

SUN COMMUNITIES INC
Form 10-K
March 13, 2009
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

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)

(248) 208-2500

(Registrant's telephone number, including area code)

Common Stock, Par Value \$0.01 per Share

Securities Registered Pursuant to Section 12(b) of the Act

New York Stock Exchange

Name of each exchange on which registered

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes []

No [X]

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (Check one):

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

As of June 30, 2008, the aggregate market value of the Registrant's stock held by non-affiliates was approximately \$299,178,000 (computed by reference to the closing sales price of the Registrant's common stock as of June 30, 2008). For this computation, the Registrant has excluded the market value of all shares of common stock reported as beneficially owned by executive officers and directors of the Registrant; such exclusion shall not be deemed to constitute an admission that any such person is an affiliate of the Registrant.

Number of shares of Common Stock, \$0.01 par value per share, outstanding as of March 2, 2009: 18,509,130

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive Proxy Statement to be filed for its 2009 Annual Meeting of Shareholders or filed as an amendment to the Form 10-K are incorporated by reference into Part III of this Report.

Table of Contents

Item	Description	Page
Part I.		
<u>Item 1.</u>	<u>Business</u>	3
<u>Item 1A.</u>	<u>Risk Factors</u>	7
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	16
<u>Item 2.</u>	<u>Properties</u>	16
<u>Item 3.</u>	<u>Legal Proceedings</u>	22
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	22
Part II.		
<u>Item 5.</u>	<u>Market for the Registrants Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	23
<u>Item 6.</u>	<u>Selected Financial Data</u>	25
<u>Item 7.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	43
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	43
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	43
<u>Item 9A.</u>	<u>Controls and Procedures</u>	44
<u>Item 9B.</u>	<u>Other Information</u>	44
Part III.		
Item 10.	Directors and Executive Officers of the Registrant	45
Item 11.	Executive Compensation	45
Item 12.	Security Ownership of Certain Beneficial Owners and Management	45
Item 13.	Certain Relationships and Related Transactions	45
Item 14.	Principal Accountant Fees and Services	45
Part IV.		
<u>Item 15.</u>	<u>Exhibits and Financial Statements Schedules</u>	47

PART I

ITEM 1. BUSINESS

GENERAL

Sun Communities, Inc., a Maryland corporation, together with the Sun Communities Operating Limited Partnership, a Michigan limited partnership (the "Operating Partnership") and other consolidated subsidiaries (the "Subsidiaries") are referred to herein as the "Company", "us", "we", and "our". We are a self-administered and self-managed real estate investment trust ("REIT").

We own, operate, and develop manufactured housing communities concentrated in the midwestern, southern, and southeastern United States. We are a fully integrated real estate company which, together with our affiliates and predecessors, have been in the business of acquiring, operating, and expanding manufactured housing communities since 1975. As of December 31, 2008, we owned and operated a portfolio of 136 properties located in 18 states (the "Properties" or "Property"), including 124 manufactured housing communities, 4 recreational vehicle communities, and 8 properties containing both manufactured housing and recreational vehicle sites. As of December 31, 2008, the Properties contained an aggregate of 47,613 developed sites comprised of 42,299 developed manufactured home sites, 3,107 permanent recreational vehicle sites, 2,207 seasonal recreational vehicle sites, and an additional 6,081 manufactured home sites suitable for development. We lease individual parcels of land ("sites") with utility access for placement of manufactured homes ("MHs") and recreational vehicles ("RVs") to our customers. The Properties are designed to offer affordable housing to individuals and families, while also providing certain amenities.

We are engaged through a taxable subsidiary, Sun Home Services, Inc., a Michigan corporation ("SHS"), in the marketing, selling, and leasing of new and pre-owned homes to current and future residents in our communities. The operations of SHS support and enhance the Company's occupancy levels, property performance, and cash flows.

Our executive and principal property management office is located at 27777 Franklin Road, Suite 200, Southfield, Michigan 48034 and our telephone number is (248) 208-2500. We have regional property management offices located in Austin, Texas; Dayton, Ohio; Grand Rapids, Michigan; Elkhart, Indiana; and Orlando, Florida, and we employed an aggregate of 644 people as of December 31, 2008.

Our website address is www.suncommunities.com and we make available, free of charge, on or through our website all of our periodic reports, including our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as soon as reasonably practicable after we file such reports with the Securities and Exchange Commission.

RECENT DEVELOPMENTS

Change in Management

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As announced on February 6, 2008, the Company appointed Karen J. Dearing, who has served as the Company's Corporate Controller since 2002, as the Company's Chief Financial Officer, and John B. McLaren, previously Senior Vice President of Home Sales and Leasing, as Chief Operating Officer. Ms. Dearing and Mr. McLaren succeed Jeffrey P. Jorissen, former Chief Financial Officer, and Brian W. Fannon, former Chief Operating Officer. Mr. Jorissen remains with the Company as Director of Corporate Development. Mr. Fannon's retirement from the Company was effective as of July 31, 2008.

Investment in Affiliate

In October 2003, the Company purchased 5,000,000 shares of common stock of Origen Financial, Inc. ("Origen"). The Company owns approximately 19% of Origen as of December 31, 2008, and its investment is accounted for using the equity method of accounting.

Origen was a publicly traded real estate investment trust that originated and serviced manufactured home loans. In March 2008, Origen announced that conditions in the credit markets had adversely impacted Origen's business and financial condition. In response, Origen suspended loan originations and took steps to right-size its work force. Following this announcement, Origen executed its asset disposition and management plan and sold \$176 million of unsecuritized loans, and its servicing and origination platforms. In December 2008, Origen voluntarily delisted its common stock from the NASDAQ Global Market and deregistered its common stock under the Securities and Exchange Act of 1934. Currently, Origen is actively managing its residual interests in securitized loans, whole loans, and bond holdings which provide continuing cash flows for the organization.

RECENT DEVELOPMENTS, CONTINUED

The Company recorded a total loss from affiliate of \$16.5 million for the year ended December 31, 2008. This includes the Company's estimate of its portion of the anticipated loss from Origen of \$6.9 million, and an other than temporary impairment loss of \$9.6 million.

Debt

The Company completed a \$27.0 million financing with Bank of America (formally LaSalle Bank Midwest) in June 2008. The loan has a three year term, with a two year extension at the Company's option. The loan is secured by four properties. The terms of the loan require interest only payments for the first year, with the remainder of the term being amortized based on a 30 year table. The interest rate is 205 basis points over LIBOR, or Prime plus 25 basis points (3.5% at December 31, 2008). Prime means for any month, the prevailing "prime rate" as quoted in the Wall Street Journal on last day of such calendar month. The proceeds from the financing were used to repay an existing mortgage note of \$4.3 million with the remainder used to pay down the Company's lines of credit.

The Company completed various transactions involving its installment notes secured by manufactured homes during 2008. The Company received \$27.5 million of cash proceeds in exchange for relinquishing its right, title and interest in the installment notes. The Company is subject to certain recourse provisions requiring the Company to purchase the underlying homes collateralizing such notes in the event of a note default and subsequent repossession of the home. The Company accounted for this transaction as a transfer of financial assets. The transferred assets have been classified as collateralized receivables and the cash received from this transaction has been classified as a secured borrowing in the consolidated balance sheet. Additional information is included in Note 3 of the Company's Notes to Consolidated Financial Statements included herein.

Investment in Property

Rental property is recorded at cost, less accumulated depreciation. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company reviews the carrying value of long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate a possible impairment. An impairment loss is recognized when a long-lived asset's carrying value is not recoverable and exceeds estimated fair value. The estimated fair value of long lived assets was calculated based on discounted future cash flows associated with the asset and any potential disposition proceeds for a given asset. Forecasting cash flows requires assumptions about such variables as the estimated holding period, rental rates, occupancy and operating expenses during the holding period, as well as disposition proceeds. Management determined certain impairment reviews were required as of December 31, 2008, as decisions were made to limit development of certain assets. Due to local economic conditions, estimated costs to develop and low estimated return on investment the Company determined to limit development in three development communities. The properties are located in Michigan, Nevada and North Carolina. Each had considerable up front development costs. A fourth property, located in Indiana, was found to be impaired based on its negative cash flows and management's estimate of continued negative cash flows. The Company also made a decision to stop providing cable television service at various communities as the business line could not provide the return on investment to justify the capital investment required to keep up with the technological advances in the offered product. As a result of the impairment analysis, the Company recognized non-cash impairment charges of \$13.1million.

STRUCTURE OF THE COMPANY

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In 1993, Sun Communities, Inc. contributed its net assets to the Operating Partnership in exchange for the sole general partner interest in the Operating Partnership and the majority of all the Operating Partnership's initial capital. We substantially conduct our operations through the Operating Partnership. The Operating Partnership is structured as an umbrella partnership REIT, or UPREIT, and owns, either directly or indirectly through Subsidiaries, all of our assets. This UPREIT structure enables us to comply with certain complex requirements under the Federal tax rules and regulations applicable to REITs, and to acquire manufactured housing communities in transactions that defer some or all of the sellers' tax consequences. The financial results of the Operating Partnership and the Subsidiaries are consolidated in the Company's consolidated financial statements. The financial results include certain activities that do not necessarily qualify as REIT activities under the Internal Revenue Code of 1986, as amended (the "Code"). The Company has formed taxable REIT subsidiaries, as defined in the Code, to engage in such activities. We use taxable REIT subsidiaries to offer certain services to our residents and engage in activities that would not otherwise be permitted under the REIT rules if provided directly by us or by the Operating Partnership. The taxable REIT subsidiaries include our home sales business, SHS, which provides manufactured home sales, leasing and other services to current and prospective tenants of the Properties.

We do not own all the interests in the Operating Partnership. Interests in the Operating Partnership held by limited partners other than Sun Communities, Inc. are referred to as "OP Units". The holders of Common OP Units receive distributions in an amount equal to the dividends paid to holders of our common stock. As of December 31, 2008, the Operating Partnership had a total of approximately 20.7 million units outstanding. We held approximately 18.5 million shares, or 89.4% of the interests (not including preferred limited partnership interests) in the Operating Partnership.

THE MANUFACTURED HOUSING COMMUNITY

A manufactured housing community is a residential subdivision designed and improved with sites for the placement of manufactured homes and related improvements and amenities. Manufactured homes are detached, single-family homes which are produced off-site by manufacturers and installed on sites within the community. Manufactured homes are available in a wide array of designs, providing owners with a level of customization generally unavailable in other forms of multifamily housing.

Modern manufactured housing communities, such as the Properties, contain improvements similar to other garden-style residential developments, including centralized entrances, paved streets, curbs and gutters, and parkways. In addition, these communities also often provide a number of amenities, such as a clubhouse, a swimming pool, shuffleboard courts, tennis courts, and laundry facilities.

The owner of each home on our Properties leases the site on which the home is located. We own the underlying land, utility connections, streets, lighting, driveways, common area amenities and other capital improvements and are responsible for enforcement of community guidelines and maintenance. Some of the Properties provide water and sewer service through public or private utilities, while others provide these services to residents from on-site facilities. Each owner within our Properties is responsible for the maintenance of the home and leased site. As a result, capital expenditure needs tend to be less significant relative to multi-family rental apartment complexes.

PROPERTY MANAGEMENT

Our property management strategy emphasizes intensive, hands-on management by dedicated, on-site district and community managers. We believe that this on-site focus enables us to continually monitor and address tenant concerns, the performance of competitive properties and local market conditions. Of the 644 Company employees, approximately 535 are located on-site as property managers, support staff, or maintenance personnel.

Throughout most of 2008, our community managers were overseen by John B. McLaren, Chief Operating Officer, who has 13 years of manufactured housing and related financing experience, 3 Senior Vice Presidents of Operations and 12 Regional Vice Presidents. In addition, the Regional Vice Presidents are responsible for semi-annual market surveys of competitive communities, interaction with local manufactured home dealers and regular property inspections.

Each district or community manager performs regular inspections in order to continually monitor the Property's physical condition and provides managers with the opportunity to understand and effectively address tenant concerns. In addition to a district or community manager, each district or property has an on-site maintenance personnel and management support staff. We hold periodic training sessions for all property management personnel to ensure that management policies are implemented effectively and professionally.

HOME SALES AND LEASING

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SHS is engaged in the marketing, selling, and leasing of new and pre-owned homes to current and future residents in our communities. Since tenants often purchase a home already on-site within a community, such services enhance occupancy and property performance. Additionally, because many of the homes on the Properties are sold through SHS, better control of home quality in our communities can be maintained than if sales services were conducted solely through third-party brokers. SHS also leases homes to prospective tenants. At December 31, 2008, SHS had 5,517 occupied leased homes in its portfolio. Homes for this rental program are purchased at discounted rates from finance companies that hold repossessed homes within the Company's communities. New homes are purchased as necessary to supplement these repossessed home purchases. Leases associated with the rental program are, in general, one year leases. This program requires intensive management of costs associated with repair and refurbishment of these homes as the tenants vacate and the homes are re-leased, similar to apartment rentals. The Company has added repair and service supervisors in areas with high concentrations of rental homes to aggressively pursue cost containment programs. The program is a strategic response to capture the value inherent in the purchase of substantially discounted repossessed homes in the Company's communities. Applications to rent homes in our Properties number over 14,000 per year, providing a significant "resident boarding" system allowing us to market purchasing a home to the best applicants and to rent to the remainder of approved applicants. Through the rental program we are able to demonstrate our product and lifestyle to the renters, while monitoring their payment history and converting qualified renters to owners.

REGULATIONS AND INSURANCE

General

Manufactured housing community properties are subject to various laws, ordinances and regulations, including regulations relating to recreational facilities such as swimming pools, clubhouses and other common areas. We believe that each Property has the necessary operating permits and approvals.

Insurance

Our management believes that the Properties are covered by adequate fire, flood, property and business interruption insurance provided by reputable companies with commercially reasonable deductibles and limits. We maintain a blanket policy that covers all of our Properties. We have obtained title insurance insuring fee title to the Properties in an aggregate amount which we believe to be adequate. Claims made to our insurance carriers that are determined to be recoverable are classified in other receivables as incurred. Insurance proceeds received in excess of the net book value of damaged or impaired capital assets are recorded in income in the period received.

SITE LEASES OR USAGE RIGHTS

The typical lease we enter into with a tenant for the rental of a manufactured home site is month-to-month or year-to-year, renewable upon the consent of both parties, or, in some instances, as provided by statute. In some cases (mainly in Florida), leases are for one-year terms, with up to ten renewal options exercisable by the tenant, with rent adjusted for increases in the consumer price index. Generally, market rate adjustments are made on an annual basis. These leases are cancelable for non-payment of rent, violation of community rules and regulations or other specified defaults. During the past five years, on average 3.1 percent of the homes in our communities have been removed by their owners and 7.3 percent of the homes have been sold by their owners to a new owner who then assumes rental obligations as a community resident. The cost to move a home is approximately \$4,000 to \$10,000. The above experience can be summarized as follows: the average resident remains in our communities for approximately fourteen years, while the average home, which gives rise to the rental stream, remains in our communities for approximately thirty two years.

At Properties zoned for RV use, our customers have short-term (“seasonal”) usage rights or long-term (“permanent”) usage rights. The seasonal RV customers typically prepay for their stay or leave deposits to reserve a site for the following year. Many of these RV customers do not live full time on the Property.

FORWARD-LOOKING STATEMENTS

This Form 10-K contains various “forward-looking statements” within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934, and the Company intends that such forward-looking statements will be subject to the safe harbors created thereby. For this purpose, any statements contained in this filing that relate to prospective events or developments are deemed to be forward-looking statements. Words such as “believes,” “forecasts,” “anticipates,” “intends,” “plans,” “expects,” “may,” “will” and similar expressions are intended to identify forward-looking statements.

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These forward-looking statements reflect the Company's current views with respect to future events and financial performance, but involve known and unknown risks and uncertainties, both general and specific to the matters discussed in this filing. These risks and uncertainties may cause the actual results of the Company to be materially different from any future results expressed or implied by such forward looking statements. Such risks and uncertainties include the national, regional and local economic climates, the ability to maintain rental rates and occupancy levels, competitive market forces, changes in market rates of interest, the ability of manufactured home buyers to obtain financing, the level of repossessions by manufactured home lenders and those risks and uncertainties referenced under the headings entitled "Risk Factors" contained in this Form 10-K and the Company's filings with the Securities and Exchange Commission. The forward-looking statements contained in this Form 10-K speak only as of the date hereof and the Company expressly disclaims any obligation to provide public updates, revisions or amendments to any forward-looking statements made herein to reflect changes in the Company's expectations of future events.

ITEM 1A. RISK FACTORS

Our prospects are subject to certain uncertainties and risks. Our future results could differ materially from current results, and our actual results could differ materially from those projected in forward-looking statements as a result of certain risk factors. These risk factors include, but are not limited to, those set forth below, other one-time events, and important factors disclosed previously and from time to time in other Company filings with the Securities and Exchange Commission. This report contains certain forward-looking statements.

REAL ESTATE RISKS

General economic conditions and the concentration of our properties in Michigan, Florida, Indiana, and Texas may affect our ability to generate sufficient revenue.

The market and economic conditions in our current markets generally, and specifically in metropolitan areas of our current markets, may significantly affect manufactured home occupancy or rental rates. Occupancy and rental rates, in turn, may significantly affect our revenues, and if our communities do not generate revenues sufficient to meet our operating expenses, including debt service and capital expenditures, our cash flow and ability to pay or refinance our debt obligations could be adversely affected. We derived significant amounts of rental income for the period ended December 31, 2008 from properties located in Michigan, Florida, Indiana, and Texas. As of December 31, 2008, 47 of our 136 Properties, or approximately 30% of developed sites, are located in Michigan; 19 Properties, or approximately 21% of developed sites, are located in Florida; 18 Properties, or approximately 14% of developed sites, are located in Indiana; and 17 Properties, or approximately 11% of developed site are located in Texas. As a result of the geographic concentration of our Properties in Michigan, Florida, Indiana, and Texas, we are exposed to the risks of downturns in the local economy or other local real estate market conditions which could adversely affect occupancy rates, rental rates and property values of properties in these markets.

The following factors, among others, may adversely affect the revenues generated by our communities:

- the national and local economic climate which may be adversely impacted by, among other factors, plant closings and industry slowdowns;
- local real estate market conditions such as the oversupply of manufactured housing sites or a reduction in demand for manufactured housing sites in an area;
- the number of repossessed homes in a particular market;
- the lack of an established dealer network;
- the rental market which may limit the extent to which rents may be increased to meet increased expenses without decreasing occupancy rates;

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- the perceptions by prospective tenants of the safety, convenience and attractiveness of the Properties and the neighborhoods where they are located;
- zoning or other regulatory restrictions;
- competition from other available manufactured housing sites and alternative forms of housing (such as apartment buildings and site-built single-family homes);
- our ability to provide adequate management, maintenance and insurance;
- increased operating costs, including insurance premiums, real estate taxes and utilities; or
- the enactment of rent control laws or laws taxing the owners of manufactured homes.

REAL ESTATE RISKS, CONTINUED

Our income would also be adversely affected if tenants were unable to pay rent or if sites were unable to be rented on favorable terms. If we were unable to promptly relet or renew the leases for a significant number of the sites, or if the rental rates upon such renewal or reletting were significantly lower than expected rates, then our business and results of operations could be adversely affected. In addition, certain expenditures associated with each Property (such as real estate taxes and maintenance costs) generally are not reduced when circumstances cause a reduction in income from the Property. Furthermore, real estate investments are relatively illiquid and, therefore, will tend to limit our ability to vary our portfolio promptly in response to changes in economic or other conditions.

Competition affects occupancy levels and rents which could adversely affect our revenues.

All of our Properties are located in developed areas that include other manufactured housing community properties. The number of competitive manufactured housing community properties in a particular area could have a material adverse effect on our ability to lease sites and increase rents charged at our Properties or at any newly acquired properties. We may be competing with others with greater resources and whose officers and directors have more experience than our officers and directors. In addition, other forms of multi-family residential properties, such as private and federally funded or assisted multi-family housing projects and single-family housing, provide housing alternatives to potential tenants of manufactured housing communities.

Our ability to sell or lease manufactured homes may be affected by various factors, which may in turn adversely affect our profitability.

SHS is engaged in the marketing, selling, and leasing of new and pre-owned homes to current and future residents in our communities. The market for the sale and lease of manufactured homes may be adversely affected by the following factors:

- downturns in economic conditions which adversely impact the housing market;
- an oversupply of, or a reduced demand for, manufactured homes;
-