,923,392	$ 2,004,914	$ 2,002,329	$ 1,696,885	$ 1,392,422
Total assets	2,513,530	2,805,611	3,049,152	2,760,373	2,249,189
Total debt (2)	1,203,797	1,389,783	1,394,904	1,170,778	916,826
Total liabilities	1,526,867	1,791,103	1,836,894	1,624,583	1,292,228
Equity	886,767	914,812	1,112,762	1,036,494	857,865

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

(2) Does not include the Marriott Ontario Airport and the Mass Mutual eight hotels, both of which have been reclassified to operations held for non-sale disposition, and the W San Diego and the Renaissance Westchester, both of which have been deconsolidated and included in discontinued operations due to the transfer of possession and control of these two hotels to receivers.

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.

We own primarily upper upscale and upscale hotels in the United States. As of December 31, 2009, we owned 29 hotels (the 29 hotels), excluding 11 hotels which are in the process of being, or have been, transferred to court appointed receivers as a result of our secured debt restructuring program. These 11 hotels include the W San Diego and the Renaissance Westchester, both of which are held in receivership and included in discontinued operations, and nine additional hotels that we are currently in the process of transferring to court-appointed receivers, all of which are included in operations held for non-sale disposition. The nine hotels are comprised of the Marriott Ontario Airport and eight of the 11 hotels securing the non-recourse mortgage with Massachusetts Mutual Life Insurance Company (the Mass Mutual eight hotels) consisting of the following 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). The three additional hotels securing the Mass Mutual loan (Courtyard by Marriott Los Angeles, Kahler Inn & Suites Rochester and Marriott Rochester) are included in the 29 hotels as the Company is in the process of releasing these hotels from the Mass Mutual loan. Of the 29 hotels, we classify 27 as upscale or upper upscale, one as luxury and one as midscale as defined by Smith Travel Research, Inc. In addition to our wholly owned hotels, we own a 38% equity interest in a joint venture that owns one hotel, and we own other non-hotel investments. 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. 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 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. Of the 29 hotels, the average hotel has 378 rooms.

The demand for lodging generally fluctuates with the overall economy. We refer to these periodic 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. 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 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 and minimize operational expenses.

During 2009, in light of the recent cyclical decline, we maintained a higher than historical unrestricted cash balance. We intend to deploy a portion of our excess cash balance in 2010 as we believe the lodging cycle is entering a recovery phase and capital markets have stabilized. During 2009, we selectively deployed a portion of our cash to fund certain transactions such as open market purchases of our Operating Partnership s 4.60% exchangeable senior notes (the Senior Notes) and the tender offer the Operating Partnership closed in May 2009 (the Senior Notes Tender Offer), through the combination of which our Operating Partnership repurchased $187.5 million of its Senior Notes at a price equivalent to 62.3% of par.

During 2009 we completed a secured debt restructuring program to proactively address value and cash flow deficits among certain of our mortgaged hotels. The primary goal of this program was to achieve benefits for our stockholders through loan amendments, or in certain cases, consensual transfers to the lenders of the hotel assets in full satisfaction of the debt. Loans within 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, are non-recourse to us. Five of our loans totaling $470.9 million were subject to our secured debt restructuring program. Pursuant to our secured debt restructuring program, during 2009, we amended the $105.2 million loan secured by the Renaissance Baltimore, transferred the W San Diego and Renaissance Westchester to receivers in advance of deeding back the hotels in satisfaction of their respective loans, and initiated the process to deed back the Marriott Ontario Airport. In addition, we worked with the lender s representative for the Mass Mutual non-recourse mortgage secured by 11 of our hotels to initiate the process to deed back the Mass Mutual eight hotels and to release the remaining three hotels for a release price. If we and Mass Mutual reach agreement on the three hotel release, we have offered to deed back the Mass Mutual eight hotels in satisfaction of the debt balance that will remain after the payment of the release price. If we and Mass Mutual are unable to reach agreement on this proposal, we have offered to deed back all 11 hotels in satisfaction of the entire debt balance and without making a cash payment to Mass Mutual. We hope to conclude this process in the first quarter of 2010, but no assurance can be given that either the partial release or the deed-in-lieu transaction will be consummated, or upon their timing or terms. Through our secured debt restructuring program, we are in the process of eliminating $365.7 million in mortgage debt by electing to deed back 11 hotels with an estimated total fair market value of $182.0 million, and offering to pay a release price to release the three hotels which had a book value including goodwill of $65.0 million at December 31, 2009.

Consistent with our cycle-appropriate strategy, during 2009, we issued 43,700,000 shares of our common stock, including the underwriters over-allotment of 5,700,000 shares. Net proceeds from this offering of approximately $257.1 million were contributed to our subsidiary, Sunstone Hotel Partnership LLC, which will use the proceeds for working capital and other general corporate purposes, which may include hotel acquisitions.

All of our debt bears fixed interest at a weighted average rate of 5.6%, and the weighted average term to maturity of our debt is approximately 7.2 years. Of our total debt, approximately $180.8 million matures over the next four years ($81.0 million in 2010, none in 2011, $34.0 million in 2012 and $65.8 million in 2013, assuming we repay our Senior Notes remaining balance of $62.5 million at the first put date in 2013). In addition, we continue to negotiate with Mass Mutual regarding the resolution of the 11 hotels comprising the collateral pool for a $246.0 million mortgage loan. We have offered to make a partial payment on the mortgage loan in an effort to secure the release of three of the 11 hotels. As such, we expect to pay a release price in 2010. The $180.8 million does not include $61.9 million in mortgage debt associated with the three hotels, or $10.9 million of normal loan amortization payments due in 2010, $15.3 million due in 2011, $15.2 million due in 2012, or $17.1 million due in 2013.

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;

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;

operating flow through, which is the quotient of incremental operating income divided by incremental revenues;

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

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 revenues, which is the product of the number of rooms sold and the ADR;

Food and beverage revenues, which is comprised of revenues realized in the hotel food and beverage outlets as well as banquet and catering events;

Other operating revenues, which include 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. Prior to December 2007, this category also included operating revenue from BuyEfficient, LLC (BuyEfficient). In December 2007, we entered into a joint venture agreement with Strategic Hotels & Resorts, Inc. (Strategic), to own and operate BuyEfficient. Our 50% interest in BuyEfficient is now reflected on our balance sheet as investments in unconsolidated joint ventures, and on our statements of operations as equity in net losses of unconsolidated joint ventures; and

Revenues of operations held for non-sale disposition, which includes room revenues, food and beverage revenues, and other operating revenues for those hotels which we intend to dispose of other than by sale. Currently, this category includes the Marriott Ontario Airport and the Mass Mutual eight hotels. In September 2009 and November 2009, we elected to cease the subsidization of debt service on the non-recourse mortgages for the Marriott Ontario Airport and the Mass Mutual loan, respectively, as we believe that the values of the 12 hotels securing these loans are, on a collective basis, significantly less than the principal amounts of their mortgages. Prior to electing this default, we worked with each loan s lender representative to amend the repayment terms, but we were unable to reach mutually acceptable amendment terms. At this point, other than as noted above with respect to the partial release of three of the hotels securing the Mass Mutual loan, we do not expect further negotiations with the lender representatives, and we are working to convey the hotels to the lenders in lieu of repayment of the debt. We have reclassified the assets, liabilities and results of operations of the Marriott Ontario Airport and the Mass Mutual eight hotels to operations held for non-sale disposition on our balance sheets, statements of operations and statements of cash flows.

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;

- *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;

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Corporate overhead expense, which includes our corporate-level expenses, such as payroll and related costs, amortization of deferred stock compensation, 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;

Operating expenses of operations held for non-sale disposition, which includes room expense, food and beverage expense, other operating expenses, advertising and promotion, repairs and maintenance, utilities, franchise costs, property tax, ground lease and insurance expense, property general and administrative expense, and depreciation and amortization expense for those hotels which we intend to dispose of other than by sale. Currently, this category includes the Marriott Ontario Airport and the Mass Mutual eight hotels;

Property and goodwill impairment losses expense, which includes the charges we have recognized to write-off goodwill in association with our quarterly impairment evaluations and to reduce the carrying value of assets on our balance sheet to their fair value when required; and

Property and goodwill impairment losses of operations held for non-sale disposition, which includes property and goodwill impairment losses expense for those hotels which we intend to dispose of other than by sale. Currently, this category includes the Marriott Ontario Airport and the Mass Mutual eight hotels.

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

Equity in net losses of unconsolidated joint ventures, which includes our portion of net 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 and other income of operations held for non-sale disposition, which includes interest we have earned on our restricted and unrestricted cash accounts for those hotels which we intend to dispose of other than by sale. Currently this category includes the Marriott Ontario Airport and the Mass Mutual eight 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;

Interest expense of operations held for non-sale disposition, which includes interest expense, amortization of deferred financing fees and any loan penalties and fees incurred on our debt for those hotels which we intend to dispose of other than by sale. Currently, this category includes the Marriott Ontario Airport and the Mass Mutual eight hotels;

Gain (loss) on extinguishment of debt, which includes the gain we recognized on the repurchase and cancellation of the Senior Notes, as well as any costs incurred to repay mortgage debt before its maturity date;

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.

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. During 2008, as a result of the U.S. recession and the deterioration of the credit markets, the lodging cycle entered a decline phase, with demand for lodging rooms declining by approximately 1.6% as compared to 2007. In 2009, this trend continued, and lodging demand declined by 5.8% as compared to 2008. As a result of declining demand and increases in new hotel supply, total RevPAR for the 29 hotels declined by 18.2% in 2009 as compared to 2008. Consistent with prior trends, we anticipate that lodging demand will improve as liquidity is restored in the credit markets and the U.S. economy begins to strengthen. Historically, periods of declining demand are followed by extended periods of relatively strong demand, resulting in a cyclical lodging growth phase. Assuming the current U.S. recession ended in the later part of 2009, we expect hotel demand to begin to show year-over-year increases beginning in 2010 and 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. We believe the lodging industry will eventually benefit from the current economic climate and restrictive financing environment, as new hotel construction projects will be difficult to finance. As a result, we believe the initiation of hotel development will be constrained until the construction financing markets recover, with a number of hotel projects currently in the planning stages being postponed or cancelled. Given the one to three year timeline needed to construct a typical hotel, we expect a window of at least two to four years beginning in 2010 during which 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 our operators effectiveness in maximizing revenues. Similarly, we believe that strong operating flow through is a good indicator of 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. Our revenue maximization initiatives may entail using alternative distribution channels, such as internet wholesalers. Our operators may also look to enter into long-term airline crew contracts, or they may accept forms of lower-rated business that we would not typically take during periods of stronger demand. Our revenue management initiatives are generally oriented towards maximizing ADR even if the result may be lower occupancy, 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 better flow through, and as a result, higher operating margins. Increases in RevPAR associated with higher occupancy may result in worse flow through and, as a result, poor margin preservation.

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, capitalizing on relaxed brand standards, such as reducing complimentary amenities, and selectively closing 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 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. In addition, operating results for operations held for non-sale disposition for both 2009 and 2008 includes the Marriott Ontario Airport and the Mass Mutual eight hotels. Income (loss) from discontinued operations for 2009 includes the results of operations for the Marriott Napa Valley, the Marriott Riverside and the Hyatt Suites Atlanta Northwest which were sold in 2009, as well as the W San Diego and the Renaissance Westchester which have been deconsolidated from our operations as a result of the transfer of possession and control of these properties to receivers during 2009. Income from discontinued operations for 2008 includes the results of operations for the Hyatt Regency Century Plaza and the Crowne Plaza Grand Rapids which were sold in 2008, the Marriott Napa Valley, the Marriott Riverside and the Hyatt Suites Atlanta Northwest that were sold in 2009, as well as the W San Diego and the Renaissance Westchester that have been deconsolidated from our operations. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

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	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)%
Revenues of operations held for non-sale disposition	93,966	116,298	(22,332)	(19.2)%
Total revenues	717,823	881,494	(163,671)	(18.6)%
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%
Operating expenses of operations held for non-sale disposition	87,007	96,548	(9,541)	(9.9)%
Property and goodwill impairment losses	30,852	57	30,795	54,026.3%
Property and goodwill impairment losses of operations held for non-sale disposition	100,143		100,143	100.0%
Total operating expenses	805,745	751,695	54,050	7.2%
Operating income (loss)	(87,922)	129,799	(217,721)	(167.7)%
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 and other income of operations held for non-sale disposition	9	69	(60)	(87.0)%
Interest expense	(76,539)	(83,176)	6,637	8.0%
Interest expense of operations held for non-sale disposition	(15,036)	(13,016)	(2,020)	(15.5)%
Gain on extinguishment of debt	54,506		54,506	100.0%
Income (loss) from continuing operations	(151,395)	35,870	(187,265)	(522.1)%
Income (loss) from discontinued operations	(118,213)	35,368	(153,581)	(434.2)%
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)%

The following table presents our operating results for our total portfolio for 2008 and 2007, 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, 2008 and 2007. In addition, operating results for operations held for non-sale disposition for both 2008 and 2007 includes the Marriott Ontario Airport and the Mass Mutual eight hotels. Income from discontinued operations for 2008 includes the results of operations for the Hyatt Regency Century Plaza and the Crowne Plaza Grand Rapids which were sold in 2008, the Marriott Napa Valley, the Marriott Riverside and the Hyatt Suites Atlanta Northwest which were sold in 2009, as well as the W San Diego and the Renaissance Westchester which have been deconsolidated from our operations as a result of the transfer of possession and control of these properties to receivers during 2009. Income from discontinued operations for 2007 includes the results of operations for the seven hotels we sold during 2007 (Courtyard by Marriott Oxnard, Courtyard by Marriott Riverside, Hawthorn Suites Sacramento, Hilton Garden Inn Lake Oswego, Residence Inn by Marriott Oxnard, Residence Inn by Marriott Sacramento, and Sheraton Salt Lake City), the Hyatt Regency Century Plaza and the Crowne Plaza Grand Rapids which were sold in 2008, the Marriott Napa Valley, the Marriott Riverside and the Hyatt Suites Atlanta Northwest that were sold in 2009, as well as the W San Diego and the Renaissance Westchester that have been deconsolidated from our operations. These amounts can be found in our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

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	2008	2007	Change $	Change %
	(dollars in thousands, except statistical data)			
REVENUES				
Room	$ 504,104	$ 492,240	$ 11,864	2.4%
Food and beverage	201,952	199,831	2,121	1.1%
Other operating	59,140	53,686	5,454	10.2%
Revenues of operations held for non-sale disposition	116,298	120,353	(4,055)	(3.4)%
Total revenues	881,494	866,110	15,384	1.8%
OPERATING EXPENSES				
Hotel operating	453,023	439,964	13,059	3.0%
Property general and administrative	86,797	86,055	742	0.9%
Corporate overhead	21,511	27,849	(6,338)	(22.8)%
Depreciation and amortization	93,759	89,925	3,834	4.3%
Operating expenses of operations held for non-sale disposition	96,548	96,433	115	0.1%
Property and goodwill impairment losses	57		57	100.0%
Total operating expenses	751,695	740,226	11,469	1.5%
Operating income	129,799	125,884	3,915	3.1%
Equity in net losses of unconsolidated joint ventures	(1,445)	(3,588)	2,143	59.7%
Interest and other income	3,639	8,880	(5,241)	(59.0)%
Interest and other income of operations held for non-sale disposition	69	103	(34)	(33.0)%
Interest expense	(83,176)	(77,463)	(5,713)	(7.4)%
Interest expense of operations held for non-sale disposition	(13,016)	(10,750)	(2,266)	(21.1)%
Loss on extinguishment of debt		(417)	417	100.0%
Income from continuing operations	35,870	42,649	(6,779)	(15.9)%
Income from discontinued operations	35,368	81,227	(45,859)	(56.5)%
Net income	71,238	123,876	(52,638)	(42.5)%
Dividends paid on unvested restricted stock compensation	(814)	(1,007)	193	19.2%
Preferred stock dividends and accretion	(20,884)	(20,795)	(89)	(0.4)%
Undistributed income allocated to unvested restricted stock compensation		(222)	222	100.0%
Undistributed income allocated to Series C preferred stock		(1,397)	1,397	100.0%
Income available to common stockholders	$ 49,540	$ 100,455	$ (50,915)	(50.7)%

Operating Statistics. Included in the following tables are comparisons of the key operating metrics for our hotel portfolio for the years ended December 31, 2009, 2008 and 2007. The comparisons do not include the results of operations for the three hotels sold in 2009, the two hotels sold in 2008, and the seven hotels sold in 2007. The comparisons also do not include the Marriott Ontario Airport and the Mass Mutual eight hotels both of which are held for non-sale disposition, and the W San Diego and the Renaissance Westchester both of which are held in receivership and included in discontinued operations. Because three of our