

Sunstone Hotel Investors, Inc.
Form DEF 14A
March 31, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

(Amendment No. __)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

Sunstone Hotel Investors, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

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Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

Sunstone Hotel Investors, Inc.

903 Calle Amanecer, Suite 100

San Clemente, California 92673

Notice of 2006 Annual Meeting

It is a pleasure to invite you to the 2006 annual meeting of stockholders of Sunstone Hotel Investors, Inc. (Sunstone), a Maryland corporation, to be held at the Fairmont Newport Beach, 4500 MacArthur Boulevard, Newport Beach, California on Tuesday, May 2, 2006 at 12:00 p.m. local time, for the following purposes:

1. To elect seven directors to serve until the next annual meeting and until their successors are elected and qualify;
2. To consider and vote upon ratification of the Audit Committee s appointment of Ernst & Young LLP to act as the independent registered public accounting firm for the fiscal year ending December 31, 2006; and
3. To transact such other business as may properly come before the annual meeting, including any motion to adjourn to a later date to permit further solicitation of proxies, if necessary, or before any adjournment or postponement thereof.

Only stockholders of record of shares of Sunstone common stock and Series C cumulative convertible redeemable preferred stock at the close of business on March 20, 2006 are entitled to notice of and to vote at the 2006 annual meeting or any adjournment or postponement of the meeting.

Whether you own a few or many shares and whether you plan to attend in person, it is important that your shares be voted on matters that come before the meeting. You may be able to authorize a proxy to vote your shares by using a toll-free telephone number or the Internet. Instructions for using these convenient services are provided on the proxy card and in the attached proxy statement. If you prefer, you may still authorize a proxy to vote your shares by marking your votes on the proxy card, signing and dating it, and mailing it in the envelope provided. If your proxy card is signed and returned without specifying your choices, your shares will be voted in accordance with our board s recommendations.

By Order of the Board of Directors

Jon D. Kline
Executive Vice President,
Chief Financial Officer and Secretary
March 31, 2006

Sunstone Hotel Investors, Inc.

903 Calle Amanecer, Suite 100

San Clemente, California 92673

Proxy Statement

Your vote is very important. For this reason, our Board of Directors is soliciting the enclosed proxy to allow your shares of common stock and Series C cumulative convertible redeemable preferred stock (Series C preferred stock) to be represented and voted, as you direct, by the proxy holders named in the enclosed proxy card at the 2006 annual meeting of stockholders of Sunstone Hotel Investors, Inc., a Maryland corporation, to be held on Tuesday, May 2, 2006, at 12:00 p.m. local time. We, our , the Company and Sunstone refer to Sunstone Hotel Investors, Inc. This proxy statement, the enclosed proxy card and our Annual Report on Form 10-K for the year ended December 31, 2005, are being mailed to stockholders entitled to vote beginning on or about March 31, 2006. Stockholders may obtain a copy of the exhibits to our Form 10-K for the year ended December 31, 2005 by writing to Sunstone Hotel Investors, Inc. at our principal executive office: 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212, Attention: Secretary. You may also view the exhibits to our Form 10-K in the Investor Relations section of our website at www.sunstonehotels.com.

Information About the Meeting and Voting

What am I voting on?

The Board of Directors is soliciting your vote:

1. To elect seven directors to serve until the next annual meeting and until their successors are elected and qualify; and
2. To ratify the Audit Committee's appointment of Ernst & Young LLP to act as the independent registered public accounting firm for the fiscal year ending December 31, 2006.

With respect to any other matter that properly comes before the meeting or any adjournment or postponement thereof, the representatives holding proxies will vote as recommended by the Board, or if no recommendation is given, in their own discretion.

Who is entitled to vote?

Stockholders of record of our common stock and Series C preferred stock as of the close of business on March 20, 2006 (record date) are entitled to vote on matters that properly come before the meeting. Shares of common stock or Series C preferred stock can be voted only if the stockholder is present in person or is represented by proxy. At the close of business on the record date, there were 57,690,649 shares of common stock and 4,102,564 shares of Series C preferred stock outstanding and entitled to vote. The holders of common stock and Series C preferred stock will vote together as a single class on all matters that properly come before the meeting.

How many votes do I have?

Each share of common stock has one vote. Each share of Series C preferred stock has one vote for each share of common stock into which it is convertible. As of the record date, each share of Series C preferred stock was convertible into one share of common stock and thus has one vote.

How do I vote?

You can ensure that your shares are voted at the meeting by submitting your instructions by completing, signing, dating and returning the enclosed proxy form in the envelope provided.

If you own your shares through a bank or broker, you may be eligible to authorize a proxy to vote your shares electronically over the Internet or by telephone. A large number of banks and brokerage firms are participating in the ADP Investor Communication Services online program. This program provides eligible stockholders who receive a paper copy of the Annual Report and Proxy Statement the opportunity to authorize a proxy to vote via the Internet or by telephone. If your bank or brokerage firm is participating in ADP's program, your voting form will provide instructions. The Internet and telephone proxy facilities will close at 11:59 p.m. E.S.T. on May 1, 2006. Stockholders who authorize a proxy to vote through the Internet or telephone should be aware that they may incur costs to access the Internet, such as usage charges from telephone companies or Internet service providers, and that these costs must be borne by the stockholder. Stockholders who authorize a proxy to vote by Internet or telephone need not return a proxy card by mail. If your voting form does not reference Internet or telephone information, please complete and return the paper Proxy in the self-addressed postage paid envelope provided.

If you attend the annual meeting in person, you may request a ballot when you arrive. If your shares are held in the name of your bank, broker or other nominee, prior to attending the meeting you need to request a legal proxy from your bank, broker or nominee as indicated on the back of the Voter Information form you received with your proxy material. The legal proxy must be presented to vote these shares in person at the annual meeting. If you have previously authorized a proxy, you may still vote in person at the annual meeting, which will serve as a revocation of your previous proxy.

Does Sunstone have a policy for confidential voting?

Sunstone has a confidential voting policy. All proxies and other materials, including telephone and Internet proxy authorization, are kept confidential and are not disclosed to third parties. Such voting documents are available for examination by the inspector of election and certain personnel associated with processing proxy cards and tabulating the vote. We plan to appoint one independent inspector of election, a representative of our transfer agent, American Stock Transfer and Trust, to review and confirm the tabulation of votes at the annual meeting.

What if I return my proxy but do not mark it to show how I am voting?

If your proxy card is signed and returned without specifying your choices, your shares will be voted as recommended by the Board of Directors.

What are the Board's recommendations?

The Board recommends that you vote FOR each of the nominees for Director and FOR Proposal 2 to ratify the Audit Committee's appointment of Ernst & Young LLP to act as the independent registered public accounting firm for the fiscal year ending December 31, 2006.

What vote is required to approve each proposal?

Election of Directors: There is no cumulative voting in the election of Directors. The seven Directors are elected by a plurality of votes cast at a meeting at which a quorum is present. Any shares not voted (whether by abstention, broker non-vote (i.e., shares held by a broker or nominee which are represented at the meeting, but with respect to which such broker or nominee is not instructed to vote on a particular proposal), or otherwise) have no impact on the vote.

Ratification of Appointment of Independent Registered Public Accounting Firm: This proposal requires the affirmative vote of a majority of the votes cast at a meeting at which a quorum is present. Any shares not voted (whether by abstention, broker non-vote, or otherwise) have no impact on the vote.

What if other items come up at the annual meeting and I am not there to vote?

We are not now aware of any matters to be presented at the annual meeting other than those described in this proxy statement. When you return a signed and dated proxy card or provide your voting instructions by telephone or the Internet, you give the proxy holders (the names of whom are listed on your proxy card) the discretionary authority to vote on your behalf on any other matter that is properly brought before the annual meeting.

Can I change my vote?

You can change your vote by revoking your proxy at any time before it is exercised in one of four ways:

*Notify Sunstone's Secretary (Jon D. Kline, c/o Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212) in writing or by facsimile (at 949-369-3179) before the annual meeting that you are revoking your proxy;

*Submit another proxy with a later date;

*Submit your voting instructions again by telephone or the Internet; or

*Vote in person at the annual meeting.

What does it mean if I receive more than one proxy card?

Some of your shares are likely registered differently or are in more than one account. You should vote each of your accounts by telephone or the Internet or mail. If you mail proxy cards, please sign, date and return each proxy card to guarantee that all of your shares are voted.

If you hold your shares in registered form and wish to combine your stockholder accounts in the future, you should contact our transfer agent, American Stock Transfer and Trust, at 1-800-937-5449. Combining accounts reduces excess printing and mailing costs, resulting in savings for Sunstone that benefit you as a stockholder.

What if I receive only one set of proxy materials although there are multiple stockholders at my address?

If you and other residents at your mailing address own shares in street name, your broker or bank may have sent you a notice that your household will receive only one annual report and proxy statement for each company in which you hold shares through that broker or bank. This practice of sending only one copy of proxy materials is known as householding. If you did not respond that you did not want to participate in householding, you were deemed to have consented to the process. If the foregoing procedures apply to you, your broker has sent one copy of our annual report and proxy to your address. You may revoke your consent to householding at any time by contacting your broker or bank. The revocation of your consent to householding will be effective 30 days following its receipt. In any event, if you did not receive an individual copy of this proxy statement or our annual report, we will send a copy to you if you address your written request to Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212, Attention: Secretary.

What constitutes a quorum?

The presence of the owners of at least a majority (greater than 50%) of the aggregate number of shares of common stock and Series C preferred stock (calculated on an as converted to common stock basis) entitled to vote at the annual meeting constitutes a quorum. Presence may be in person or by proxy. You will be considered part of the quorum if you return a signed and dated proxy card, if you authorize a proxy to vote by telephone or the Internet, or if you attend the annual meeting.

Abstentions and broker non-votes are counted as present and entitled to vote for purposes of determining a quorum. A broker non-vote occurs when a bank or broker holding shares for a beneficial stockholder does not vote on a particular proposal because the bank or broker does not have discretionary voting power with respect to the item and has not received voting instructions from the beneficial stockholder.

How do I access proxy materials on the Internet?

Stockholders can access our notice of annual meeting and proxy statement and annual report on the Internet on the Sunstone website at www.sunstonehotels.com (Investor Relations Section).

How do I submit a stockholder proposal for inclusion in the proxy statement for next year's annual meeting?

Stockholder proposals may be submitted for inclusion in our 2007 annual meeting proxy statement after the 2006 annual meeting, but must be received no later than December 1, 2006. Proposals should be sent via registered, certified, or express mail to: Jon D. Kline, Executive Vice President, Chief Financial Officer and Secretary, 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212. See also Stockholder Proposals for the 2007 Annual Meeting later in this proxy statement.

What do I need to do to attend the annual meeting?

If you are a holder of record, you should indicate on your proxy card that you plan to attend the meeting by marking the box on the proxy card provided for that purpose.

For the safety and comfort of our stockholders, admission to the annual meeting will be restricted to:

*Stockholders of record as of the close of business on March 20, 2006 or their duly authorized proxies;

*Beneficial stockholders whose shares are held by a bank, broker or other nominee, and who present proof of beneficial ownership as of the close of business on March 20, 2006;

*Representatives of the press or other news media with proper credentials;

*Financial analysts with proper credentials; and

*Employees and representatives of Sunstone whose job responsibilities require their presence at the meeting.

Please note that space limitations may make it necessary to limit attendance. Admission to the meeting will be on a first-come, first-served basis. No more than two representatives of any corporate or institutional stockholder will be admitted to the meeting.

If you attend the meeting, you may be asked to present valid government-issued photo identification, such as a driver's license or passport, before being admitted. Cameras, recording devices, and other electronic devices will not be permitted, and attendees may be subject to security inspections or other security precautions.

Proposal 1:

Election of Directors

Board of Directors

The business and affairs of Sunstone are managed under the direction of our Board of Directors. Our Board has responsibility for establishing broad corporate policies and for the overall performance of Sunstone, rather than for day-to-day operating details. Our Board currently consists of 7 directors.

The proxy holders named on the proxy card intend to vote for the election of the seven nominees listed below. The Nominating and Corporate Governance Committee selected these nominees, which selection was ratified by the Board. If you do not wish your shares to be voted for particular nominees, please identify the exceptions in the designated space provided on the proxy card or, if you are authorizing a proxy to vote by telephone or the Internet, follow the instructions provided when you access the telephone or internet proxy facilities. Directors will be elected by a plurality of the votes cast. Any shares not voted, whether by abstention, broker non-vote, or otherwise, will have no impact on the vote.

If at the time of the meeting one or more of the nominees have become unable to serve, shares represented by proxies will be voted for the remaining nominees and for any substitute nominee or nominees designated by the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee knows of no reason why any of the nominees will be unable to serve.

Directors elected at the annual meeting will hold office until the next annual meeting and until their successors have been elected and qualified. For each nominee there follows a brief listing of principal occupation for at least the past five years, other major affiliations, and age as of March 1, 2006. Each of the nominees, other than Thomas A. Lewis and Keith M. Locker, is currently a director of the Company.

Nominees for Election as Directors

Robert A. Alter Age: 55 Director

Mr. Alter is our Chief Executive Officer. Until our formation, Mr. Alter served as Chief Executive Officer of one of our predecessor companies formed in 1985, which became a public company in August 1995. The public company, Sunstone Hotel Investors, Inc., commenced doing business in August 1995 upon its initial public offering. In November 1999, Mr. Alter and one of the Contributing Entities (as defined below) completed a management-led buyout to take the company private. He has been an owner of hotels since 1976 and is a past president of the Holiday Inn Franchise Association and a member of the Marriott Franchise board. Mr. Alter holds a B.S. degree in Hotel Administration from Cornell University.

Lewis N. Wolff Age: 70 Chairman

Mr. Wolff currently serves as our Chairman. Mr. Wolff has been Chairman of Wolff Urban Development, LLC since 1980. Wolff Urban Development, LLC is a real estate acquisition, investment, development and management firm. Mr. Wolff is also a co-founder and, since 1994, has served as Chairman of Maritz, Wolff & Co., a privately held hotel investment group that owns top-tier luxury hotels. From 1999 to 2004, Mr. Wolff also served as Co-Chairman of Fairmont Hotels & Resorts, a hotel management company formed by Fairmont Hotel Management Company and Canadian Pacific Hotels & Resorts, Inc. In addition, Mr. Wolff acquired ownership of Major League Baseball's Oakland Athletics in April 2005. Mr. Wolff also serves on the boards of Grill Concepts, Inc., First Century Bank and Maguire Properties, Inc. Mr. Wolff holds a B.A. degree in Business Administration from the University of Wisconsin, Madison, and an M.B.A. degree from Washington University in St. Louis, Missouri.

Z. Jamie Behar Age: 48 Director

Ms. Behar is Managing Director, Real Estate & Alternative Investments, for General Motors Investment Management Corporation, or GMIMCo. She manages GMIMCo clients' real estate investment portfolios, including both private market and publicly-traded security investments, as well as their alternative investment portfolios, totaling \$9.5 billion. She is a member of GMIMCo's Management Council and Investment Committee, and is Vice Chairman of the GMIMCo Real Estate & Alternative Investment Approval Committee. Ms. Behar is a member of the board of directors of Desarrolladora Homex, S.A. de C.V., a publicly-listed home development company located in Mexico (and for which she also serves on the audit committee), and serves on the advisory boards of several domestic and international private real estate investment entities. Ms. Behar holds a B.S.E. degree from The Wharton School of the University of Pennsylvania and an M.B.A. degree from the Columbia University Graduate School of Business. Ms. Behar is a Chartered Financial Analyst.

Anthony W. Dona Age: 47 Director

Mr. Dona co-founded Thackeray Partners in January of 2005. Thackeray is a real estate private equity fund which invests in real estate nationally. Prior to founding Thackeray, Mr. Dona served as the Chief Executive Officer of Crow Holdings which included oversight of both Crow's real estate business and its diversified investments. He had been with Crow affiliated entities for almost 20 years at the time of his departure in November of 2004. Mr. Dona is a full member and actively involved in the Dallas Real Estate Council, serves on the investment committee for the American Red Cross endowment in Washington D.C., and is also a board member of In the City for Good, a Dallas organization whose mission is servicing the Fair Park area of Dallas. Mr. Dona also serves as Adjunct Lecturer at the Cox School of Business at Southern Methodist University in the Real Estate department of the MBA program. A graduate of Southern Methodist University, Mr. Dona also received an M.B.A. from the Harvard Graduate School of Business Administration.

Keith P. Russell Age: 60 Director

Mr. Russell is President of Russell Financial, Inc., a strategic and financial consulting firm serving businesses and high net worth individuals. Mr. Russell is retired as the Chairman of Mellon West and the Vice Chairman of Mellon Financial Corporation, in which capacities he served from May 1996 until March 2001. From September 1991 through April 1996, Mr. Russell served in various positions at Mellon, including Vice Chairman and Chief Risk Officer of Mellon Bank Corporation and Chairman of Mellon Bank Corporation's Credit Policy Committee. From 1983 to 1991, Mr. Russell served as President and Chief Operating Officer, and a director, of Glenfed/Glendale Federal Bank. Mr. Russell also serves on the boards of Nationwide Health Properties, Inc. and Countrywide Financial Corporation. Mr. Russell holds a B.A. degree in Economics from the University of Washington and an M.A. degree in Economics from Northwestern University.

Thomas A. Lewis, Jr. Age: 52 Nominee

Mr. Lewis is Chief Executive Officer of Realty Income Corporation, a New York Stock Exchange listed real estate investment trust. He is also Vice Chairman of the Board of Directors of Realty Income Corporation and has been a member of its Board of Directors since September 1993. He joined Realty Income Corporation in 1987 and served in a variety of executive positions, including Vice President, Capital Markets until 1997, when he was named Chief Executive Officer. In 2000 and 2001 he also held the position of President.

Keith M. Locker Age: 44 Nominee

Mr. Locker is Chief Executive Officer and President of Inlet Capital LLC. In addition, Mr. Locker is President and Managing Member of Global Capital Resources LLC and President of GCR Advisors Inc. Inlet Capital is an alternative investment and asset management firm providing debt and equity to the commercial real estate industry. Mr. Locker was previously a Managing Director in the Real Estate Investment Banking Group at Deutsche Bank Securities, Inc. from September 2000 to February 2003. Prior to joining Deutsche Bank in 2000, Mr. Locker was Senior Managing Director at Bear, Stearns & Co. Inc., responsible for Real Estate Investment

Banking. Mr. Locker earned a B.S./B.A. from Boston University School of Management in 1983 and an M.B.A. from the Wharton School in 1988. Mr. Locker is a member of Glenborough Realty Trust's Board of Directors, Director of IVP Securities, LLC and Trustee of the National Jewish Center. He is also a member of NAREIT, Urban Land Institute, Commercial Mortgage Securities Association, International Council of Shopping Centers, The Wharton School Zell-Lurie Real Estate Center, Policy Advisory Board Fisher Center for Real Estate and Urban Economics and numerous philanthropic and community organizations.

The Board of Directors recommends a vote FOR each of the nominees.

Two of our incumbent directors, David M. Siegel and Barbara S. Brown, are not standing for re-election. The Board thanks Mr. Siegel and Ms. Brown for their service to the Company and its stockholders.

Proposal 2:

**Ratification of the Audit Committee's Appointment of
Independent Registered Public Accounting Firm**

The Audit Committee has selected and appointed the firm of Ernst & Young LLP to act as our independent registered public accounting firm for the year ending December 31, 2006. Ernst & Young LLP audited the financial statements for us for the year ended December 31, 2005 and for the period October 26, 2004 through December 31, 2004 and for our predecessor for the period January 1, 2004 through October 25, 2004 and for the year ended December 31, 2003. Ratification of the appointment of Ernst & Young LLP requires a majority of the votes cast. Any shares not voted, whether by abstention, broker non-vote, or otherwise, have no impact on the vote.

The Board recommends that Sunstone stockholders vote FOR ratification of the appointment of Ernst & Young LLP.

Although stockholder ratification of the appointment of our independent auditor is not required by our bylaws or otherwise, we are submitting the selection of Ernst & Young LLP to our stockholders for ratification as a matter of good corporate governance practice. Even if the selection is ratified, the Audit Committee in its discretion may select a different independent registered public accounting firm at any time if it determines that such a change would be in the best interests of Sunstone and its stockholders. If our stockholders do not ratify the Audit Committee's selection, the Audit Committee will take that fact into consideration, together with such other factors it deems relevant, in determining its next selection of our independent registered public accounting firm.

Representatives of Ernst & Young LLP are expected to be present at the annual meeting. These representatives will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Audit, Audit-Related, Tax and Other Fees

The aggregate fees billed for professional services provided by Ernst & Young LLP for 2005 and 2004 were as follows:

Type of Fees	2005	2004
Audit Fees	\$ 1,555,425	\$ 1,524,174
Audit-related Fees	61,023	
Tax Fees	20,000	185,012
All Other Fees		
Total Fees	\$ 1,636,448	\$ 1,709,186

In the above table, in accordance with the definitions of the Securities and Exchange Commission, audit fees are fees paid by the Company to Ernst & Young LLP for the audit of the Company's consolidated financial statements included in its annual report on Form 10-K and review of the unaudited financial statements included in its quarterly reports on Form 10-Q or for services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements, including in connection with public offerings of securities. Audit fees also include fees paid by the Company to Ernst & Young LLP for its audit of the Company's internal control over financial reporting. In 2005, audit fees consisted primarily of \$475,000 for the 2005 audit, \$701,947 for services related to public offerings, \$372,500 for the audit of the Company's internal control over financial reporting and \$5,978 for accounting consultations. In 2004, audit fees included \$260,000 for the 2004 audit and \$1,264,174 for services related to the Company's initial public offering.

Audit-related Fees are fees billed by Ernst & Young LLP for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements. In 2005, audit-related fees consisted of fees for the audit of an acquisition.

Tax Fees are fees billed by Ernst & Young LLP that relate to tax consulting and advisory services.

All Other Fees are fees billed by Ernst & Young LLP to the Company for any services not included in the first three categories.

Preapproval Policies and Procedures

Our Audit Committee has adopted a pre-approval policy requiring that the Audit Committee pre-approve all audit and permissible non-audit services to be performed by Ernst & Young LLP. Any proposed service that has received pre-approval but which will exceed pre-approved cost limits will require separate pre-approval by the Audit Committee. The Audit Committee has delegated to its Chairman the authority to grant the required approvals for approved services that do not exceed \$75,000 for any one project, provided that the Chairman reports the details of the exercise of any such delegated authority at the next meeting of the Audit Committee. All services performed by the independent registered public accounting firm in 2005 were approved by the Audit Committee pursuant to its pre-approval policy.

Corporate Governance

In light of recent and ongoing developments, such as the Sarbanes-Oxley Act of 2002 and related rules promulgated by both the New York Stock Exchange (NYSE) and the Securities and Exchange Commission (SEC), we provide the following discussion to bring you up to date with respect to our efforts to assure that Sunstone employs best practices in its corporate governance. A copy of our Corporate Governance Guidelines is available in the Investor Relations section of our website at www.sunstonehotels.com. In addition, a printed copy of the Corporate Governance Guidelines will be provided without charge upon request to the Secretary, Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, CA 92673.

We have also established conflict of interest and other policies to serve the long-term interests of our stockholders and further align the interests of directors and management with our stockholders.

Conflict of Interest Policy

We have adopted a policy which provides that the approval of our Nominating and Corporate Governance Committee is required for any transaction involving us and any of our directors, officers or employees, or any entity in which any of our directors, officers or employees is employed or has an interest of more than 5%.

Code of Business Conduct and Ethics

We have adopted a Code of Business Conduct and Ethics, which provides that directors, officers (including our Chief Executive Officer and all senior financial officers) and employees owe a duty to us to advance our business interests when the opportunity to do so arises. Among other things, our directors, officers and employees are prohibited from taking (or directing to a third party) a business opportunity that is discovered through the use of corporate property, information or position, unless we have already been offered the opportunity and turned it down, in which case our Nominating and Corporate Governance Committee must in any event approve the director, officer or employee interest therein. More generally, our directors, officers and employees are prohibited from using corporate property, information or position for personal gain. The Code of Business Conduct and Ethics is posted in the Investor Relations section of our website at www.sunstonehotels.com. In addition, a copy of the Code of Business Conduct and Ethics will be provided without charge upon request to the Secretary, Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, CA 92673.

Independence of Directors and Committees

The Board has determined that a majority of the Board is independent as defined under the NYSE's rules. Directors who serve on the Compensation Committee and the Nominating and Corporate Governance Committee are also subject to these independence requirements. Directors who serve on the Audit Committee are subject to additional independence requirements.

To be considered independent under the NYSE's rules, the Board must determine that a director does not have a material relationship with Sunstone and/or its consolidated subsidiaries (either directly or as a partner, stockholder or officer of an organization that has a relationship with any of those entities).

The Board undertook a review of the independence of the directors nominated for election at the upcoming annual meeting. During this review, the Board considered the transactions and relationships during the prior three years between each director or any member of his or her immediate family and Sunstone and its subsidiaries and affiliates as reported under *Certain Relationships And Related Transactions* below. The Board also examined transactions and relationships between Directors or their affiliates and members of the senior management or their affiliates. The purpose of this review was to determine whether any such relationships or transactions were inconsistent with a determination that such director is independent.

As a result of this review, the Board affirmatively determined that Messrs. Wolff, Dona, Russell and Siegel and Ms. Behar and Brown are independent of Sunstone and its management under the independence standards of the NYSE. The Board also affirmatively determined that Messrs. Lewis and Locker are independent of Sunstone and its management under these standards.

Director Attendance at Meetings

Each of our directors is expected to attend each annual meeting of stockholders. Although our Board recognizes that conflicts may occasionally prevent a director from attending a Board or stockholder meeting, the Board expects each director to make every possible effort to keep such absences to a minimum. The Board held six meetings in 2005. During that period, all directors attended at least 75% of the meetings of the Board and committees of the Board on which they served. In addition, all of our directors attended our annual meeting of stockholders in 2005.

Stockholder Communication with the Board and Non-Management Directors

Stockholders may communicate any matters they wish to raise with the directors by writing to the Board of Directors, Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212, Attn: Secretary. Stockholders should provide proof of share ownership with their correspondence. All communications from verified stockholders will be received and processed by the Secretary and then directed to the appropriate member(s) of the Board.

In addition, any interested party who wishes to communicate directly with our Non-Management Directors or the presiding Non-Management Director may contact our Chairman at the mailing address of the Company's executive offices at 903 Calle Amanecer, Suite 100, San Clemente, California 92673-6212. All communications will be received and processed by the Secretary and then directed to the appropriate Non-Management Director(s).

Committees of the Board of Directors

Committees

Our Board of Directors has established a number of committees, including the Compensation Committee, the Audit Committee and the Nominating and Corporate Governance Committee, each of which is briefly described below. Each of our committees has a charter, current copies of which may be viewed in the Investor Relations section of our website at www.sunstonehotels.com. In addition, printed copies of our committee charters will be provided without charge upon request to the Secretary, Sunstone Hotel Investors, Inc., 903 Calle Amanecer, Suite 100, San Clemente, CA 92673.

Compensation Committee

The Compensation Committee determines compensation and benefits for all executive officers, oversees our equity compensation plans and assists in the establishment of policies applicable to employees generally.

The members of the Compensation Committee are independent directors as required by the listing standards and rules of the NYSE and are nonemployee directors within the meaning of Section 162(m) of the Internal Revenue Code and the applicable rules of the SEC. None of these directors, nor any of our executive officers, serves as a member of the governing body or compensation committee of any entity that has one or more executive officers serving as a member of our Board of Directors or Compensation Committee.

Our Compensation Committee is comprised of Anthony W. Dona and Lewis N. Wolff. Mr. Dona is the chair. The Compensation Committee held three meetings during 2005.

Audit Committee

Our Board of Directors has adopted an Audit Committee charter, which defines the Audit Committee's purposes to include oversight of:

- (1) the integrity of our financial statements;
- (2) our compliance with legal and regulatory requirements;
- (3) the independent auditors' qualifications and independence;
- (4) the performance of the independent auditors and our internal audit function; and
- (5) preparation of an audit committee report as required by the SEC for inclusion in our annual proxy statement.

All of the members of the Audit Committee are financially literate within the meaning of the listing standards and rules of the NYSE. At least one member is an audit committee financial expert as that term is defined by applicable rules of the SEC, and at least one member possesses accounting and financial management expertise within the meaning of the listing standards and rules of the NYSE. The Board has determined that each member of the Audit Committee is independent within the meaning of the rules of both the NYSE and the SEC.

Our Audit Committee is currently comprised of David M. Siegel, Anthony W. Dona and Keith P. Russell. Mr. Siegel is the chair. If Messrs. Lewis and Locker are elected to the Board, the Company expects that, after the Annual Meeting, the Audit Committee will consist of Messrs. Locker, Lewis and Russell and that Mr. Locker will be the chair. The Audit Committee held four meetings during 2005.

Nominating and Corporate Governance Committee

The Board has delegated to the Nominating and Corporate Governance Committee the responsibility to select, or to recommend to the Board, nominees for election at any annual meeting, or any special meeting of stockholders, and any person to be considered to fill a vacancy or a newly created directorship that is the result of any increase in the authorized number of directors. The Nominating and Corporate Governance Committee is also responsible for nominating board committee members, reviewing our corporate governance guidelines, assisting with the annual evaluation of the Board and approving certain transactions involving a conflict of interest. The Board has determined that each of the members of the Nominating and Corporate Governance Committee is independent within the meaning of the listing standards of the NYSE.

In connection with its annual process for identifying directors to nominate or renominate, or to be recommended to the Board for nomination or renomination, the Nominating and Corporate Governance Committee seeks to determine whether the proposed candidate demonstrates an ability and willingness to:

- *maintain the highest personal and professional ethics, integrity and values;
- *represent the long-term interests of stockholders;
- *exercise independence of thought, objective perspective and mature judgment;
- *constructively challenge ideas and assumptions;
- *understand the business operations and objectives of Sunstone and provide thoughtful and creative strategic guidance;
- *contribute to the ongoing development and effective functioning of the Board;
- *dedicate sufficient time, energy and attention to ensure the diligent and thoughtful performance of his or her duties; and
- *demonstrate sincere commitment to the long-term success of Sunstone and the achievement of its objectives.

Additionally, in reviewing the qualifications of particular candidates, the Nominating and Corporate Governance Committee may choose to recommend individuals who can contribute an important, special or unique skill, expertise or perspective to the Board. The Nominating and Corporate Governance Committee also reviews the results of the self-evaluations provided by the directors with respect both to the Board and the individual directors and considers these results in light of the criteria for individual directors and objectives of the Board. Based on this process, the Nominating and Corporate Governance Committee is able to recommend, among other things, whether the existing Board contains the appropriate size, structure and composition, whether some or all of the incumbent directors should be recommended to the Board for re-nomination, and whether the Board should be enlarged to include additional directors.

If the Board determines to seek additional directors for nomination, the Nominating and Corporate Governance Committee will consider as potential director nominees, candidates recommended by various sources, including any member of the Board or senior management. The Nominating and Corporate Governance Committee may also retain a third-party search firm to identify candidates. Messrs. Lewis and Locker were recommended as nominees to the Nominating and Corporate Governance Committee by our chief executive officer. The Nominating and Corporate Governance Committee also considers recommendations for nominees timely submitted by stockholders under and in accordance with the provisions of Article II, Section 2.11 of our Bylaws for stockholder nominees. (See *Stockholder Proposals For The 2007 Annual Meeting.*). In addition to satisfying the timing, ownership and other requirements specified in Article II, Section 2.11 of the Bylaws, a stockholder's notice must set forth as to each person whom the stockholder proposes to recommend that the committee nominate for election to the Board all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required,

pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including such person's written consent to being named in the proxy statement as a nominee and to serve as a director if elected). Properly communicated stockholder recommendations will be considered in the same manner as recommendations received from other sources.

Our Nominating and Corporate Governance Committee is currently comprised of Keith P. Russell, Z. Jamie Behar, and Lewis N. Wolff. Mr. Russell is the chair. If Mr. Locker is elected to the Board, the Company expects that, after the Annual Meeting, the Nominating and Corporate Governance Committee will consist of Messrs. Wolff and Locker and Ms. Behar and that Mr. Wolff will be the chair. The Nominating and Corporate Governance Committee held two meetings during 2005.

Committee Membership

The table below summarizes current membership information for each of the Board committees:

	Compensation	Audit	Nominating and Corporate Governance
Mr. Alter			
Mr. Wolff	X		X
Ms. Behar			X
Ms. Brown			
Mr. Dona	X*	X	
Mr. Russell		X	X*
Mr. Siegel		X*	

* Chair

The table below summarizes expected membership information for each of the Board committees assuming that Messrs. Lewis and Locker are elected as directors at the Annual Meeting:

	Compensation	Audit	Nominating and Corporate Governance
Mr. Alter			
Mr. Wolff	X		X*
Ms. Behar			X
Mr. Dona	X*		
Mr. Lewis		X	
Mr. Locker		X*	X
Mr. Russell		X	

* Chair

Audit Committee Financial Expert

The Board has determined that each of Keith P. Russell and David M. Siegel are qualified as audit committee financial experts within the meaning of SEC regulations. In making this determination, the Board considered the following qualifications: (a) understanding of generally accepted accounting principles (GAAP); (b) ability to apply GAAP to accounting for estimates, accruals and reserves; (c) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the issues likely to be raised by our financial statements, or experience actively supervising persons engaged in these activities; (d) understanding of internal control over financial reporting; and (e) understanding of audit committee functions.

Meetings of Non-Management Directors

Ms. Behar and Ms. Brown and Messrs. Wolff, Dona, Russell and Siegel are our non-management directors (the Non-Management Directors). Mr. Wolff has been selected to preside over executive sessions of the Non-Management Directors. The Non-Management Directors held four meetings in 2005. If all of the nominees for director are elected at the Annual Meeting, our Non-Management Directors will be Ms. Behar and Messrs. Wolff, Dona, Lewis, Locker and Russell.

Report of the Audit Committee of the Board of Directors

The following report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any Company filings under the Securities Act of 1933, as amended (the Securities Act) or under the Exchange Act, except to the extent we specifically incorporate this Report by reference.

The purpose of the Audit Committee of Sunstone Hotel Investors, Inc. (Sunstone) is to assist the Board of Directors in its oversight of (i) the integrity of Sunstone s financial statements, (ii) Sunstone s compliance with legal and regulatory requirements, (iii) the independent auditors qualifications and independence, and (iv) the performance of the independent auditors; to retain Sunstone s independent auditors and to prepare this report. As set forth in the Audit Committee charter, a copy of which may be found in the Investor Relations section of Sunstone s website at www.sunstonehotels.com, management of Sunstone is responsible for the preparation, presentation and integrity of Sunstone s financial statements, Sunstone s accounting and ensuring that financial reporting principles and internal controls and procedures are designed to assure compliance with accounting standards and applicable laws and regulations. The independent auditors are responsible for auditing Sunstone s financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

In performance of its oversight function, the Audit Committee has considered and discussed the audited financial statements with management and the independent auditors. The Audit Committee has also discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 90, Communication with Audit Committees, as amended. In addition, the Audit Committee has discussed with the independent auditors the auditors independence from Sunstone and its management, including the matters in the written disclosures and letter required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, a copy of which the Audit Committee has received.

The members of the Audit Committee are not full-time employees of Sunstone and are not performing the functions of auditors or accountants. As such, it is not the duty or responsibility of the Audit Committee or its members to conduct field work or other types of auditing or accounting reviews or procedures or to set auditor independence standards. Members of the Audit Committee necessarily rely on the information provided to them by management and the independent accountants. Accordingly, the Audit Committee s considerations and discussions referred to above do not assure that the audit of the Company s financial statements has been carried out in accordance with generally accepted accounting principles or that the Company s auditors are in fact independent.

In reliance on the reviews and discussions referred to above, and subject to the limitations on the role and responsibilities of the Audit Committee referred to above and in the Audit Committee charter, the Audit Committee recommended to the Board the inclusion of the audited financial statements in Sunstone s 2005 Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE

David M. Siegel, Chair

Anthony W. Dona

Keith P. Russell

March 20, 2006

Compensation of Directors

Each of our independent directors is entitled to receive an annual stock grant of shares having a value equal to \$50,000 for serving on our Board of Directors, and an attendance fee paid in cash of \$1,000 per meeting of our Board of Directors if the meeting is attended in person or \$250 if the meeting is attended telephonically. Pursuant to an arrangement with Ms. Behar's employer, all director fees for Ms. Behar (including the annual stock grant) are paid in cash to her employer.

In addition, each member of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee is entitled to an attendance fee of \$1,000 per committee meeting or \$250 if the meeting is attended telephonically. The chair of our Audit Committee receives \$5,000, the chair of our Compensation Committee receives \$4,000 and the chair of our Nominating and Corporate Governance Committee receives \$1,000, in each case, in cash payable in quarterly installments.

Directors are also entitled to reimbursement for expenses incurred in fulfilling their duties as our directors and receive complimentary hotel rooms at our hotels and resorts when on personal travel. In certain circumstances, directors may also receive such complimentary hotel rooms for one year following their retirement or resignation from the Board.

Executive Officers

The following sets forth biographical information regarding our executive officers as of March 1, 2006 other than Mr. Alter whose biographical information is set forth above under Proposal 1: Election of Directors .

Jon D. Kline, 39, is our Executive Vice President and Chief Financial Officer. From April 2003 to our formation, Mr. Kline served as the Executive Vice President and Chief Financial Officer of Sunstone Hotel Investors, L.L.C. Previously, Mr. Kline spent five years with Merrill Lynch & Co.'s Investment Banking Division, during which time he directed the firm's Hospitality and Leisure practice. Before that time, he was a member of the Real Estate and Lodging Finance Group of Smith Barney's Investment Banking Division as well as an attorney with Sullivan & Cromwell LLP. Mr. Kline holds a B.A. degree in Economics from Emory University and a J.D. degree from New York University School of Law.

Gary A. Stougaard, 51, is our Executive Vice President and Chief Investment Officer. From October 1997 to our formation, Mr. Stougaard was employed by Sunstone Hotel Investors, L.L.C. overseeing the company's acquisition, development and hotel renovation and redevelopment activities. Since 1985 and prior to joining Sunstone, he served as a developer and asset manager of hotel properties and prior to that time he was a certified public accountant in private practice. Mr. Stougaard holds a B.A. degree in Accounting from Michigan State University.

Andrew W. Gross, 44, is our Senior Vice President and General Counsel. Mr. Gross joined us in February 2006. From 1996 to January 2006, Mr. Gross was a Partner in the law firm of Irell & Manella LLP. Irell & Manella LLP has represented and continues to represent the Company in certain transactional matters. Mr. Gross holds a B.A. degree in Economics from the University of California, Berkeley and a J.D. degree from Boalt Hall School of Law at the University of California, Berkeley.

Executive Compensation

The following table sets forth the compensation paid or accrued in the years ended December 31, 2005, 2004, and 2003 to our Chief Executive Officer and our two other most highly compensated executive officers (our named executive officers).

Summary Compensation Table

Name and Principal Position	Year ⁽¹⁾	Annual Compensation		Long-Term Compensation Restricted Stock or	
		Salary	Bonus	Restricted Stock Unit Awards ⁽²⁾	All Other Compensation
Robert A. Alter, <i>Chairman and Chief Executive Officer</i>	2005	\$ 550,000	\$ 653,125	\$ 1,578,333	\$ 72,981 ⁽³⁾
	2004	709,692	365,000	3,578,947	369,415 ⁽⁴⁾
	2003	707,023			290,264 ⁽⁵⁾
Jon D. Kline <i>Executive Vice President and Chief Financial Officer⁽⁶⁾</i>	2005	\$ 375,000	\$ 445,313	\$ 1,012,500	\$ 12,564 ⁽⁷⁾
	2004	281,599	294,000	2,013,158	298,783 ⁽⁸⁾
	2003	168,269			