

SUN COMMUNITIES INC
Form 10-Q
November 09, 2007
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2007.

OR

Transition pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 1-12616

SUN COMMUNITIES, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland
(State of Incorporation)
27777 Franklin Rd.

Suite 200
Southfield, Michigan
(Address of Principal Executive Offices)

38-2730780
(I.R.S. Employer Identification No.)

48034
(Zip Code)

Registrant's telephone number, including area code: (248) 208-2500

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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 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Number of shares of Common Stock, \$.01 par value per share, outstanding

as of September 30, 2007: 18,249,610

SUN COMMUNITIES, INC.

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SUN COMMUNITIES, INC.

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2007 AND DECEMBER 31, 2006

(amounts in thousands)

	(Unaudited) September 30, 2007	December 31, 2006
ASSETS		
Investment property, net	\$ 1,137,184	\$ 1,161,649
Cash and cash equivalents	3,809	3,183
Inventory of manufactured homes	13,230	12,082
Investment in affiliate	29,850	29,319
Notes and other receivables	39,191	41,407
Other assets	37,840	42,099
 Total assets	 \$ 1,261,104	 \$ 1,289,739
 LIABILITIES		
Debt	\$ 1,102,580	\$ 1,080,450
Lines of credit	76,016	86,400
Other liabilities	33,069	31,301
 Total liabilities	 1,211,665	 1,198,151
 Minority interest	 6,203	 12,391
 STOCKHOLDERS' EQUITY		
Preferred stock, \$.01 par value, 10,000 shares authorized, none issued	\$ —	\$ —
Common stock, \$.01 par value, 90,000 shares authorized, 20,145 and 20,028 issued in 2007 and 2006, respectively	201	200
Additional paid-in capital	458,099	452,882
Officer's notes	(8,826	) (9,083
Accumulated other comprehensive income	180	820
Distributions in excess of accumulated earnings	(342,818	) (302,022
Treasury stock, at cost, 1,802 shares in 2007 and 2006	(63,600	) (63,600
 Total stockholders' equity	 43,236	 79,197
 Total liabilities and stockholders' equity	 \$ 1,261,104	 \$ 1,289,739

The accompanying notes are an integral part of the consolidated financial statements

SUN COMMUNITIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE PERIODS ENDED SEPTEMBER 30, 2007 AND 2006

(amounts in thousands except for per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
REVENUES				
Income from real property	\$ 46,381	\$ 45,680	\$ 142,043	\$ 139,340
Revenue from home sales	5,492	4,783	17,847	15,330
Rental home revenue	4,331	3,658	12,891	10,224
Ancillary revenues, net	4	(16)	355	284
Interest	686	1,244	2,142	2,916
Other income (loss)	(432)	(644)	(526)	816
Total revenues	56,462	54,705	174,752	168,910
COSTS AND EXPENSES				
Property operating and maintenance	12,408	12,349	35,823	35,448
Real estate taxes	4,174	4,031	12,369	11,828
Cost of home sales	4,408	3,749	14,164	11,952
Rental home operating and maintenance	3,096	2,586	8,960	7,080
General and administrative - real property	3,734	3,426	11,931	12,825
General and administrative - home sales and rentals	1,462	1,633	4,440	4,907
Depreciation and amortization	15,512	15,072	46,444	44,835
Interest	15,783	15,623	46,164	45,598
Interest on mandatorily redeemable debt	896	935	2,705	3,010
Total expenses	61,473	59,404	183,000	177,483
Equity income from affiliate	583	300	1,431	967
Provision for state income tax	500	—	500	—
Loss from operations	(4,928)	(4,399)	(7,317)	(7,606)
Less loss allocated to minority interest	(560)	(510)	(832)	(851)
Loss before cumulative effect of change in accounting principle	(4,368)	(3,889)	(6,485)	(6,755)
Cumulative effect of change in accounting principle	—	—	—	289
Net loss	\$ (4,368)	\$ (3,889)	\$ (6,485)	\$ (6,466)
Weighted average common shares outstanding:				
Basic	17,962	17,655	17,909	17,601
Diluted	17,962	17,655	17,909	17,601
Basic and diluted earnings (loss) per share:				
Loss before cumulative effect of change in accounting principle	\$ (0.24)	\$ (0.22)	\$ (0.36)	\$ (0.39)
Cumulative effect of change in accounting principle	—	—	—	0.02
Net loss	\$ (0.24)	\$ (0.22)	\$ (0.36)	\$ (0.37)

The accompanying notes are an integral part of the consolidated financial statements

SUN COMMUNITIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

FOR THE PERIODS ENDED SEPTEMBER 30, 2007 AND 2006

(amounts in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net loss	\$ (4,368)	\$ (3,889)	\$ (6,485)	\$ (6,466)
Unrealized income (loss) on interest rate swaps	(1,042)	(1,133)	(640)	289
Comprehensive loss	\$ (5,410)	\$ (5,022)	\$ (7,125)	\$ (6,177)

SUN COMMUNITIES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007

(amounts in thousands)

(unaudited)

	Common Stock	Additional Paid-in Capital	Officer's Notes	Accumulated Comprehensive Earnings	Distributions in Excess of Accumulated Earnings	Treasury Stock	Total Equity
Balance, December 31, 2006	\$ 200	\$ 452,882	\$ (9,083)	\$ 820	\$ (302,022)	\$ (63,600)	\$ 79,197
Issuance of common stock, net	1	3,547	—	—	(3,845)	—	(297)
Exercise of stock options	—	38	—	—	—	—	38
Stock-based compensation - amortization and forfeitures	—	1,632	—	—	64	—	1,696
Repayment of officer's notes	—	—	257	—	—	—	257
Net loss	—	—	—	—	(6,485)	—	(6,485)

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Unrealized loss on interest rate swaps	—	—	—	(640)	—	—	(640)
Cash distributions declared of \$1.89 per share	—	—	—	—	(30,530)	—	(30,530)
Balance, September 30, 2007	\$ 201	\$ 458,099	\$ (8,826)	\$ 180	\$ (342,818)	\$ (63,600)	\$ 43,236

The accompanying notes are an integral part of the consolidated financial statements

SUN COMMUNITIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(amounts in thousands)

(unaudited)

	2007		2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (6,485	)	\$ (6,466)
Adjustments to reconcile net loss to cash provided by operating activities:			
Loss allocated to minority interests	(832	)	(851)
Gain on valuation of derivative instruments	(250	)	(165)
Stock compensation expense, net of cumulative effect of change in accounting principle	1,798		2,465
Depreciation and amortization	48,935		47,188
Amortization of deferred financing costs	1,066		1,285
Distributions from affiliate	900		300
Equity income from affiliate	(1,431	)	(967)
Increase in notes receivable from sale of homes	(7,427	)	(3,721)
Decrease (increase) in inventory, other assets and other receivables, net	(5,949	)	5,667
Increase (decrease) in accounts payable and other liabilities	1,666		(2,752)
Net cash provided by operating activities	31,991		41,983
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in rental properties	(19,239	)	(46,330)
Proceeds from sale of installment loans on manufactured homes to Origen	—		4,226
Decrease in notes receivable and officer's notes	13,077		272
Net cash used in investing activities	(6,162	)	(41,832)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Redemption of common stock and OP units	(1,259	)	(1,335)
Proceeds from option exercise	38		2,151
Borrowings on lines of credit	81,998		113,287
Repayments on lines of credit	(92,382	)	(96,015)
Payments to retire preferred operating partnership units	(4,500	)	(8,175)
Payments to redeem notes payable and other debt	(10,916	)	(22,020)
Proceeds from notes payable and other debt	37,500		48,100
Payments for deferred financing costs	(804	)	(685)
Distributions	(34,878	)	(37,292)
Net cash used in financing activities	(25,203	)	(1,984)
Net increase (decrease) in cash and cash equivalents	626		(1,833)
Cash and cash equivalents, beginning of period	3,183		5,880
Cash and cash equivalents, end of period	\$ 3,809		\$ 4,047
SUPPLEMENTAL INFORMATION:			

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Cash paid for interest	\$ 44,808	\$ 45,086
Cash paid for interest on mandatorily redeemable debt	\$ 2,677	\$ 2,998
Noncash investing and financing activities:		
Debt assumed for rental properties	\$ —	\$ 4,500
Unrealized gain (loss) on interest rate swaps	\$ (640	) \$ 289

The accompanying notes are an integral part of the consolidated financial statements

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation:

These unaudited consolidated financial statements of Sun Communities, Inc., a Maryland corporation, (the “Company”) and all majority-owned and controlled subsidiaries including Sun Communities Operating Limited Partnership (the “Operating Partnership”), SunChamp LLC (“SunChamp”), and Sun Home Services, Inc. (“SHS”), have been prepared pursuant to the Securities and Exchange Commission (“SEC”) rules and regulations and should be read in conjunction with the consolidated financial statements and accompanying notes of the Company included in Annual Report on Form 10-K for the year ended December 31, 2006. The following notes to consolidated financial statements present interim disclosures as required by the SEC. The accompanying consolidated financial statements reflect, in the opinion of management, all adjustments necessary for a fair presentation of the interim financial statements. All such adjustments are of a normal and recurring nature. Certain reclassifications have been made to prior periods’ financial statements in order to conform to current period presentation.

2. Investment Property:

The following summarizes investment property (amounts in thousands):

	(Unaudited) September 30, 2007	December 31, 2006
Land	\$ 117,309	\$ 117,563
Land improvements and buildings	1,181,939	1,175,045
Rental homes and improvements	161,873	151,843
Furniture, fixtures, and equipment	36,234	37,229
Land held for future development	30,199	31,082
	1,527,554	1,512,762
Less accumulated depreciation	(390,370)	(351,113)
Investment property, net	\$ 1,137,184	\$ 1,161,649

Land improvements and buildings consist primarily of infrastructure, roads, landscaping, clubhouses, maintenance buildings and amenities.

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

3. Notes and Other Receivables:

The following table sets forth certain information regarding notes and other receivables (amounts in thousands):

	September 30, 2007	December 31, 2006
Mortgage note receivable, with a weighted average interest rate of 7.92% at December 31, 2006, collateralized by a manufactured home community.	\$ —	\$ 13,532
Installment loans on manufactured homes with interest payable monthly at a weighted average interest rate and maturity of 7.4% and 13.4 years and 6.7% and 13.7 years at September 30, 2007, and December 31, 2006, respectively.	28,675	20,537
Other receivables, net of allowance for losses of \$0.2 and \$0.3 million at September 30, 2007, and December 31, 2006, respectively.	10,516	7,338
	\$ 39,191	\$ 41,407

On March 1, 2007, the \$13.5 million mortgage note receivable was repaid by the borrower.

The installment loans on manufactured homes totaling \$28.7 and \$20.5 million at September 30, 2007 and December 31, 2006, respectively, are presented net of allowance for losses of \$0.2 million for each period.

Officer's notes, presented as a reduction to stockholders' equity in the balance sheet, are 10 year, LIBOR + 1.75% notes, with a minimum and maximum interest rate of 6% and 9%, respectively. The notes become due in three installments on each of December 31, 2008, 2009 and 2010. The following table sets forth certain information regarding officer's notes as of September 30, 2007, and December 31, 2006 (in thousands except for shares and units):

At September 30, 2007

At December 31, 2006

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	Secured by			Secured by		
	Outstanding Principal Balance	Common Stock	Common OP Units	Outstanding Principal Balance	Common Stock	Common OP Units
Promissory Notes						
Secured - \$1.3 million	\$ 1,020	62,763	—	\$ 1,050	64,586	—
Secured - \$6.6 million	5,182	139,362	100,259	5,332	143,409	103,170
Secured - \$1.0 million	802	74,194	—	826	76,348	—
Unsecured - \$1.0 million	802	—	—	826	—	—
Unsecured - \$1.3 million	1,020	—	—	1,049	—	—
	\$ 8,826	276,319	100,259	\$ 9,083	284,343	103,170

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

3. Notes and Other Receivables, continued:

The officer's personal liability on the secured promissory notes is limited to all accrued interest on such notes plus fifty percent (50%) of the deficiency, if any, after application of the proceeds from the sale of the secured shares and/or the secured units to the then outstanding principal balance of the promissory notes. The unsecured notes are fully recourse to the officer.

The reduction in the aggregate principal balance of these notes was \$0.3 million for the nine months ended September 30, 2007 and 2006.

4. Investment in Affiliate:

Origen Financial, Inc. ("Origen") is a real estate investment trust in the business of originating, acquiring and servicing manufactured home loans. In October 2003, the Company purchased 5,000,000 shares of common stock of Origen for \$50 million. In December of 2006, the Company recognized an \$18.0 million impairment of the carrying value of its equity investment in Origen. The Company owns approximately 19% of Origen at September 30, 2007, and its investment is accounted for using the equity method of accounting. Equity earnings recorded through September 30, 2007, reflect the Company's estimate of its portion of the anticipated earnings of Origen for the period ending September 30, 2007, and the Company's adjustments for estimates made in prior quarters based on the actual reported results of Origen for such prior quarters.

5. Debt:

The following table sets forth certain information regarding debt (amounts in thousands):

	September 30, 2007	December 31, 2006
Collateralized term loans - CMBS, 4.93-5.32%, due July 1, 2011-2016	\$ 487,829	\$ 492,749
Collateralized term loans - FNMA, of which \$102.4M is variable, due April 28, 2014 and January 1, 2015, at the Company's option, interest at 4.71 - 5.53% at September 30, 2007, and 4.51-5.24% at December 31, 2006.	382,552	385,299
Preferred OP units, redeemable at various dates through January 2, 2014, average interest at 7.2% at June 30, 2007, and 6.9% at December 31, 2006.	49,447	53,947
Mortgage notes, other, maturing at various dates through May 1, 2017, average interest at 6.1% at September 30, 2007, and 6.2% at December 31, 2006.	182,752	148,455

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\$ 1,102,580 \$ 1,080,450

The collateralized term loans totaling \$870.4 million at September 30, 2007, are secured by 87 properties comprising approximately 31,089 sites representing approximately \$583.0 million of net book value. The mortgage notes totaling \$182.8 million at September 30, 2007, are collateralized by 16 communities comprising approximately 5,873 sites representing approximately \$170.0 million of net book value.

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

5. Debt, continued:

The Company has an unsecured revolving line of credit with a maximum borrowing capacity of \$115 million bearing interest at LIBOR + 1.65% (6.85% at September 30, 2007). The outstanding balance on the line of credit at September 30, 2007, was \$72.2 million. In addition, \$3.4 million of availability was used to back standby letters of credit leaving a maximum of \$39.4 million available to be drawn under the facility. The line of credit matures on October 1, 2010 with a one year option to extend.

In March of 2006, SHS closed on a \$40.0 million floor plan facility that allows for draws on new and pre-owned home purchases and on the Company's portfolio of rental homes. At September 30, 2007, the outstanding balance was \$3.8 million.

In January of 2007, the Company completed financings of \$17.5 million and \$20.0 million at interest rates of 5.842 percent and 5.825 percent, respectively. The loans are secured by two properties and have interest only payments for a term of 10 years. The proceeds from both financings were used to pay down the Company's revolving line of credit.

In February of 2007, the Company redeemed \$4.5 million of Preferred OP units.

In April of 2007, the Company extended \$15.8 million of debt with an original maturity date of April 1, 2007. The transaction extended the maturity date of the debt until April 1, 2012, and reduced the spread over LIBOR by 0.25 percent. As part of the transaction the Company paid down the principal balance of the debt by \$1.0 million. The transaction was accounted for as a modification of debt.

At September 30, 2007, the total of maturities and amortization of debt and lines of credit during the next five years, are as follows:

		Maturities and Amortization By Period					
		(in thousands)					
	Total Due	Oct 2007 - Sep 2008	Oct 2008 - Sep 2009	Oct 2009 - Sep 2010	Oct 2010 - Sep 2011	Oct 2011 - Sep 2012	After 5 years
Debt	\$ 1,102,580	\$ 15,898	\$ 25,685	\$ 21,657	\$ 121,461	\$ 26,502	\$ 891,377
Lines of credit	76,016	—	3,816	—	72,200	—	—
	\$ 1,178,596	\$ 15,898	\$ 29,501	\$ 21,657	\$ 193,661	\$ 26,502	\$ 891,377

The most restrictive of the Company's debt agreements place limitations on secured and unsecured borrowings and contain minimum debt service coverage, leverage, distribution and net worth requirements. At September 30, 2007, and December 31, 2006, the Company was in compliance with all covenants.

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

6. Share-Based Compensation:

In May of 2007, the Company issued 10,500 director options under its 2004 Non-Employee Director Option Plan. The weighted average fair value of the options issued is estimated on the date of grant using the Binomial (lattice) option pricing model, with the following weighted average assumptions used for the grants for the period indicated:

	May 2007 award
Estimated fair value per share of options granted:	\$ 2.66
Assumptions:	
Annualized dividend yield	8.43 %
Common stock price volatility	17.24 %
Risk-free rate of return	4.76 %
Expected option term (in years)	7.3

The following table summarizes the Director option activity for the nine months ended September 30, 2007:

	Number of shares	Weighted Average Exercise Price (per common share)	Weighted Average Contractual Term (in years)	Aggregate Intrinsic Value (in 000's)
Options outstanding at January 1, 2007	79,500	\$ 34.22		
Granted	10,500	\$ 29.91		
Exercised	—			
Canceled	—			
Options outstanding at September 30, 2007	90,000	\$ 33.71	4.1	\$ 265
Options vested and expected to vest	90,000	\$ 33.71	4.1	\$ 265
Options exercisable at September 30, 2007	72,000	\$ 34.30	2.8	\$ 217

7. Other Income (Loss):

The components of other income (loss) are as follows for the periods ended September 30, 2007 and 2006 (in thousands):

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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Brokerage commissions	\$ 168	\$ 212	\$ 541	\$ 881
Disposal of assets	(724)	(774)	(1,193)	(682)
Lawsuit settlement	—	(17)	—	399
Other	124	(65)	126	218
	\$ (432)	\$ (644)	\$ (526)	\$ 816

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

8. Segment Reporting (amounts in thousands):

The consolidated operations of the Company can be segmented into home sales and home rentals, and real property operations segments. Following is a presentation of selected financial information:

	Three months ended September 30, 2007			Nine months ended September 30, 2007		
	Real Property Operations	Home Sales and Home Rentals	Consolidated	Real Property Operations	Home Sales and Home Rentals	Consolidated
Revenues	\$ 46,381	(2) \$ 9,823	\$ 56,204	\$ 142,043	(2) \$ 30,738	\$ 172,781
Operating expenses/Cost of sales	16,582	7,504	24,086	48,192	23,124	71,316
Net operating income ⁽¹⁾ /Gross profit	29,799	2,319	32,118	93,851	7,614	101,465
Adjustments to arrive at net income (loss):						
Other revenues	281	(23)	258	1,683	288	1,971
General and administrative	(3,734)	(1,462)	(5,196)	(11,931)	(4,440)	(16,371)
Depreciation and amortization	(11,281)	(4,231)	(15,512)	(34,093)	(12,351)	(46,444)
Interest expense	(16,629)	(50)	(16,679)	(48,745)	(124)	(48,869)
Equity income from affiliate	583	—	583	1,431	—	1,431
Provision for state income tax	(500)	—	(500)	(500)	—	(500)
Loss allocated to minority interest	560	—	560	832	—	832
Net income (loss)	\$ (921)	\$ (3,447)	\$ (4,368)	\$ 2,528	\$ (9,013)	\$