Sunstone Hotel Investors, Inc.
Form S-3/A
November 16, 2005
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As filed with the Securities and Exchange Commission on November 16, 2005

Registration No. 333-129258

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 2

TO

FORM S-3

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

SUNSTONE HOTEL INVESTORS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**20-1296886**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

903 Calle Amanecer, Suite 100

San Clemente, California 92673

(949) 369-4000

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

Jon D. Kline

Executive Vice President and Chief Financial Officer

903 Calle Amanecer, Suite 100

San Clemente, California 92673

(949) 369-4000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Alison S. Ressler

Patrick S. Brown

Sullivan & Cromwell LLP

1888 Century Park East, Suite 2100

Los Angeles, California 90067-1725

(310) 712-6600

APPROXIMATE DATE OF PROPOSED SALE TO THE PUBLIC: From time to time after the effective date of this registration statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ ___________

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment that specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED NOVEMBER 16, 2005

Prospectus

8,043,572 Shares Common Stock

4,102,564 Shares Series C Cumulative Convertible Redeemable Preferred Stock

Sunstone Hotel Investors, Inc.

This prospectus relates to the offering for resale from time to time of up to 8,043,572 shares of common stock and 4,102,564 shares of series C cumulative convertible redeemable preferred stock, which we refer to as series C preferred, including 4,102,564 shares of common stock issuable upon conversion of the series C preferred, by the selling stockholders named in this prospectus and any additional stockholders that may be identified in a supplement to this prospectus or an amendment to the registration statement of which this prospectus forms a part. We will not receive any of the proceeds from the sale of the shares by the selling stockholders. The selling stockholders, or their pledgees, donees, transferees or other successors in interest, may offer the shares through public or private transactions at prevailing market prices, at prices related to prevailing market prices or at privately negotiated prices.

The securities covered by this prospectus are comprised of up to 3,699,572 shares of common stock that may be issued to certain selling stockholders, at our option, upon the redemption of their membership units in Sunstone Hotel Partnership, LLC, and 4,344,000 shares of common stock and 4,102,564 shares of series C preferred, including 4,102,564 shares of common stock issuable upon conversion of the series C preferred, issued or issuable in private placements and the shares of common stock underlying the series C preferred.

Shares of our common stock are subject to ownership and transfer limitations that must be applied to maintain our status as a real estate investment trust, or REIT, which are described under Description of Stock.

Our common stock currently trades on the New York Stock Exchange, or NYSE, under the symbol SHO. On November 15, 2005, the last reported sale price of our common stock was $25.05 per share. There is currently no public trading market for the series C preferred. We will apply to have the series C preferred listed on the NYSE at such time as the distribution of series C preferred meets the applicable listing standards of the NYSE. There can be no assurance such listing will occur.

You should read carefully this prospectus before you invest.

Investing in our securities involves risks. See **Risk Factors beginning on page 4** **to read about factors you should consider before buying our securities.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

Our principal executive offices are at 903 Calle Amanecer, Suite 100, San Clemente, California 92673. Our telephone number is (949) 369-4000. Our website is located at www.sunstonehotels.com. Information on the website is not deemed to be a part of this prospectus.

The date of this Prospectus is __________, 2005

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You should rely only on the information contained, or incorporated by reference, in this prospectus or any prospectus supplement. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained, or incorporated by reference, in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents.

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This prospectus contains, or incorporates by reference, registered trademarks that are the exclusive property of companies other than us, including Courtyard by Marriott®, Crowne Plaza®, Doubletree®, Embassy Suites Hotels®, Fairmont®, Four Points®, Hawthorn Suites®, Hilton®, Holiday Inn®, Hyatt®, Marriott®, Renaissance®, Residence Inn by Marriott®, Sheraton®, Wyndham® and Starbucks®. We are a party to license agreements or management agreements with the owners of these trademarks, which enable hotels we own to be operated using those trademarks. None of the owners of these trademarks or their affiliates, officers, directors, agents or employees own any of our hotels. None of the owners of these trademarks, or any of their affiliates, officers, directors, agents or employees is an issuer or underwriter of the securities being offered hereby or a participant in this offering. In addition, none of the owners of these trademarks, or any of their officers, directors, agents or employees has or will endorse the offering or assume any liability arising out of or related to the sale or offer of the securities being offered hereby, including any liability or responsibility for any financial statements or other financial information contained, or incorporated by reference, in this prospectus. None of the owners of these trademarks, or any of their officers, directors, agents or employees will receive any proceeds from the sale of the securities in this offering and the purchasers of shares will not receive any interest in the trademarks of such owners.

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Unless otherwise indicated, industry statistics are from Smith Travel Research, an independent statistical research service that specializes in the lodging industry. Some of the terms used or incorporated by reference in this prospectus, such as luxury, upper upscale, upscale and midscale, are consistent with Smith Travel Research terms. The category of luxury includes Fairmont; the upper upscale includes hotels such as Doubletree, Embassy Suites Hotels, Hilton, Hyatt, Marriott, Renaissance and Sheraton; the category of upscale includes hotels such as Courtyard by Marriott, Crowne Plaza, Hawthorn Suites, Hilton Garden Inn, Radisson, Residence Inn by Marriott and Wyndham; and the category of midscale includes hotels such as Four Points Sheraton, Holiday Inn, Holiday Inn Express and Holiday Inn Select.

As used in this prospectus, references to the Contributing Entities are to Sunstone Hotel Investors, L.L.C., Sunstone/WB Hotel Investors IV, LLC, Sunstone/WB Manhattan Beach, LLC and WB Hotel Investors, LLC, each of which is controlled by Westbrook Real Estate Partners, L.L.C. References to we, our and us are to Sunstone Hotel Investors, Inc. and, except as the context otherwise requires, its consolidated subsidiaries, including Sunstone Hotel Partnership, LLC and its consolidated subsidiaries.

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, using a shelf registration process or continuous offering process. Under this shelf registration process, the selling stockholders may, from time to time, sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities that may be offered by the selling stockholders. We may also file, from time to time, a prospectus supplement or an amendment to the registration statement of which this prospectus forms a part containing specific information about the selling stockholders and the terms of the securities being offered. That prospectus supplement or amendment may include additional risk factors or other special considerations applicable to those securities. Any prospectus supplement or amendment may also add, update, or change information in this prospectus. If there is any supplement or amendment, you should rely on the information in that prospectus supplement or amendment.

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RISK FACTORS

Investing in our securities involves risk. In deciding whether to invest in our common stock or series C preferred, you should carefully consider the disclosures in our Annual Report on Form 10-K for the year ended December 31, 2004 as well as the risk factors set forth below, the disclosures in our Quarterly Reports on Form 10-Q for the quarters ended March 31 and June 30, and the other information contained, or incorporated by reference, in this prospectus or any prospectus supplements. The risks and uncertainties described below and in these documents are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of the following risks occurs, our business, financial condition or results of operations could be materially and adversely affected. In that case, the value of our common stock or series C preferred and your investment could decline.

Risks Related to Our Business

In the recent 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 or occupancy.

The performance of the lodging industry has traditionally been closely linked with the performance of the general economy and, specifically, growth in the United States gross domestic product. Revenue per available room, or RevPAR, in the lodging industry declined 6.9% in 2001 and 2.6% in 2002. In 2002, RevPAR for the 52 hotels that we owned at May 31, 2005 decreased 1.2%. 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. This characteristic may result from the fact that upper upscale and upscale hotels generally target business and high-end leisure travelers. In periods of economic difficulties, business and leisure travelers may seek to reduce travel costs by limiting travel or seeking to reduce costs on their trips. In addition, the terrorist attacks of September 11, 2001 had a dramatic adverse effect on business and leisure travel, and on our occupancy and average daily rate, or ADR. Future terrorist activities could have a similarly harmful effect on both the industry and us.

As of September 30, 2005, we had approximately $1.0 billion of outstanding debt, or $1.2 billion on a pro forma basis giving effect to the acquisition of the Hyatt Regency Century Plaza in October 2005. Carrying such debt may harm our financial flexibility or harm our business and financial results by imposing requirements on our business.

Carrying our outstanding debt may harm 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 borrow more money for operations, capital expenditures or to finance acquisitions in the future; and

requiring us to sell one or more properties, possibly on disadvantageous terms, in order to make required payments of interest and principal.

We also intend to incur additional debt in connection with future acquisitions of real estate, which may include loans secured by a portfolio of some or all of the hotels we acquire. If necessary or advisable, we may also borrow funds to satisfy the requirement that we distribute to our stockholders at least 90% of our annual REIT taxable income or otherwise to ensure that we maintain our qualification as a REIT for Federal income tax purposes. In addition, at September 30, 2005, we had $29.5 million in outstanding letters of credit.

If we were to default on our secured debt in the future, the loss of our property securing the debt would harm 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 for a purchase price equal to the outstanding balance of the debt secured by the mortgage. 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 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.

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 harm our operating results.

Since 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 harm our ability to repay our debt through refinancings. If we are unable to refinance our indebtedness on acceptable terms, or at all, we might be forced to sell one or more of our properties on 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 refinancing, 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 restrictions, requirements and other limitations on our ability to incur additional debt on specific properties, 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.

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Our revolving credit facility and term loan facility contain financial covenants that could harm our financial condition.

Our revolving credit facility and term loan facility 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 (other than those required by the Internal Revenue Code of 1986, as amended, or the Code), 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. Advances under the revolving credit facility are subject to borrowing base requirements based on the hotels securing the facility. These covenants may restrict our ability to engage in transactions that we believe would otherwise be in the best interests of our stockholders. Failure to comply with any of the covenants in our revolving credit facility or term loan facility could result in a default under one or more of our debt instruments. This could cause one or more of our lenders to accelerate the timing of our payment obligations and could harm our business, operations, financial condition or liquidity.

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 become highly leveraged, 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.

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

Four of our directors, Messrs. Kazilionis, Paul, Wolff and Dona, 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. In addition, our executive officers, Messrs. Alter, Kline and Stougaard, have economic interests in other hotel investments and, therefore, may have competing demands on their time.

Some of our directors have conflicts of interest involving Westbrook Real Estate Partners, L.L.C.

Two of our directors, Messrs. Kazilionis and Paul, are Managing Principals of Westbrook Real Estate Partners, L.L.C. In addition, one of our directors, Ms. Behar, is employed by an entity that has investments in funds managed by Westbrook Real Estate Partners, L.L.C. that own interests in the Contributing Entities. Accordingly, these directors may have conflicts of interest in evaluating situations in which we and Westbrook Real Estate Partners, L.L.C. or its affiliates have a conflicting interest.

The Contributing Entities and their affiliates own interests in hotels that compete with us.

The Contributing Entities and their affiliates, including our executive officers, own interests in other hotels in which we have no interest or rights. Some of these hotels are located in the same geographic area as our hotels, and hotels we acquire in the future also may be located in the same geographic area as the hotels owned by the Contributing Entities and their affiliates. Hotels located in the same geographic area compete for business, and this competition may harm our results of operations.

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Sales of our common stock by the Contributing Entities may reduce or eliminate the desire of two of our directors to serve on our board.

Messrs. Kazilionis and Paul are Managing Principals of Westbrook Real Estate Partners, L.L.C., which is the managing member of entities that have controlling ownership interests in the Contributing Entities. If the Contributing Entities sell their shares of our common stock, Messrs. Kazilionis and Paul, in light of their role at Westbrook Real Estate Partners, L.L.C., may resign from our board if Westbrook Real Estate Partners, L.L.C., which controls each of the Contributing Entities, no longer has an indirect ownership interest in us. The Contributing Entities and their affiliates beneficially own approximately 7.2% of our common stock assuming full conversion of their membership units of Sunstone Hotel Partnership into shares of our common stock.

We face competition for the acquisition of hotels, and we may not be successful in identifying or completing hotel acquisitions that meet our criteria, which may impede our growth.

One component of our business strategy is expansion through acquisitions, and we may not be successful in identifying or completing acquisitions 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. 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. 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.

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

We have focused, and may continue to focus, on the acquisition of multiple hotels in single transactions to seek to reduce acquisition costs per hotel and enable us to expand our hotel portfolio more rapidly. Multiple hotel acquisitions such as the acquisition of the Renaissance Hotels, 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 does 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. These hotels may harm our operating results if they operate at a loss or we sell them at a loss. Also, a portfolio of hotels may 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.

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Most of our hotels are 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 harm 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 rental 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 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. For example, from 1998 to 2003, upscale RevPAR growth was lower than RevPAR growth for the overall lodging industry, and from 2001 to 2003, upper upscale RevPAR growth was lower than RevPAR growth for the overall lodging industry.

Rising operating expenses 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.

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.

Giving effect to the acquisition of the nine hotels we have completed in 2005, approximately 36.1% of our hotels, representing 32.0% of our rooms and 33.6% of our 2004 pro forma revenues, are located in California. The concentration of our hotels in California makes our business disproportionately affected by economic conditions, competition and real and personal property tax rates in 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 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, such as the 2002 Winter Olympics, are not always easy to predict and are often episodic in nature. In addition, we incurred a $1.3 million

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provision for bad debt expense related to a customer at one of our hotels in 2004 and an additional reserve of $2.1 million taken in 2005 related to a contract interpretation issue with this customer. 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 with national franchisors, termination of franchise agreements or circumstances that negatively affect the franchisor itself could cause us to lose business at hotels operated under the franchisor s name or lead to a default or acceleration of our obligations under certain of our notes payable.

As of September 30, 2005, approximately 95.0% of our hotels, representing 92.9% of our rooms, were operated under franchise or management agreements with national franchisors. In general, under franchise arrangements, the franchisor provides marketing services and room reservations and certain other operating assistance, but requires us, as the franchisee, to pay significant fees to it, and to maintain the hotel in a required condition. If our primary management company, Interstate Hotels & Resorts, Inc, or the Management Company, or other management companies fail to maintain these required standards, then the franchisor may terminate the franchise agreement and obtain damages for any liability we may have caused. Moreover, from time to time, we may receive notices from franchisors regarding our alleged non-compliance with the franchise agreements, and we may disagree with a franchisor s claim that we are not in compliance with applicable franchise agreements. Any disputes arising under our franchise agreements could also lead to a termination of a franchise 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 on a particular hotel, it could harm the operation, financing, financeability or value of that hotel due to the loss of the franchise name, marketing support and centralized reservation system. Moreover, negative publicity affecting a franchisor in general could reduce the revenue we receive from the hotels subject to that particular franchise. Any loss of revenue at a hotel could harm the ability of Sunstone Hotel TRS Lessee Inc., our wholly owned subsidiary, or 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 Sunstone Hotel Partnership, LLC and could harm our ability to pay dividends on our common stock or series C preferred.

Our franchisors require us to make capital expenditures pursuant to property improvement plans, or PIPs, under our franchise agreements, and the failure to make the expenditures required under the PIPs could cause the franchisors to terminate the franchise agreements.

As a result of our initial public offering, some of our franchisors required that new franchise agreements be executed with the TRS Lessee or its subsidiaries. As a condition to receiving the new franchise agreements, some of our franchisors required that we make renovations to some of our hotels, which we expect to do as part of our ordinary capital expenditure programs. In addition, upon regular inspection of our hotels, our franchisors may determine that additional renovations are required to bring the physical condition of our hotels into compliance with the specifications and standards each franchisor has developed in connection with the operation of our hotels. In connection with the acquisitions of hotels, franchisors may also require PIPs. The franchisors generally set forth their renovation requirements in PIPs and if we do not satisfy the PIP renovation requirements pursuant to the franchisor s criteria, the franchisor will have the right to terminate the applicable franchise 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 room 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.

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

In addition to capital expenditures required by our franchise and loan agreements, we will need to make capital expenditures to comply with applicable laws and regulations, remain competitive with other hotels and maintain the economic value of our hotels. In connection with our recently completed acquisitions we expect to make a total of approximately $80.0 million of capital expenditures. Occupancy and ADR are often affected by the maintenance and improvements at a 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.

Our returns depend on management of our hotels by third parties and, in particular, on the performance of Interstate Hotels & Resorts, Inc., or the Management Company.

In order to qualify as a REIT under the Code, 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 the hotels. Thus, independent management companies, including, among others, the Management Company, under management agreements with us, control the daily operations of our hotels.

The Management Company manages and operates 48 of our 61 hotels pursuant to management agreements with the TRS Lessee or its subsidiaries. Five of our remaining hotels are managed by Marriott or Hyatt under existing management agreements, six Renaissance Hotels are managed by Renaissance Hotel Operating Company, one recently acquired hotel is operated pursuant to a management agreement with Fairmont Hotels & Resorts (U.S.) Inc. and one is operated pursuant to a management agreement with Hyatt. Under the terms of these management agreements, 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 adequately 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 may not have a contractual right to cause an independent management company to change its 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

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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 and, therefore, need to replace any of our management companies, those events could result in significant disruptions at the affected hotels upon the termination of a manager. If any of the foregoing occurs, our relationships with franchisors may be damaged, and we may be in breach of one or more of our franchise agreements.

Therefore, we are dependent to a large degree on the operating performance of the Management Company and its ability to generate revenue at our hotels in excess of our operating expenses. We cannot assure you that the Management Company will successfully manage our hotels. A failure by the Management Company to successfully manage our hotels could lead to an increase in our operating expenses or a decrease in our revenue, which would reduce the amount available for dividends on our common 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.

Our contractual arrangements with the Management Company are relatively new. Accordingly, we cannot assure you that our relationship with the Management Company will be satisfactory to us, or that our expectations regarding the quality and effectiveness of its performance will be met. As a result, the management agreements with the Management Company could be terminated by us prior to the expiration of their respective terms, which would be disruptive to our business and could harm our profitability and cash flow.

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 leased our hotel properties to the TRS Lessee, who contracted with the Management Company and other 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 base rent and percentage rent based upon a percentage of gross revenue above a certain minimum level. As a result, we participate in the economic operations of our hotels only through our share of gross revenue under the leases.

The TRS Lessee s ability to pay rent will be 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) will 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 since 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 land underlying eleven of our hotels is held by ground leases, termination of these leases by the ground 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 11 of our hotels is based upon our interest under long-term ground or air leases. 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 under the ground or air leases. As of December 31, 2004, the terms of these ground or air leases (including renewal options) range from 43 to 92 years. Any pledge of our interest in a ground or air lease may also require the consent of the applicable ground 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 ground or air lessor 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 or taking 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.

Our hedging strategies may not be successful in mitigating our risks associated with interest rates.

We use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When rates change, we expect to record a gain or loss on derivatives. Our hedging activities may include entering into interest rate swaps, caps and floors and options to purchase these items. We currently use interest rate caps to manage our interest rate risks related to our variable rate indebtedness; however, our actual hedging decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated hedging strategy. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses, and such losses could harm our results of operations, financial condition and business prospects.

In addition, we also may be limited in the type and amount of hedging transactions we may use in the future by our need to satisfy the REIT income tests under the Code. Only income from certain hedging transactions qualifies for purposes of the 95% gross income test, and no hedging income qualifies for purposes of the 75% gross income test. As a result, our ability to effectively hedge against changes in interest rates could be limited, and our earnings could be reduced and could vary more from period to period.

Risks Related to the Common Stock Offered Hereby

Shares available for future sale could cause the market price of our common stock to drop significantly, even if our business is doing well.

As of September 30, 2005, we have 55,320,447 (including, without limitation, the shares covered by this prospectus) shares of our common stock and membership units outstanding. Of the common stock, 5,993,554 were sold in September 2005, 24,625,000 shares were sold in connection with our initial public offering and 3,000,000 shares were sold in June 2005, all of which are freely tradable without restriction, except for any shares purchased by our affiliates, as that term is used in Rule 144 of the Securities Act. Affiliates may only sell their shares pursuant to the requirements of Rule 144, in a registered public offering or pursuant to an exemption under the Securities Act. Furthermore, 3,699,572 shares of common stock

issuable to the Contributing Entities upon exchange of their membership units in Sunstone Hotel Partnership, 300,000 shares of common stock issued or issuable to Security Capital Preferred Growth Incorporated, 4,102,564 shares of common stock issuable to Security Capital Preferred Growth Incorporated upon conversion of the same number of shares of series C preferred and 4,044,000 shares of common stock issued to GIC Real Estate, may be sold by the selling stockholders in the public market pursuant to this prospectus. In addition, all shares of our common stock that we may issue under our 2004 long-term incentive plan have been registered and can be freely sold in the public market after vesting.

The sale of these shares could cause the market price of our common stock to decline significantly and could impair our ability to raise capital through the sale of additional stock.

The terms of our management agreements with the Management Company were negotiated by us and Sunstone Hotel Investors, L.L.C., which had a conflict of interest because of the payment it received from the Management Company 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 terms of the management agreements with the Management Company are the result of negotiations among us, Sunstone Hotel Investors, L.L.C. and the Management Company. At the time of the formation and structuring transactions, the Management Company purchased from Sunstone Hotel Investors the corporate subsidiary that managed our hotels and employed the employees of our hotels and paid $8.0 million in cash to Sunstone Hotel Investors, L.L.C.; 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, L.L.C. had a conflict of interest with us in negotiating the management agreements with the Management Company.

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

In connection with the contribution by the Contributing Entities of the hotel properties and entities to us 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 those properties and entities that were incurred prior to the consummation of the formation and structuring transactions. In addition, in connection with the Management Company s agreement to purchase the corporate subsidiary of Sunstone Hotel Investors, L.L.C. that managed our hotels and employed the employees of our hotels, the Management Company 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 the Management Company. Any such claims could give rise to economic liabilities which could be substantial and for which we would have no recourse. If any such liability is established against us, our financial condition could be harmed.

The market price of our equity securities may vary substantially.

The trading prices of equity securities issued by REITs may be affected by changes in market interest rates. 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.

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Other factors that could affect the market price of our equity securities include the following:

- 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;
- the reputation and performance of our franchisors;
- the reputation and performance of the Management Company and our other management companies;
- 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 key personnel or board members;
- announcements by us or our competitors of acquisitions, investments or strategic alliances;
- adverse market reaction to any increased indebtedness we incur in the future; and
- general market, economic and political conditions and world events.

Our distributions to stockholders may change.

We paid a quarterly dividend of $0.285 per share of common stock and membership unit, a quarterly dividend of $0.50 per share of series A cumulative redeemable preferred stock, or the series A preferred, and a quarterly dividend of $0.393 per share of series C preferred on October 14, 2005 to stockholders of record on September 30, 2005. 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 restrictions under applicable law and our capital requirements. Consequently, our dividend levels may fluctuate.

Risk Factors Relating to the Series C Preferred Offered Hereby

Our series C preferred does not have an established trading market, which may negatively impact its market value and your ability to transfer or sell your shares, and the series C preferred have no stated maturity date.

Our series C preferred is a newly issued security with no established trading market. Because the series C preferred does not have a stated maturity date, investors seeking liquidity will be limited to selling their shares in the secondary market. We will apply to have the series C preferred listed on the NYSE at such time as the distribution of series C preferred meets the applicable listing standards of the NYSE; however, we cannot assure you that the series C preferred will be approved for listing. An active trading market for the series C preferred may not develop or, even if it develops, may not last, in which case the trading price of the series C preferred could be adversely affected.

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The market value of the series C preferred could be substantially affected by various factors.

As with other publicly-traded securities, the trading price for the series C preferred will depend on many factors, which may change from time to time, including:

- the market price for our common stock and our preferred stock;
- any increases in prevailing interest rates, which may negatively affect the market for the series C preferred;
- the market for similar securities;
- additional issuances of other series or classes of preferred shares;
- general economic conditions or conditions in the financial or real estate markets; and
- our financial condition, performance and prospects.

Our series C preferred has not been rated and is subordinated to our existing and future debt, and there are no restriction on the issuance of parity preferred securities.

Our series C preferred has not been rated by any nationally recognized statistical rating organization, which may negatively affect its market value and your ability to sell them. The payment of amounts due on the series C preferred will be subordinated to all of our existing and future debt, including our revolving credit facility and term loan facility. We may also issue additional preferred shares in the future which are on a parity with (or, upon the affirmative vote or consent of the holders of two-thirds of the outstanding series A preferred and each other class or series of preferred stock ranking on a parity with the series C preferred which are entitled to similar voting rights, voting as a single class, senior to) the series C preferred with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up. Any of these factors may affect the trading price for the series C preferred.

Risks Related to Our Organization and Structure

The Contributing Entities may exercise significant control over our company and possibly delay, prevent or cause us to defer taking actions that would be beneficial to our other stockholders.

As of September 30, 2005, the Contributing Entities and their affiliates beneficially owned approximately 7.2% of our common stock, assuming full conversion of their membership units of Sunstone Hotel Partnership into shares of our common stock. Accordingly, the Contributing Entities and their affiliates are able to exercise significant control over the outcome of substantially all matters required to be submitted to our stockholders for approval, including decisions relating to the election of our board of directors, and influence the determination of our day-to-day corporate and management policies, the appointment of executive officers, the amount of distributions, the timing of additional offerings (including offerings of our securities held by them) and the terms of the management agreements with the Management Company and the other independent management companies and the leases with the TRS Lessee. In addition, we have entered into an agreement with the Contributing Entities pursuant to which the Contributing Entities, acting as a group, have the right to require our board of directors and nominating and corporate governance committee to nominate up to two of their designees to our board of directors with the actual number at any time dependent on their percentage ownership

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interest in us at that time. Also, the Contributing Entities and their affiliates are able to exercise significant control over the outcome of any proposed merger or consolidation of our company under Maryland law. The Contributing Entities and their affiliates ownership interest in our company may discourage third parties from seeking to acquire control of our company, which may harm the market price of our shares of common stock.

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 of 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 Share and Common Share 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 actually 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. Our board of directors may not consent to such a transfer if it would result in the termination of our status as a REIT. 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 of control is in their best interests. The Contributing Entities and their affiliates constructively own approximately 9.7% of the outstanding shares of our common stock prior to this offering.

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 shall hold office until the next annual meeting of stockholders, and until his or her successor is elected and qualifies. As a result, stockholder influence over these matters is limited.

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

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

Exclusive 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 statutes. Thus, our stockholders may not effect any changes to our bylaws.

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 in similar circumstances. The duties of directors of Maryland corporations do not require them to (1) accept, recommend or respond to any proposal by a person seeking to acquire control of the corporation, (2) authorize the corporation to redeem any rights under, of modify or render inapplicable, any stockholders rights plan, (3) make a determination under the Maryland business combination act or the Maryland control share acquisition act or (4) 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 Securities Exchange Act of 1934 and at least three independent directors, without stockholder approval, to implement possible takeover defenses, such as a classified board. These provisions may make it more difficult for a third party to effect a takeover.

Our management team has a limited history of operating a REIT and managing a public company, which may give rise to inefficiencies or strain our operations and resources.

We have recently been organized and we have a limited operating history as a REIT. Our management team operated our business as a privately-owned company for the five years prior to our initial public offering in October 2004 and, therefore, other than Mr. Alter, had no experience operating a REIT and managing a publicly-owned company. We will need to continue to develop control systems and procedures adequate to support a public REIT, and this transition could place a significant strain on our management systems, infrastructure, financial condition and other resources.

We rely on our executive officers, 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 executive officers, especially Messrs. Alter, Kline and Stougaard. 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, financial condition and operating results.

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Because we made changes to our operations and to qualify and elect to be treated as a REIT, our future financial performance may be affected by unanticipated changes and may differ materially from our historical and pro forma performance.

The historical financial data incorporated by reference in this prospectus is the historical financial data for us and our predecessor companies. Our initial public offering resulted in changes to our assets and operations that are reflected in our pro forma financial data for 2004. We are unable to predict all changes that will result under our new structure, including our agreements with the Management Company. Accordingly, you should not rely on our historical or pro forma financial data as a predictor of our future performance.

Our insurance arrangements with affiliates of Westbrook Real Estate Partners, L.L.C. expose us to expense and coverage risks.

Our environmental insurance coverage also relates to affiliates of Westbrook Real Estate Partners, L.L.C. and other hotels owned by them and our executive officers. We expect to obtain our own insurance, which we expect to be more expensive. In addition, if claims or losses are experienced under the current policy that do not relate to us, the amount of coverage available to us would be reduced.

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:

- increased 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 and other factors that may not be offset by increased room rates;

- 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;

- dependence on business and commercial travel, 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