

Sunstone Hotel Investors, Inc.
Form 10-K
February 25, 2014
[Table of Contents](#)

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, 2013

OR

o 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.

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(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

20-1296886
(I.R.S. Employer
Identification Number)

120 Vantis, Suite 350
Aliso Viejo, California
(Address of Principal Executive Offices)

92656
(Zip Code)

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

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing sale price of the registrant's common stock on June 30, 2013 as reported on the New York Stock Exchange (NYSE) was approximately \$1.9 billion. The registrant had no non-voting common equity outstanding on such date. This amount excludes 2,306,010 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 14, 2014 was 182,860,469.

Documents Incorporated by Reference

Part III of this Report incorporates by reference information from the definitive Proxy Statement for the registrant's 2014 Annual Meeting of Stockholders.

Table of Contents

SUNSTONE HOTEL INVESTORS, INC.

ANNUAL REPORT ON

FORM 10-K

For the Year Ended December 31, 2013

TABLE OF CONTENTS

	Page	
PART I		
<u>Item 1</u>	<u>Business</u>	3
<u>Item 1A</u>	<u>Risk Factors</u>	11
<u>Item 1B</u>	<u>Unresolved Staff Comments</u>	28
<u>Item 2</u>	<u>Properties</u>	28
<u>Item 3</u>	<u>Legal Proceedings</u>	29
<u>Item 4</u>	<u>Mine Safety Disclosures</u>	29
PART II		
<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	30
<u>Item 6</u>	<u>Selected Financial Data</u>	31
<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	61
<u>Item 8</u>	<u>Financial Statements and Supplementary Data</u>	61
<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	61
<u>Item 9A</u>	<u>Controls and Procedures</u>	61
<u>Item 9B</u>	<u>Other Information</u>	63
PART III		
<u>Item 10</u>	<u>Directors, Executive Officers and Corporate Governance</u>	63
<u>Item 11</u>	<u>Executive Compensation</u>	63
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	63
<u>Item 13</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	63
<u>Item 14</u>	<u>Principal Accounting Fees and Services</u>	63
PART IV		
<u>Item 15</u>	<u>Exhibits, Financial Statement Schedules</u>	63
SIGNATURES		67

Table of Contents

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 (the Code). As of December 31, 2013, we had interests in 29 hotels (the 29 hotels). The 29 hotels are comprised of 13,744 rooms, located in 12 states and in Washington, D.C.

Our primary business is to acquire, own, asset manage and renovate full-service hotel properties in the United States. As part of our ongoing portfolio management strategy, we may also sell certain hotel properties from time to time. All but one (the Boston Park Plaza) of the 29 hotels are operated under nationally recognized brands such as Marriott, Hilton, Hyatt, Fairmont and Sheraton. Our portfolio primarily consists of upper upscale hotels in the United States. As of December 31, 2013, our 29 hotels include two luxury hotels, 26 upper upscale hotels and one upscale hotel. The classifications luxury, upper upscale and upscale are defined by Smith Travel Research, an independent provider of lodging industry statistical data. Smith Travel Research classifies hotel chains into the following segments: luxury; upper upscale; upscale; upper midscale; midscale; economy; and independent.

Our hotels are operated by third-party managers pursuant to long-term management agreements with our TRS Lessee or its subsidiaries. As of December 31, 2013, our third-party managers included: subsidiaries of Marriott International, Inc. or Marriott Hotel Services, Inc. (collectively Marriott), managers of 10 of the Company's 29 hotels; a subsidiary of Interstate Hotels & Resorts, Inc. (IHR), manager of six of the Company's

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29 hotels; Highgate Hotels L.P. and an affiliate (Highgate), manager of four of the Company's 29 hotels; Davidson Hotels & Resorts (Davidson), Hilton Worldwide (Hilton) and Hyatt Corporation (Hyatt), each a manager of two of the Company's 29 hotels; and Crestline Hotels & Resorts (Crestline), Dimension Development Company (Dimension) and Fairmont Hotels & Resorts (U.S.) (Fairmont), each a manager of one of the Company's 29 hotels. In addition, we own BuyEfficient, LLC (BuyEfficient), an electronic purchasing platform that allows members to procure food, operating supplies, furniture, fixtures and equipment.

Competitive Strengths

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

- **Strong Access to Capital.** As a publicly traded REIT, over the long-term, we may benefit from greater access to a variety of forms of capital as compared to non-public investment vehicles.
- **Low Cost of Capital.** As a publicly traded REIT, over the long-term, we may benefit from a lower cost of capital as compared to non-public investment vehicles as a result of our liquidity, professional management and portfolio diversification.

Table of Contents

- **Significant Cash Position.** As of December 31, 2013, we had total cash of \$193.7 million, including \$89.3 million of restricted cash. By minimizing our need to access external capital by maintaining higher than typical cash balances, our financial security and flexibility are meaningfully enhanced because we are able to fund our business needs and debt maturities partially with our cash. As we believe the lodging cycle is in the middle phase of a potentially prolonged cyclical recovery, we may deploy a portion of our excess cash balance in 2014 towards debt repayments and repurchases, selective acquisitions and capital investments in our portfolio. In addition, as we have made progress on our core objective to improve the quality and scale of our portfolio while gradually deleveraging our balance sheet, we have reinstated a cash quarterly dividend on our common shares.

- **Flexible Capital Structure.** We believe our capital structure provides us with appropriate financial flexibility to execute our strategy. As of December 31, 2013, the weighted average term to maturity of our debt is approximately four years, and 70.7% of our debt is fixed rate with a weighted average interest rate of 5.4%. Including our variable-rate debt obligations based on variable rates at December 31, 2013, the weighted average interest rate on our debt is 4.9%. All of our mortgage debt is in the form of single asset non-recourse loans rather than in cross-collateralized multi-property pools. We currently believe this structure is appropriate for the operating characteristics of our business as it isolates risk and provides flexibility for various portfolio management initiatives, including the sale of individual hotels subject to existing debt.

- **Low Leverage.** Over the past two years, we have been committed to thoughtfully and methodically reducing our leverage while maintaining a focus on creating and protecting stockholder value. As of December 31, 2013, our debt-to-EBITDA ratio (including our preferred equity as debt) is 5.4 to 1, down from 6.7 to 1 as of December 31, 2011. See Part II Item 7 for a reconciliation of net income to EBITDA. We believe that by achieving low leverage and high financial flexibility by the time the current cycle peaks, we will position the Company to create value during the next successive cyclical trough by acquiring distressed assets or securities.

- **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 2013, approximately 92% 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, New Orleans, San Francisco, 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 94% of the hotel revenue generated by the 29 hotels during 2013, tend to outperform the lodging industry, particularly in the recovery phase of the lodging cycle. As of December 31, 2013, the hotels comprising our 29 hotel portfolio averaged 474 rooms in size, and our total 28 hotel Comparable Portfolio RevPAR was \$148.09 for the year ended December 31, 2013.

Nationally Recognized Brands. All but one (the Boston Park Plaza) of the 29 hotels are operated under nationally recognized brands, including Marriott, Hilton, Hyatt, Fairmont and Sheraton. We believe that affiliations with strong brands improve the appeal of our hotels to a broad set of travelers and help to drive business to our hotels.

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Recently Renovated Hotels. From January 1, 2009 through December 31, 2013, we invested \$362.9 million in capital renovations throughout the 29 hotels. We believe that these capital renovations have improved the competitiveness of our hotels and have helped to position our portfolio for future growth.

- **Seasoned Management Team.** Each of our core disciplines, asset management, acquisitions and finance, are overseen by industry leaders with demonstrated track records.

Asset Management. Our asset management team is responsible for maximizing the long-term value of our real estate investments by achieving above average revenue and profit performance through proactive oversight of hotel operations. Our asset management team leads property-level innovation, benchmarks best practices and aggressively oversees hotel management teams and property plans. We work with our operators to develop hotel-level master plans, which include positioning and capital renovation plans. We believe that a proactive asset management program can help to grow the revenues of our hotel portfolio and maximize operational efficiency by leveraging best practices and innovations across our various hotels, and by initiating well-timed focused capital improvements aimed at improving the appeal of our hotels.

Table of Contents

Acquisitions. Our acquisitions team is responsible for enhancing our portfolio quality and scale by executing well-timed acquisitions and dispositions that maximize our risk-adjusted return on invested capital. We believe that our significant acquisition and disposition experience will allow us to continue to execute our cycle-appropriate strategy to redeploy capital from slower growth to higher growth hotels. From the date of our initial public offering through December 31, 2013, we acquired interests in 25 hotel properties and sold 42 hotel properties. Pursuant to our cycle-appropriate strategy, our focus shifted from acquisitions to dispositions in 2007, 2008 and for the majority of 2009 as the lodging cycle peaked and experienced a down cycle. Towards the later part of 2009 and into 2010 and 2011, our focus shifted to the selective acquisition of upper upscale hotels as we entered a recovery phase in the lodging cycle. In light of increasing demand for lodging and the generally limited supply of new hotel development, we believe we are currently in the middle phase of a cyclical lodging recovery. Hotels acquired during the early stages of past cyclical recoveries have benefited from multi-year increases in profitability. Accordingly, during the past three years, we selectively acquired interests in eight hotels: the Doubletree Guest Suites Times Square in January 2011; the JW Marriott New Orleans in February 2011; the Hilton San Diego Bayfront in April 2011; the Hyatt Chicago Magnificent Mile in June 2012; the Hilton Garden Inn Chicago Downtown/Magnificent Mile in July 2012; the Hilton New Orleans St. Charles in May 2013; the Boston Park Plaza in July 2013; and the Hyatt Regency San Francisco in December 2013. We plan to maintain this focus of selective acquisitions in 2014, as we believe our industry relationships may create opportunities for us to acquire individual hotel assets at attractive values. Meanwhile, we will also focus on capital recycling, and may selectively sell hotels that we believe have lower growth prospects, have significant ongoing capital needs or are encumbered with larger debt balances.

Finance. 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, while maintaining a best in class disclosure and investor relations program. We remain committed to thoughtfully and methodically reducing leverage while maintaining a focus on creating and protecting stockholder value. During 2013, we reduced our total mortgage debt by \$105.8 million through amortization, debt repayments and extinguishment. In addition, in March 2013, we redeemed all 7,050,000 shares of our 8.0% Series A Cumulative Redeemable Preferred Stock (Series A preferred stock) for an aggregate redemption price of \$178.6 million, and in May 2013, we redeemed all 4,102,564 shares of our Series C Cumulative Convertible Redeemable Preferred Stock (Series C preferred stock) for an aggregate redemption price of \$101.1 million. The Series A preferred stock and Series C preferred stock redemptions effectively offset the leverage we took on pursuant to the Boston Park Plaza acquisition, which included the assumption of a \$119.2 million non-recourse 4.4% fixed-rate mortgage.

Business Strategy

Our mission is to create meaningful value for our stockholders by becoming the premier hotel owner. Our values include transparency, trust, ethical conduct, communication and discipline. As demand for lodging generally fluctuates with the overall economy (we refer to these changes in demand as the lodging cycle), we seek to employ a balanced, cycle-appropriate corporate strategy. Our strategy over the next several years, during what we believe will be the middle/mature phase of the lodging cycle, is to improve the quality and scale of our portfolio while gradually deleveraging our balance sheet. Our goal is to achieve low leverage and high financial flexibility by the time the current cycle peaks. We believe if we are successful in executing on this strategy, we will position the Company to create value during the next successive cyclical trough by acquiring distressed assets or securities. Our strategy encompasses several elements, including proactive portfolio management, intensive asset management, disciplined external growth and measured balance sheet improvement as detailed below:

- **Proactive Portfolio Management.** The leaders of each of our core disciplines function as a portfolio management team. The portfolio management team's purpose is to strategically maximize the long-term value of our assets by enhancing our portfolio quality and scale, optimizing our exposure to key markets, and improving the effectiveness and efficiency of our decision making. Accordingly, the team is responsible for developing a portfolio-wide strategy related to brand and operator relationships, asset quality and scale, target markets, capital investments, and portfolio capitalizations. Our portfolio strategy may also include the disposition of certain hotels.

- **Intensive Asset Management.** Through all phases of the lodging cycle, our strategy emphasizes internal growth and value enhancements through proactive asset management, which entails working closely with our third-party hotel operators to develop and implement long-term strategic plans for each hotel designed to enhance revenues, minimize operational expenses and asset risk, maximize the appeal of our hotels to travelers and maximize our return on invested capital. We also focus on improving the appeal and growth potential of our existing hotels through internally-managed hotel renovations.

Table of Contents

- **Disciplined External Growth.** By gradually increasing the scale and quality of our portfolio, we may provide our stockholders with greater exposure to key growth markets, improved liquidity and broader access to value-adding transactions. Accordingly, our strategy emphasizes disciplined external growth during the recovery phase of the lodging cycle. Our external growth plan is oriented around investing in institutional-quality hotels that generate returns in excess of our cost of capital, that are additive to the quality of our portfolio, that have attractive growth potential and that may benefit from our asset management competencies. We endeavor to structure our acquisitions in ways that will not only increase the value of our shares of common stock, but also will advance our other corporate objectives, such as improving our financial flexibility and reducing our leverage. During periods of cyclical decline, our strategy may emphasize opportunistically investing in distressed assets and the repurchase of our equity or debt securities. In addition to hotel acquisitions, we may seek to grow our portfolio by making investments in defaulted and/or distressed debt positions in loan-to-own hotel transactions, utilizing our REIT structure to effect strategic combinations with select property owners, effecting portfolio purchases from institutional and other owners seeking portfolio liquidity, and by providing capital solutions to illiquid owners facing debt maturities or capital requirements.
- **Measured Balance Sheet Improvement.** We believe that a low overall cost of capital and significant financial flexibility are very important to the successful execution of our strategy. Our balance sheet strategy is oriented toward maximizing financial flexibility especially during cyclical declines. Accordingly, our financial objectives include the measured improvement of our credit ratios and the maintenance of appropriate levels of liquidity throughout the cyclical recovery phase. Our financial objectives are integral to our overall corporate strategy and, accordingly, we have developed our financial objectives in conjunction with our portfolio management and growth objectives. The lodging industry is economically sensitive. Therefore, our financial objectives are aimed at reducing the potentially negative impact of combining high operating leverage with high financial leverage, while preserving access to multiple capital sources and minimizing our weighted-average cost of capital. We seek to capitalize our acquisitions in a way that will advance our financial objectives. During the mature phase of the lodging cycle, our financial objectives may include increasing our liquidity position as a means to enhance financial flexibility in the event of a subsequent period of cyclical decline. Our liquidity improvement objective may be accomplished through selective hotel dispositions, capital raises or by retaining excess cash generated by our operations.

Through our industry relationships, our knowledge and experience in both real estate and REIT issues, our extensive experience in acquiring and upgrading hotel properties, as well as our financial structuring capabilities, flexible capital structure, strong liquidity position and REIT structure, we believe we are well positioned to create meaningful value to our stockholders.

Competition

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

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

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As of December 31, 2013, all but one (the Boston Park Plaza) of the 29 hotels are operated under nationally recognized brands such as Marriott, Hilton, Hyatt, Fairmont and Sheraton, which are among the most respected and widely recognized brands in the lodging industry. We believe the largest and most stable segment of travelers prefer the consistent service and quality associated with nationally recognized brands.

Table of Contents

Management Agreements

All of our 29 hotels are managed by third parties pursuant to management agreements with our TRS Lessee or its subsidiaries. As of December 31, 2013, Marriott managed 10 of our hotels, IHR managed six of our hotels, Highgate managed four of our hotels, Davidson, Hilton and Hyatt each managed two of our hotels, and the remaining three hotels were individually managed by Crestline, Dimension and Fairmont. The following is a general description of our third-party management agreements as of December 31, 2013.

Marriott. Our management agreements with Marriott require us to pay Marriott a base management fee between 2.31% and 3.0% of total revenue. These management agreements expire between August 2014 and 2055, absent prior termination by either party. Additionally, five of these aforementioned management agreements require payment of an incentive fee of 20.0% of the excess of gross operating profit over a certain threshold; one management agreement requires payment of an incentive fee of 20% of the excess of gross operating profit over a certain threshold, however the total base and incentive fees are capped at 4.25% of gross revenue for 2012 and 2013, 4.5% of gross revenue for 2014, 4.75% of gross revenue for 2015, 5.0% of gross revenue for the first seven months of 2016, and 5.25% of gross revenue for the remaining term of the agreement; one management agreement requires payment of an incentive fee of 35.0% of the excess of gross operating profit over a certain threshold; one management agreement requires payment of 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 management agreement requires payment of an incentive fee of 10.0% of adjusted gross operating profit, limited to 3.0% of gross revenue; and one management agreement does not require payment of an incentive fee. The management agreements with Marriott may be terminated earlier than the stated term if certain events occur, including the failure of Marriott to satisfy certain performance standards, a condemnation of, a casualty to, or force majeure event involving a hotel, the withdrawal or revocation of any license or permit required in connection with the operation of a hotel and upon a default by Marriott or us that is not cured prior to the expiration of any applicable cure periods. In certain instances, Marriott has rights of first refusal to either purchase or lease hotels, or to terminate the applicable management agreement in the event we sell the respective hotel.

IHR. Our management agreements with IHR require us to pay a management fee ranging from 2.0% to 2.1% of gross revenue; plus an incentive fee of 10.0% of the excess of net operating income over a certain threshold. The incentive fee, however, may not exceed a range of 1.5% to 1.9% of the total revenue for all the hotels managed by IHR for any fiscal year.

With the exception of the IHR management agreement at the Sheraton Cerritos (which agreement is subject to automatic two-year renewal terms, the first of which commenced in 2012), the IHR management agreements expire in 2024 and provide us the right to renew each management agreement for up to two additional terms of five years each, absent a prior termination by either party.

Highgate. Our Boston Park Plaza, Doubletree Guest Suites Times Square, Hilton Times Square and Renaissance Westchester hotels are operated under management agreements with Highgate. The management agreement at the Boston Park Plaza requires us to pay Highgate a base management fee of 2.5% of gross revenue until July 1, 2014, 2.75% of gross revenue from July 2, 2014 to July 1, 2015, and 3.0% of gross revenue thereafter. The agreement expires in 2023, absent a prior termination by either party. In addition, the management agreement at the Boston Park Plaza requires us to pay an incentive fee of 15.0% of the excess of net operating income over a certain threshold.

The management agreements at the Doubletree Guest Suites Times Square, the Hilton Times Square and the Renaissance Westchester require us to pay Highgate a base management fee of 3.0% of gross revenue. The management agreement at the Doubletree Guest Suites Times Square expires in 2037, absent a prior termination by either party. In addition, the management agreement at the Doubletree Guest Suites Times Square requires us to pay an incentive fee of 1.0% of annual gross receipts in the event that a certain return threshold is achieved. The management

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agreement at the Hilton Times Square expires in 2021 and provides Highgate with the right to renew for two additional terms of five years upon the achievement of certain performance thresholds, absent a prior termination by either party. In addition, the management agreement at the Hilton Times Square requires us to pay an incentive fee of 50.0% of the excess of net operating income over a certain threshold, limited to 1.25% of total revenue. The management agreement at the Renaissance Westchester expires in 2022, absent early termination by either party, and does not require payment of an incentive fee.

Davidson. Our Embassy Suites Chicago and Hyatt Chicago Magnificent Mile hotels are operated under management agreements with Davidson. The management agreement at the Embassy Suites Chicago expires in 2015, and provides us with the right to renew for up to two additional terms of five years each, absent a prior termination by either party. The agreement requires us to pay 2.0% of total revenue as a base management fee and calls for an incentive fee of 15.0% of the excess of net operating income over a certain threshold (capped at 1.0% of total revenue) and an additional incentive fee in the amount of 1.0% of total revenue upon achieving a certain level of net operating income (capped at 1.0% of total revenue). The base and incentive management fees payable to Davidson under the Embassy Suites Chicago management agreement have an aggregate cap of 4.0% of total revenue. The management agreement at the Hyatt Chicago Magnificent Mile expires in 2019, and provides us with the right to renew for up to two additional terms of five years each, absent a prior termination by either party. The agreement requires us to pay 2.5% of total revenue as a base management fee and calls for an incentive fee of 10.0% of the excess of net operating income over a certain threshold (capped at 1.5% of total revenue). The base and incentive management fees payable to Davidson under the Hyatt Chicago Magnificent Mile management agreement have an aggregate cap of 4.0% of total revenue. In addition to the base and incentive management fees, the Hyatt Chicago Magnificent Mile management agreement required us to pay Davidson a development fee for their assistance in converting the hotel to a Hyatt equal to the lesser of 2.0% of the total development costs we incurred, or \$0.5 million. The development fee, which totaled \$0.5 million, was paid in full by the end of 2013.

Table of Contents

Hilton. Our Embassy Suites La Jolla and Hilton San Diego Bayfront hotels are operated under management agreements with Hilton. The management agreement at the Embassy Suites La Jolla expires in 2016 (absent early termination by either party), and provides no renewal options. The agreement requires us to pay a base management fee of 2.25% of gross revenue. The agreement includes an incentive fee of 15.0% of our net profit at the hotel in excess of certain net profit thresholds. The management agreement at the Hilton San Diego Bayfront expires in 2018 and provides Hilton with the right to renew for up to three additional terms of five years each, absent a prior termination by either party. The agreement requires us to pay a base fee of 2.5% of total revenue and an incentive fee of 15.0% of the excess of operating cash flow over a certain percentage.

Hyatt. Our Hyatt Regency Newport Beach hotel is operated under a management agreement with Hyatt. The agreement expires in 2019 and provides either party the right to renew for successive periods of 10 years (provided that the term of the agreement shall in no event extend beyond 2039), absent early termination by either party. The agreement requires us to pay 3.5% of total hotel revenue as a base management fee, with an additional 0.5% of total revenue payable to Hyatt based upon the hotel achieving specific operating thresholds. The agreement also requires us to pay an incentive fee equal to 10.0% of the excess of adjusted profit over \$2.0 million, and 5.0% of the excess of adjusted profit over \$6.0 million.

Our Hyatt Regency San Francisco hotel is operated by Hyatt under an operating lease with economics that follow a typical management fee structure. The lease expires in 2050, and provides no renewal options. Pursuant to the lease, Hyatt retains 3.0% of total revenue as a base management fee. The lease also provides for Hyatt the opportunity to earn an incentive fee if gross operating profit exceeds certain thresholds.

Crestline. Our Hilton Garden Inn Chicago Downtown/Magnificent Mile hotel is operated under a management agreement with Crestline. The agreement expires in 2022 (absent early termination by either party), and provides us with the right to renew for up to two additional terms of five years each. The agreement requires us to pay 2.0% of gross revenue as a base management fee, and requires us to pay an incentive fee of 10.0% of the excess of operating profit over a certain threshold.

Dimension. Our Hilton New Orleans St. Charles hotel is operated under a management agreement with Dimension. The agreement expires at the end of 2017 (absent early termination by either party), and provides for automatic month-to-month renewals thereafter. The agreement requires us to pay 3.0% of gross revenue as a base management fee. The agreement does not require payment of an incentive fee.

Fairmont. Our Fairmont Newport Beach hotel is operated under a management agreement with Fairmont. The agreement expires in 2015 (absent early termination by either party) and provides Fairmont with two extension options, the first option having a term of 20 years and the second option having a term of 10 years. The agreement requires us to pay 3.0% of total revenue as a base management fee and calls for payment of incentive fees ranging from 20.0% to 30.0% of the hotel's net profit above certain net profit thresholds. The base and incentive management fees payable to Fairmont under the management agreement have an aggregate cap of 6.0% of total revenue.

The existing management agreements with Marriott, Hilton, Hyatt and Fairmont 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, 2013, 15 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 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.

Table of Contents

The franchise agreements also provide for termination at the franchisor's option upon the occurrence of certain events, including failure to pay royalties and fees or to perform other obligations under the franchise license, bankruptcy and abandonment of the franchise or a change in control. The subsidiary that is the franchisee is responsible for making all payments under the franchise agreements to the franchisors, however the Company guarantees certain obligations under a majority of the franchise agreements.

In June 2012, we purchased the Wyndham Chicago and immediately rebranded the hotel the Hyatt Chicago Magnificent Mile. As incentive to rebrand the hotel to a Hyatt, Hyatt Franchising, L.L.C. paid us \$6.5 million in June 2013, once the conversion to Hyatt was complete. We are amortizing the \$6.5 million on a straightline basis over the remaining 25-years of our franchise agreement with Hyatt, which term ends in 2039.

Tax Status

We have elected to be taxed as a REIT under Sections 856 through 859 of the Code, commencing with our taxable year ended 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,

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motel or other establishment in which more than one-half of the dwelling units are used on a transient basis. A qualified lodging facility does not include any facility where wagering activities are conducted. A qualified lodging facility includes customary amenities and facilities operated as part of, or associated with, the lodging facility as long as such amenities and facilities are customary for other properties of a comparable size and class owned by other unrelated owners.

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

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

Table of Contents

Ground, Building and Air Lease Agreements

At December 31, 2013, 10 of the 29 hotels are subject to ground, building and/or air leases with unaffiliated parties that cover either all or portions of their respective properties. As of December 31, 2013, the remaining terms of these ground, building and air leases (including renewal options) range from approximately 30 to 113 years. These leases generally require us to make rental payments and payments for all or portions of costs and expenses, including real and personal property taxes, insurance and utilities associated with the leased property.

Any proposed sale of a property that is subject to a ground, building or air lease or any proposed assignment of our leasehold interest as ground, building or air lessee under the ground, building or air lease may require the consent of the applicable ground, building or air lessor. As a result, we may not be able to sell, assign, transfer or convey our ground, building or air lessee's interest in any such property in the future absent the consent of the ground, building or air lessor, even if such transaction may be in the best interests of our stockholders. Four of the 10 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.

Four of the 10 leases allow us the option to acquire the ground or building lessor's interest in the ground or building lease subject to certain exercisability provisions. From time to time, we evaluate our options to purchase the ground lessor's interests in the leases. As such, we have entered into an agreement to purchase the land beneath the Fairmont Newport Beach for \$11.0 million, and expect this transaction to close by May 2014.

Offices

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

Employees

At February 1, 2014, we had 76 employees, including 30 employees at BuyEfficient. 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

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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, result in increased regulation or costs, or have a negative impact on travel.

Table of Contents

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

ADA Regulation

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

Seasonality and Volatility

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

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

In the past, events beyond our control, including economic slowdowns 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 hotels. In an economic downturn, this type of hotel 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 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, operating results at our hotels in key gateway markets may be negatively affected by reduced demand from international travelers due to financial conditions in their home countries. Also, volatility in transportation fuel costs, increases in air and ground travel costs and decreases in airline capacity may reduce the demand for our hotel rooms. Accordingly, our financial results may be harmed if economic conditions worsen, or if travel-associated costs, such as transportation fuel costs, increase. 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.

Table of Contents

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

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

We have historically used capital obtained from debt and equity markets, including secured mortgage debt, to acquire hotel assets. If these markets become 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 business could be adversely affected. Similar factors could also adversely affect the ability of others to obtain capital and therefore could make it more difficult for us 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 the perceived risks associated with our assets, interest rates on debt and return expectations of equity investors. Interest rates for hotel mortgages had increased by several percentage points from 2007 to 2009 before moderating in 2010 and then decreasing from 2011 to 2013. Equity investor return expectations have risen during the same time period primarily due to increased volatility and global economic uncertainty. If capital costs increase from current levels, and if the income generated by our hotels does not increase by amounts sufficient to cover such higher capital costs, the market value of our hotel real estate may decline. In some cases, the value of our hotel real estate has previously declined, and may in the future decline, to levels below the principal amount of the debt securing such hotel real estate.

As of December 31, 2013, we had approximately \$1.4 billion of consolidated outstanding debt, and carrying such debt may impair our financial flexibility or harm our business and financial results by imposing requirements on our business.

Of our total debt outstanding as of December 31, 2013, approximately \$790.6 million matures over the next four years (none in 2014, \$137.2 million in 2015, \$411.6 million in 2016 and \$241.8 million in 2017). The \$790.6 million does not include \$23.3 million of scheduled loan amortization payments due in 2014, \$23.0 million due in 2015, \$14.2 million due in 2016, or \$10.7 million due in 2017. 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 our operations and capital expenditures, future business opportunities and other purposes, including distributions to our stockholders;

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- 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, 2013, we had \$0.8 million in outstanding letters of credit.

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 with property secured debt or corporate debt on acceptable terms, or at all, and are unable to negotiate an extension with the lender, we may be in default or forced to sell one or more of our properties on potentially disadvantageous terms, which might increase our borrowing costs, result in losses to us and reduce the amount of cash available to us for distributions to our stockholders. If prevailing interest rates or other factors at the time of any refinancing result in higher interest rates on new debt, our interest expense would increase, which would harm our operating results.

Table of Contents

During 2009, pursuant to a completed secured debt restructuring program, we voluntarily elected to cease the subsidization of debt service on mortgages securing some of our hotels. If operating fundamentals decline in the future, 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 with whom we may in the future seek to do business. During 2009, pursuant to secured debt restructuring negotiations with respect to certain of our mortgage loans (the 2009 secured debt restructuring program), we ultimately determined that it was in our best interest to voluntarily cease the subsidization of debt service shortfalls under four of our non-recourse mortgages totaling \$303.9 million, which were secured by 11 of our hotels. During 2010, we transferred the titles on 10 of these hotels to either the lenders or new owners, and the related debt was extinguished. Such historical title transfers could continue to 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.

All of our debt at December 31, 2013 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 or employ a partial cash and partial stock dividend to satisfy our taxable income distribution requirements.

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

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

Many of our existing mortgage debt agreements contain cash trap provisions that could limit our ability to make distributions to our stockholders.

Certain of our loan agreements contain cash trap provisions that may be triggered if the performance of the hotels securing the loans decline. If these provisions are triggered, substantially all of the profit generated by the secured hotel would be deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of the lender. As of December 31, 2013, the cash trap provisions had been triggered at one hotel resulting in \$9.4 million being held by the respective lender as of December 31, 2013. In January 2014, this hotel was released from the cash trap, and the lender returned the \$9.4 million to us. In addition, the mortgage secured by one of the hotels we sold during 2012 (the Hilton Del Mar) is subject to cash trap provisions. Although this mortgage was assumed by the buyer of the hotel, our cash, totaling \$4.4 million as of December 31, 2013, remained trapped by the lender as of the end of the year. In February 2014, the lender released the cash, and the entire \$4.4 million was returned to us.

Table of Contents

Cash generated by our hotels that secure our existing mortgage debt agreements is distributed to us only after the related debt service and certain impound amounts are paid, which could affect our liquidity and limit our ability to make distributions to our stockholders.

Cash generated by our hotels that secure our existing mortgage debt agreements is distributed to us only after certain items are paid, including deposits into leasing and maintenance reserves and the payment of debt service, insurance, taxes, operating expenses, and extraordinary capital expenditures and leasing expenses. This limit on distributions could affect our liquidity and our ability to make distributions to our stockholders.

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 were to 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 capital investments or external growth, and could harm our ability to make payments on our outstanding indebtedness and our financial condition.

One of our directors has direct and active economic interests in hotels, which may result in conflicts and competing demands on his time.

One of our directors, Lewis N. Wolff, is actively involved in the management of entities that invest in hotels. Accordingly, this director may have a conflict of interest in owning hotels that operate in similar markets or in evaluating hotel acquisition opportunities in which we and Mr. Wolff both have a potential interest. Our Code of Business Conduct and Ethics requires Mr. Wolff to obtain approval from our in-house counsel and/or the chair of our Nominating and Corporate Governance Committee prior to engaging in any transaction or relationship that could reasonably be expected to give rise to a potential conflict of interest. We cannot assure you that these procedures will prevent any conflicts or mitigate the impact of such conflicts if they arise.

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

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

Delays we encounter in the selection, acquisition, renovation and development of real properties could adversely affect investor returns. Our ability to commit to purchase specific assets will depend, in part, on the amount of our available cash at a given time. Renovation programs may take longer and cost more than initially expected. Therefore, we may experience delays in receiving cash distributions from such hotels. If our projections are inaccurate, we may not achieve our anticipated returns.

Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their estimated fair values. Should the allocation be incorrect, our assets and liabilities may be overstated or understated, which may also affect depreciation expense on our statement of operations.

Accounting for the acquisition of a hotel property or other entity as a purchase transaction requires an allocation of the purchase price to the assets acquired and the liabilities assumed in the transaction at their respective estimated fair values. The most difficult estimations of individual fair values are those involving long-lived assets, such as property and equipment, intangible assets and

Table of Contents

capital lease obligations that are assumed as part of the acquisition of a leasehold interest. During 2011, 2012 and 2013, we used all available information to make these fair value determinations, and engaged an independent valuation specialist to assist in the fair value determination of the long-lived assets acquired and liabilities assumed in our purchases of the outside 62.0% equity interests in the Doubletree Guest Suites Times Square joint venture, the outside 50.0% equity interests in the BuyEfficient joint venture, the JW Marriott New Orleans, the purchase of a 75.0% majority interest in the entity that owns the Hilton San Diego Bayfront, the Hyatt Chicago Magnificent Mile, the Hilton Garden Inn Chicago Downtown/Magnificent Mile, the Hilton New Orleans St. Charles, the Boston Park Plaza and the Hyatt Regency San Francisco hotels. Should any of these allocations be incorrect, our assets and liabilities may be overstated or understated, which may also affect depreciation expense on our statement of operations.

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

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

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 have co-invested, and may in the future co-invest, 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. For example, on April 15, 2011, we acquired a 75.0% majority equity interest in One Park Boulevard, LLC, a Delaware limited liability company (One Park), the joint venture that holds title to the 1,190-room Hilton San Diego Bayfront hotel located in San Diego, California. Hilton Worldwide, Inc. is the 25.0% minority equity partner in One Park. Accordingly, we are not in a position, and may not be in a position in the future to exercise sole decision-making authority regarding a property, partnership, joint venture or other entity. Investments in partnerships, joint ventures or other entities may, under certain circumstances, involve risks not present were a third party not involved, including the possibility that partners or co-venturers might become bankrupt or fail to fund their share of required capital contributions. Partners or co-venturers may have economic or other business interests or goals which are inconsistent with our business interests or goals, and may be in a position to take actions contrary to our policies or objectives. Such investments may also have the potential risk of impasses on decisions, such as a sale, because neither we nor the partner or co-venturer would have full control over the partnership or joint venture. Disputes between us and partners or co-venturers may result in litigation or arbitration that would increase our expenses and prevent our officers and/or trustees from focusing their time and effort on our business. Consequently, actions by, or disputes with, partners or co-venturers might result in subjecting properties owned by the partnership or joint venture to additional risk. In addition, we may in certain circumstances be liable for the actions of our third party partners or co-venturers.

The mortgage loan and preferred equity investment we currently own, or mortgage loans or preferred equity investments we may invest in at a future date, may be affected by unfavorable real estate market or other conditions, events or occurrences, which could decrease the value

of those loans and the return on our investment.

In 2010, we paid \$0.5 million for a \$5.0 million mortgage loan secured by the 101-room boutique hotel known as Twelve Atlantic Station in Atlanta, Georgia. As the expected cash flows from the loan have not been reasonably probable and estimable, we have accounted for this loan using the cost-recovery method, which reduced the carrying value of this loan to \$0.2 million as of December 31, 2012. The mortgage loan matured in November 2012, and is currently in default, causing us to our reserve the \$0.2 million balance on our balance sheet at December 31, 2012. The carrying value of this loan on our balance sheet is zero as of December 31, 2013. We are currently working with the borrower and the special servicer to restructure the loan, at which time we may reverse the bad debt expense we recorded in 2012 if and when collectability becomes reasonably assured.

In conjunction with our January 2013 sale of four hotels and a commercial laundry facility located in Rochester, Minnesota, we retained a \$25.0 million preferred equity investment in the four hotels that yields an 11% dividend, resulting in a deferred gain on the sale of \$25.0 million. The \$25.0 million gain will be deferred until the preferred equity investment is redeemed. The preferred equity investment is recorded at face value on our consolidated balance sheet, net of the deferred gain, resulting in a net book value of zero on our consolidated balance sheet as of December 31, 2013.

Table of Contents

We do not know whether the value of the security for the mortgage loan and preferred equity investment we currently own, or any mortgage loans or preferred equity investments we may acquire in the future, will remain at the levels existing on the dates of origination of those mortgage loans or preferred equity investments. 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 or preferred equity investments.

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

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

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

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

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

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

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

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We periodically review each of our hotels, BuyEfficient and goodwill for possible impairment. We did not identify any properties or other assets with indicators of impairment during either 2013 or 2012. In 2011, however, we recognized an impairment loss of \$1.5 million to discontinued operations to reduce the carrying value of our commercial laundry facility in Salt Lake City, Utah to its fair value based on proceeds received on the sale of the commercial laundry facility in July 2011. In addition, we recognized an impairment loss of \$10.9 million in 2011 to reduce the carrying value of a note receivable from the purchaser of the Royal Palm Miami Beach (the Royal Palm note) to its fair value based on proceeds received from the sale of the Royal Palm note in October 2011. Our other hotels, BuyEfficient 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 hotels, and the upper upscale segment of the lodging market is highly competitive and may be subject to greater volatility than other segments of the market, which could negatively affect our profitability.

The upper upscale segment of the hotel business is 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

Table of Contents

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 may 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 hotels when compared to other classes of hotels.

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

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

A significant portion of our hotels are geographically concentrated in California, New York, Illinois, Massachusetts and the greater Washington D.C. area and, accordingly, we could be disproportionately harmed by economic downturns or natural disasters in these areas of the country.

As of December 31, 2013, nine of the 29 hotels are located in California, which is the largest concentration of our hotels in any state, representing 32% of our rooms and 34% of the revenue generated by the 29 hotels during 2013. In addition, as of December 31, 2013, three of the 29 hotels are located in each of the States of New York, Illinois and Massachusetts, as well as in the greater Washington D.C. area. The three hotels located in New York represented 9% of our rooms and 13% of the revenue generated by the 29 hotels during 2013. The three hotels located in Illinois represented 8% of our rooms and 7% of the revenue generated by the 29 hotels during 2013. The three hotels located in Massachusetts represented 14% of our rooms and 14% of the revenue generated by the 29 hotels during 2013. The three hotels located in the greater Washington D.C. area represented 13% of our rooms and 13% of the revenue generated by the 29 hotels during 2013. The concentration of our hotels in California, New York, Illinois, Massachusetts and the greater Washington D.C. area exposes our business to economic conditions, competition and real and personal property tax rates unique to these locales. In addition, natural disasters in California, New York, Illinois, Massachusetts or the greater Washington D.C. area would disproportionately affect our hotel portfolio. The California, New York, Illinois, Massachusetts and the greater Washington D.C. area economies and tourism industries, in comparison to other parts of the country, are negatively affected to a greater extent by changes and downturns in certain industries, including the entertainment, high technology, financial and government industries. It is also possible that because of our California, New York, Illinois, Massachusetts and the greater Washington D.C. area concentrations, a change in laws applicable to such 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, New York, Illinois, Massachusetts and the greater Washington D.C. area could harm our revenue or increase our operating expenses.

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

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

Because all but one of our hotels are operated under franchise agreements or are brand managed, termination of these franchise, management or operating lease 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, 2013, all of the 29 hotels except the Boston Park Plaza were operated under franchise, management or operating lease agreements with international franchisors or hotel management companies, such as Marriott, Hilton, Hyatt, Fairmont and Sheraton. 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, management or operating lease agreement and a payment of liquidated damages. Such a termination may trigger a default or acceleration of our obligations under some of our notes payable. In addition, as our franchise, management or operating lease

Table of Contents

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, 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.

Our franchisors and brand managers may 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, management or operating lease agreements.

Our franchisors and brand managers may require that we make renovations to certain of our hotels in connection with revisions to our franchise, management or operating lease 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.

Our franchisors and brand managers may change certain policies or cost allocations that could negatively impact our hotels.

Our franchisors and brand managers incur certain costs that are allocated to our hotels subject to our franchise, management or operating lease agreements. Those costs may increase over time or our franchisors and brand managers may elect to introduce new programs that could increase costs allocated to our hotels. In addition, certain policies may be altered resulting in reduced revenue or increased costs to our hotels. For example, a change in one of our third-party manager's frequent traveler reward program during 2013 negatively impacted revenue at both our Doubletree Guest Suites Times Square and Hilton Times Square hotels.

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. Accordingly, we must enter into management or operating lease agreements (together, management agreements) with eligible independent contractors to manage our hotels. Thus, independent management companies control the daily operations of our hotels.

As of December 31, 2013, our 29 hotels were managed as follows: Marriott 10 hotels; IHR six hotels; Highgate four hotels; Davidson two hotels; Hilton two hotels; Hyatt two hotels; and Crestline, Dimension and Fairmont one hotel each. 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 or profitability, we may not necessarily have

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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 our remedies may be limited by the terms of 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.

Of these agreements, three were entered into during each of the years 2013 and 2012, and four of these agreements were entered into during 2011. 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, or that a new management company would be successful in managing our hotels.

We also cannot assure you that our existing 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.

Table of Contents

We are subject to risks associated with the employment of hotel personnel.

Our third-party managers are responsible for hiring and maintaining the labor force at each of our hotels. Although we do not directly employ or manage employees at our consolidated hotels, we are still subject to many of the costs and risks generally associated with the hotel labor force. From time to time, hotel operations may be disrupted as a result of strikes, lockouts, public demonstrations or other negative actions and publicity. We also may incur increased legal costs and indirect labor costs as a result of contract disputes involving our third-party managers and their labor force or other events. The resolution of labor disputes or re-negotiated labor contracts could lead to increased labor costs, a significant component of our costs, either by increases in wages or benefits or by changes in work rules that raise hotel operating costs. We generally do not have the ability to affect the outcome of these negotiations.

System security risks, data protection breaches, cyber-attacks and systems integration issues could disrupt our internal operations or services provided to guests at our hotels, and any such disruption could reduce our expected revenue, increase our expenses, damage our reputation and adversely affect our stock price.

Experienced computer programmers and hackers may be able to penetrate our network security or the network security of our third-party managers and franchisors, and misappropriate or compromise our confidential information or that of our hotel guests, create system disruptions or cause the shutdown of our hotels. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack our computer systems or the computer systems operated by our third-party managers and franchisors, or otherwise exploit any security vulnerabilities of our respective networks. In addition, sophisticated hardware and operating system software and applications that we and our third-party managers or franchisors may procure from outside companies may contain defects in design or manufacture, including bugs and other problems that could unexpectedly interfere with our internal operations or the operations at our hotels. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential business at our hotels.

Portions of our information technology infrastructure or the information technology infrastructure of our third-party managers and franchisors also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We or our third-party managers and franchisors may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact the ability of our third-party managers and franchisors to fulfill reservations for guestrooms and other services offered at our hotels. Delayed sales or bookings, lower margins or lost guest reservations resulting from these disruptions could adversely affect our financial results, stock price and reputation.

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 management, 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. During 2013, we invested \$117.5 million on capital improvements to our hotels, and we expect this amount to increase in 2014 driven by renovations at recently acquired hotels as part of our acquisition strategy. Occupancy and ADR are often affected by the maintenance and capital improvements at a hotel, especially in the event

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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 managers or franchisors regarding our compliance with the requirements under the relevant management, operating lease or franchise agreement.

Table of Contents

Because we are a REIT, we depend on the TRS Lessee and its subsidiaries to make rent payments to us, and their 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 or one of its subsidiaries, 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 and its subsidiaries to make rent payments under these leases. In general, under the leases with the TRS Lessee and its subsidiaries, we will receive from the TRS Lessee or its subsidiaries 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 ability of the TRS Lessee and its subsidiaries 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 or its subsidiaries 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 or enter into a new lease with our TRS Lessee or its subsidiaries 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 similar terms.

Because 10 of the 29 hotels are subject to ground, building 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 underlying land, building and/or air space of 10 of the 29 hotels are based upon our interest under long-term ground, building or air leases with unaffiliated parties. Pursuant to the terms of the ground, building and air leases for these hotels, we are required to pay all rent due and comply with all other lessee obligations. As of December 31, 2013, the terms of these ground, building and air leases (including renewal options) range from approximately 30 to 113 years. Any pledge of our interest in a ground, building 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, building 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, building or air leases, to surrender or remove any improvements, alterations or additions to the land at our own expense. The ground, building or air leases also generally require us to restore the premises following a casualty and to apply in a specified manner any proceeds received in connection therewith. We may have to restore the premises if a material casualty, such as a fire or an act of nature, occurs and the cost thereof exceeds available insurance proceeds.

If we fail to maintain effective internal control over financial reporting and disclosure controls and procedures in the future, we may not be able to accurately report our financial results, which could have an adverse effect on our business.

If our internal control over financial reporting and disclosure controls and procedures are not effective, we may not be able to provide reliable financial information. If we discover deficiencies in our internal controls, we will make efforts to remediate these deficiencies; however, there is no assurance that we will be successful either in identifying deficiencies or in their remediation. Any failure to maintain effective controls in the future could adversely affect our business or cause us to fail to meet our reporting obligations. Such non-compliance could also result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements. In addition, perceptions of our business among customers, suppliers, rating agencies, lenders, investors, securities analysts and others could be adversely affected.

Table of Contents

Risks Related to Our Organization and Structure

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

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

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

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

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

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

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

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

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

Table of Contents

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. In April 2013, however, we amended our charter to prohibit us from dividing directors into classes unless such action is first approved by the affirmative vote of a majority of the votes cast on the matter by stockholders entitled to vote generally in the election of directors.

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

Our continued success will depend to a significant extent on the efforts and abilities of our senior management team. These individuals are important to our business and strategy and to the extent that any of them departs and is not replaced with a qualified substitute, such person's departure could harm our operations and financial condition.

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, internationally, nationally and locally, including a U.S. recession or global economic slowdown;
- 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;
- volatility in the capital markets and the effect on the lodging demand or our ability to obtain capital on favorable terms or at all;
- 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, workers' compensation and health-care related costs (including the impact of the Patient Protection and Affordable Care Act), 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, natural disasters and other considerations affecting travel. Seasonal fluctuations in revenue may affect our ability to make distributions to our stockholders or to fund our debt service.

Table of Contents

The growth of internet reservation channels could adversely affect our business and profitability.

A significant percentage of hotel rooms for individual guests is booked through internet travel intermediaries. Many of our managers and franchisors contract with such intermediaries and pay them various commissions and transaction fees for sales of our rooms through their systems. If such bookings increase, these intermediaries may be able to obtain higher commissions, reduced room rates or other significant concessions from us or our franchisees. Although our managers and franchisors may have established agreements with many of these intermediaries that limit transaction fees for hotels, there can be no assurance that our managers and franchisors will be able to renegotiate such agreements upon their expiration with terms as favorable as the provisions that exist today. Moreover, hospitality intermediaries generally employ aggressive marketing strategies, including expending significant resources for online and television advertising campaigns to drive consumers to their websites. As a result, consumers may develop brand loyalties to the intermediaries' offered brands, websites and reservations systems rather than to brands of our managers and franchisors. If this happens, our business and profitability may be significantly negatively impacted.

In addition, in general, internet travel intermediaries have traditionally competed to attract individual consumers or transient business rather than group and convention business. However, hospitality intermediaries have recently grown their business to include marketing to large group and convention business. If that growth continues, it could both divert group and convention business away from our hotels, and it could also increase our cost of sales for group and convention business.

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

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

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

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

We could incur liabilities resulting from loss or injury to our hotels or to persons at our hotels. These losses could be attributable to us or result from actions taken by a hotel 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.

We have in the past and could in the future incur liabilities resulting from claims by hotel employees. While these claims are, for the most part, covered by insurance, some claims (such as claims for unpaid overtime wages) generally are not insured or insurable. These claims, whether or not they have merit, could harm the reputation of a hotel or cause us to incur losses which could harm our results of operations.

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

Various types of litigation losses and 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.

Table of Contents

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.

In addition, there are other risks, such as certain environmental hazards, that may be deemed to fall completely outside the general coverage limits of our policies or may be uninsurable or too expensive to justify coverage. We also may encounter challenges with an insurance provider regarding whether it will pay a particular claim that we believe to be covered under our policy. Should a loss in excess of insured limits or an uninsured loss occur, or should we be unsuccessful in obtaining coverage from an insurance carrier, we could lose all or a part of the capital we have invested in a property, as well as the anticipated future revenue from the hotel. In that event, we might nevertheless remain obligated for any mortgage debt or other financial obligations related to the property.

Terrorist attacks and military conflicts may adversely affect the hospitality industry.

The terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 underscore the possibility that large public facilities or economically important assets could become the target of terrorist attacks in the future. In particular, properties that are well-known or are located in concentrated business sectors in major cities may be subject to the risk of terrorist attacks. The occurrence or the possibility of terrorist attacks or military conflicts could:

- cause damage to one or more of our properties that may not be fully covered by insurance to the value of the damages;
- cause all or portions of affected properties to be shut down for prolonged periods, resulting in a loss of income;
- generally reduce travel to affected areas for tourism and business or adversely affect the willingness of customers to stay in or avail themselves of the services of the affected properties;
- expose us to a risk of monetary claims arising out of death, injury or damage to property caused by any such attacks; and
- result in higher costs for security and insurance premiums or diminish the availability of insurance coverage for losses related to terrorist attacks, particularly for properties in target areas, all of which could adversely affect our results.

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

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

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

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

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

Table of Contents

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 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.

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We may also be subject to federal and/or state income taxes when using net operating loss carryforwards to offset current taxable income. During 2013 and 2012, our use of net operating loss carryforwards resulted in federal alternative minimum tax and state income tax expense (where our use of net operating loss carryforwards was either limited or unavailable) totaling \$1.9 million and \$1.1 million, respectively.

We may also be subject to state and local taxes on our income or property at the level of our operating partnership or at the level of the other companies through which we indirectly own our assets. In the normal course of business, entities through which we own or operate real estate either have undergone, or are currently undergoing, tax audits. Although we believe that we have substantial arguments in favor of our positions in the ongoing audits, in some instances there is no controlling precedent or interpretive guidance on the specific point at issue. Should we receive a material tax deficiency notice in the future which requires us to incur additional expense, our earnings may be negatively impacted. There can be no assurance that future audits will not occur with increased frequency or that the ultimate result of such audits will not have a material adverse effect on our results of operations. 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. Passive income includes rent paid pursuant to our operating leases between our TRS Lessee and its subsidiaries and our Operating Partnership. These rents constitute substantially all of our gross income. For the rent 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.

Table of Contents

We may be subject to taxes in the event our operating leases are held not to be on an arm's-length basis.

In the event that leases between us and our taxable REIT subsidiaries are held not to have been made on an arm's-length basis, we or our taxable REIT subsidiaries could be subject to income taxes. In 2011, the Internal Revenue Service, or the IRS, notified us of their intent to audit our taxable REIT subsidiary, Sunstone Hotel TRS Lessee, Inc., and its subsidiaries. During 2013, the IRS issued a notice of proposed adjustment to us, challenging certain aspects of our leases with our TRS Lessee and its subsidiaries. Though we believe our leases comply with all Code requirements, we determined that the costs associated with defending our position were greater than the benefits that might result therefrom. As such, we recognized income tax expense of \$4.7 million related to the IRS's audit of tax years 2008, 2009 and 2010, including \$0.6 million in related interest expense. We recorded additional income tax expense of \$1.5 million during 2013 based on the ongoing evaluations of our uncertain tax positions related to 2012, and as a result of our recent resolution of outstanding issues with the IRS.

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 10 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.

Risks Related to Our Common Stock

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 2013, our closing daily stock price fluctuated from a low of \$11.02 to a high of \$14.06. 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 U.S. recession impacting the market for common equity generally;
- actual or anticipated variations in our quarterly or annual results of operations;

Table of Contents

- changes in market valuations of companies in the hotel or real estate industries;
- changes in expectations of our future financial performance, changes in our estimates by securities analysts or failures to achieve those expectations or estimates;
- the trading volumes of our stock;
- additional issuances of our common stock or other securities, including the issuance of our preferred stock;
- the addition or departure of board members or senior management;
- disputes with any of our lenders or managers or franchisors; and
- announcements by us or our competitors of acquisitions, investments or strategic alliances.

Our distributions to stockholders may vary.

We paid a quarterly cash dividend of \$0.50 per share to the stockholders of our Series A preferred stock through its redemption date in March 2013. We paid a quarterly cash dividend of \$0.393 per share to our Series C preferred stockholders through its redemption date in May 2013. In addition, we paid a quarterly cash dividend of \$0.50 per share to the stockholders of our Series D cumulative redeemable preferred stock, or the Series D preferred stock, in each of January, April, July and October 2013. We also paid a cash dividend of \$0.05 per share to the stockholders of our common stock in October 2013. In November 2013, our board of directors authorized the payment of a quarterly cash dividend of \$0.50 per share to our Series D preferred stockholders, and a quarterly cash dividend of \$0.05 per share to our common stockholders. We paid such dividends in January 2014. 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 balance sheet and capital requirements. Furthermore, our board of directors may elect to pay dividends on our common stock by any means allowed under the Code, including a combination of cash and shares of our common stock. We cannot assure you as to the timing or amount of future dividends. 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 could cause the market price of our shares to decrease.

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. Changes in our dividend policy could adversely affect the price of our stock.

The IRS may disallow our use of stock dividends to satisfy our distribution requirements.

We may elect to satisfy our REIT distribution requirements in the form of shares of our common stock along with cash. While we have received a private letter ruling from the IRS in the past, and plan to request another private letter ruling from the IRS regarding the treatment of these distributions for purposes of satisfying our REIT distribution requirements, we may make cash/common stock distributions prior to receiving such private letter ruling. Should the IRS disallow our future use of cash/common stock dividends, the distribution would not qualify for purposes of meeting our distribution requirements, and we would need to make additional all cash distributions to satisfy the distribution requirement through the use of the deficiency dividend procedures outlined in the Code.

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

Sales of a substantial number of shares of our common stock, or the perception that sales could occur, could adversely affect prevailing market prices for our common stock. In addition, a substantial number of shares of our common stock have been and will be issued or reserved for issuance from time to time under our employee benefit plans or pursuant to securities we may issue that are convertible into shares of our common stock or securities that are exchangeable for shares of our common stock.

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 our expectations or the market's expectation with regard to future earnings and cash distributions would likely adversely affect the market price of our common stock.

Table of Contents**Item 1B. Unresolved Staff Comments**

None.

Item 2. Properties

The following table sets forth additional summary information with respect to our 29 hotels as of December 31, 2013:

Hotel	City	State	Chain Scale Segment (1)	Service Category	Rooms	Manager
Boston Park Plaza	Boston	Massachusetts	Upper Upscale	Full Service	1,053	Highgate
Courtyard by Marriott Los Angeles (2)	Los Angeles	California	Upscale	Select Service	185	IHR
Doubletree Guest Suites Times Square (2)	New York City	New York	Upper Upscale	Full Service	460	Highgate
Embassy Suites Chicago	Chicago	Illinois	Upper Upscale	Full Service	368	Davidson
Embassy Suites La Jolla	San Diego	California	Upper Upscale	Full Service	340	Hilton
Fairmont Newport Beach (2)	Newport Beach	California	Luxury	Full Service	444	Fairmont
Hilton Garden Inn Chicago Downtown/Magnificent Mile	Chicago	Illinois	Upper Upscale	Full Service	357	Crestline
Hilton New Orleans St. Charles	New Orleans	Louisiana	Upper Upscale	Full Service	250	Dimension
Hilton North Houston	Houston	Texas	Upper Upscale	Full Service	480	IHR
Hilton San Diego Bayfront (2) (3)	San Diego	California	Upper Upscale	Full Service	1,190	Hilton
Hilton Times Square (2)	New York City	New York	Upper Upscale	Full Service	460	Highgate
Hyatt Chicago Magnificent Mile (2)	Chicago	Illinois	Upper Upscale	Full Service	419	Davidson
Hyatt Regency Newport Beach (2)	Newport Beach	California	Upper Upscale	Full Service	407	Hyatt
Hyatt Regency San Francisco	San Francisco	California	Upper Upscale	Full Service	802	Hyatt
JW Marriott New Orleans (2)	New Orleans	Louisiana	Luxury	Full Service	496	Marriott
Marriott Boston Long Wharf	Boston	Massachusetts	Upper Upscale	Full Service	412	Marriott
Marriott Houston	Houston	Texas	Upper Upscale	Full Service	390	IHR
Marriott Park City	Park City	Utah	Upper Upscale	Full Service	199	IHR
Marriott Philadelphia	West Conshohocken	Pennsylvania	Upper Upscale	Full Service	289	Marriott
Marriott Portland	Portland	Oregon	Upper Upscale	Full Service	249	IHR
Marriott Quincy	Quincy	Massachusetts	Upper Upscale	Full Service	464	Marriott
Marriott Tysons Corner	Vienna	Virginia	Upper Upscale	Full Service	396	Marriott
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® (4)	Orlando	Florida	Upper Upscale	Full Service	781	