

SUN COMMUNITIES INC  
Form 10-Q  
May 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 March 31, 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                                 | 38-2730780                           |
| (State of Incorporation)                 | (I.R.S. Employer Identification No.) |
| 27777 Franklin Rd.                       |                                      |
| Suite 200                                |                                      |
| Southfield, Michigan                     | 48034                                |
| (Address of Principal Executive Offices) | (Zip Code)                           |

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

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 [ ☐ ]

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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 March 31, 2007: 18,276,032

**SUN COMMUNITIES, INC.**

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## SUN COMMUNITIES, INC.

## CONSOLIDATED BALANCE SHEETS

MARCH 31, 2007 AND DECEMBER 31, 2006

(amounts in thousands)

|                                                                                                                        | (Unaudited)<br>March 31,<br>2007 | December 31,<br>2006 |
|------------------------------------------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                          |                                  |                      |
| Investment property, net                                                                                               | \$ 1,153,507                     | \$ 1,161,649         |
| Cash and cash equivalents                                                                                              | 4,335                            | 3,183                |
| Inventory of manufactured homes                                                                                        | 8,830                            | 12,082               |
| Investment in affiliate                                                                                                | 29,626                           | 29,319               |
| Notes and other receivables                                                                                            | 29,906                           | 41,407               |
| Other assets                                                                                                           | 41,581                           | 42,099               |
| Total assets                                                                                                           | \$ 1,267,785                     | \$ 1,289,739         |
| <b>LIABILITIES</b>                                                                                                     |                                  |                      |
| Debt                                                                                                                   | \$ 1,109,056                     | \$ 1,080,450         |
| Line of credit                                                                                                         | 48,600                           | 86,400               |
| Other liabilities                                                                                                      | 30,098                           | 31,301               |
| Total liabilities                                                                                                      | 1,187,754                        | 1,198,151            |
| Minority interest                                                                                                      | 9,940                            | 12,391               |
| <b>STOCKHOLDERS' EQUITY</b>                                                                                            |                                  |                      |
| Preferred stock, \$.01 par value, 10,000 shares<br>authorized, none issued                                             | \$                               | \$                   |
| Common stock, \$.01 par value, 90,000 shares<br>authorized, 20,078 and 20,028 issued<br>in 2007 and 2006, respectively | 201                              | 200                  |
| Additional paid-in capital                                                                                             | 455,302                          | 452,882              |
| Officers' notes                                                                                                        | (8,999)                          | (9,083)              |
| Accumulated comprehensive earnings                                                                                     | 566                              | 820                  |
| Distributions in excess of accumulated earnings                                                                        | (313,379)                        | (302,022)            |
| Treasury stock, at cost, 1,802 shares in 2007 and 2006                                                                 | (63,600)                         | (63,600)             |
| Total stockholders' equity                                                                                             | 70,091                           | 79,197               |
| Total liabilities and stockholders' equity                                                                             | \$ 1,267,785                     | \$ 1,289,739         |

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

**SUN COMMUNITIES, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006****(amounts in thousands except for per share data)****(unaudited)**

|                                                                          | <b>2007</b> | <b>2006</b> |
|--------------------------------------------------------------------------|-------------|-------------|
| <b>REVENUES</b>                                                          |             |             |
| Income from real property                                                | \$ 49,242   | \$ 48,073   |
| Revenue from home sales                                                  | 6,150       | 3,256       |
| Rental home revenue                                                      | 4,128       | 2,936       |
| Ancillary revenues, net                                                  | 263         | 269         |
| Interest                                                                 | 789         | 828         |
| Other income                                                             | 250         | 469         |
| Total revenues                                                           | 60,822      | 55,831      |
| <b>COSTS AND EXPENSES</b>                                                |             |             |
| Property operating and maintenance                                       | 11,722      | 11,385      |
| Real estate taxes                                                        | 4,098       | 3,894       |
| Cost of home sales                                                       | 4,924       | 2,397       |
| Rental home operating and maintenance                                    | 2,829       | 2,199       |
| General and administrative - real property                               | 4,410       | 5,130       |
| General and administrative - home sales and rentals                      | 1,658       | 1,587       |
| Depreciation and amortization                                            | 15,350      | 14,978      |
| Interest                                                                 | 15,169      | 14,725      |
| Interest on mandatorily redeemable debt                                  | 917         | 1,089       |
| Total expenses                                                           | 61,077      | 57,384      |
| Equity income from affiliate                                             | 307         | 281         |
| Income (loss) from operations                                            | 52          | (1,272 )    |
| Less income (loss) allocated to minority interest                        | 6           | (115 )      |
| Income (loss) before cumulative effect of change in accounting principle | 46          | (1,157 )    |
| Cumulative effect of change in accounting principle                      |             | 289         |
| Net income (loss)                                                        | \$ 46       | \$ (868 )   |
| Weighted average common shares outstanding:                              |             |             |
| Basic                                                                    | 17,841      | 17,534      |
| Diluted                                                                  | 17,985      | 17,534      |
| Basic and diluted earnings (loss) per share:                             |             |             |
| Income (loss) before cumulative effect of change in accounting principle | \$ 0.00     | \$ (0.07 )  |
| Cumulative effect of change in accounting principle                      |             | 0.02        |
| Net income (loss)                                                        | \$ 0.00     | \$ (0.05 )  |

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

**SUN COMMUNITIES, INC.**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006**
**(amounts in thousands)**
**(unaudited)**

|                                                 | <b>2007</b> | <b>2006</b> |
|-------------------------------------------------|-------------|-------------|
| Net income (loss)                               | \$46        | \$(868)     |
| Unrealized income (loss) on interest rate swaps | (254)       | 844         |
| Comprehensive loss                              | \$(208)     | \$(24)      |

**SUN COMMUNITIES, INC.**
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**
**FOR THE THREE MONTHS ENDED MARCH 31, 2007**
**(amounts in thousands)**
**(unaudited)**

|                                                            | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Officers'<br/>Notes</b> | <b>Accumulated<br/>Comprehensive<br/>Earnings (Loss)</b> | <b>Distributions<br/>in Excess of<br/>Accumulated<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Total<br/>Equity</b> |
|------------------------------------------------------------|-------------------------|-------------------------------------------|----------------------------|----------------------------------------------------------|--------------------------------------------------------------------|---------------------------|-------------------------|
| <b>Balance, December 31, 2006</b>                          | \$ 200                  | \$ 452,882                                | \$(9,083)                  | \$ 820                                                   | \$(302,022)                                                        | \$ 63,600                 | \$ 79,197               |
| Issuance of common stock, net                              | 1                       | 1,505                                     |                            |                                                          | (1,757)                                                            |                           | (251)                   |
| Exercise of stock options                                  |                         | 38                                        |                            |                                                          |                                                                    |                           | 38                      |
| Stock-based compensation - amortization<br>and forfeitures |                         | 877                                       |                            |                                                          | 21                                                                 |                           | 898                     |
| Repayment of officers' notes                               |                         |                                           | 84                         |                                                          |                                                                    |                           | 84                      |
| Net income                                                 |                         |                                           |                            |                                                          | 46                                                                 |                           | 46                      |
| Unrealized loss on interest rate swaps                     |                         |                                           |                            | (254)                                                    |                                                                    |                           | (254)                   |
| Cash distributions declared of \$0.63<br>per share         |                         |                                           |                            |                                                          | (9,667)                                                            |                           | (9,667)                 |
| <b>Balance, March 31, 2007</b>                             | \$ 201                  | \$ 455,302                                | \$(8,999)                  | \$ 566                                                   | \$(313,379)                                                        | \$ 63,600                 | \$ 70,091               |

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

## SUN COMMUNITIES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006

(amounts in thousands)

|                                                                                        | 2007      | 2006      |
|----------------------------------------------------------------------------------------|-----------|-----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                           |           |           |
| Net income (loss)                                                                      | \$ 46     | \$ (868 ) |
| Adjustments to reconcile net income (loss) to cash provided by operating activities:   |           |           |
| Income (loss) allocated to minority interests                                          | 6         | (115 )    |
| Loss (gain) on valuation of derivative instruments                                     | (122 )    | 43        |
| Stock compensation expense, net of cumulative effect of change in accounting principle | 928       | 1,060     |
| Depreciation and amortization                                                          | 16,090    | 15,754    |
| Amortization of deferred financing costs                                               | 364       | 454       |
| Equity income from affiliate                                                           | (307 )    | (281 )    |
| Decrease (increase) in notes receivable from sale of homes                             | (1,853 )  | 12        |
| Decrease in inventory, other assets and other receivables, net                         | 2,147     | 1,307     |
| Decrease in accounts payable and other liabilities                                     | (1,233 )  | (1,698 )  |
| Net cash provided by operating activities                                              | 16,066    | 15,668    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                           |           |           |
| Investment in rental properties                                                        | (6,388 )  | (19,426 ) |
| Decrease in notes receivable and officer's notes, net                                  | 13,161    | 88        |
| Net cash provided by (used in) investing activities                                    | 6,773     | (19,338 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                           |           |           |
| Redemption of common stock and OP units                                                | (1,213 )  | (1,323 )  |
| Proceeds from option exercise                                                          | 38        | 1,564     |
| Borrowings on lines of credit                                                          | 22,194    | 41,800    |
| Repayments on lines of credit                                                          | (59,994 ) | (24,800 ) |
| Payments to retire preferred operating partnership units                               | (4,500 )  |           |
| Payments to redeem notes payable and other debt                                        | (4,440 )  | (1,013 )  |
| Proceeds from notes payable and other debt                                             | 37,500    |           |
| Payments for deferred financing costs                                                  | (156 )    | (105 )    |
| Distributions                                                                          | (11,116 ) | (12,725 ) |
| Net cash provided by (used in) financing activities                                    | (21,687 ) | 3,398     |
| Net increase (decrease) in cash and cash equivalents                                   | 1,152     | (272 )    |
| Cash and cash equivalents, beginning of period                                         | 3,183     | 5,880     |
| Cash and cash equivalents, end of period                                               | \$ 4,335  | \$ 5,608  |
| <b>SUPPLEMENTAL INFORMATION:</b>                                                       |           |           |
| Cash paid for interest                                                                 | \$ 14,817 | \$ 14,489 |
| Cash paid for interest on mandatorily redeemable debt                                  | \$ 888    | \$ 1,077  |
| Noncash investing and financing activities:                                            |           |           |
| Debt assumed for rental properties                                                     | \$        | \$ 4,500  |
| Unrealized gain (loss) on interest rate swaps                                          | \$ (254 ) | \$ 844    |

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 notes thereto of the Company included in the 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)       |                      |
|------------------------------------|-------------------|----------------------|
|                                    | March 31,<br>2007 | December 31,<br>2006 |
| Land                               | \$ 117,564        | \$ 117,563           |
| Land improvements and buildings    | 1,177,391         | 1,175,045            |
| Rental homes and improvements      | 154,960           | 151,843              |
| Furniture, fixtures, and equipment | 36,571            | 37,229               |
| Land held for future development   | 31,082            | 31,082               |
|                                    | 1,517,568         | 1,512,762            |
| Less accumulated depreciation      | (364,061)         | (351,113)            |
| Investment property, net           | \$ 1,153,507      | \$ 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):

|                                                                                                                                                                                                                                                                                   | March 31,<br>2007 | December 31,<br>2006 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|----------------------|
| Mortgage note receivable, with interest payable at 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 6.9% and 15 years and 6.7% and 15 years, net of allowance for losses of \$0.1 and \$0.2 million at March 31, 2007, and December 31, 2006, respectively. | 22,844            | 20,537               |
| Other receivables, net of allowance for losses of \$0.2 and \$0.3 million at March 31, 2007, and December 31, 2006, respectively.                                                                                                                                                 | 7,062             | 7,338                |
|                                                                                                                                                                                                                                                                                   | \$ 29,906         | \$ 41,407            |

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

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 March 31, 2007, and December 31, 2006 (in thousands except for shares and units):

|                           | At March 31, 2007 |         |          | At December 31, 2006 |         |          |
|---------------------------|-------------------|---------|----------|----------------------|---------|----------|
|                           | Secured by        |         |          | Secured by           |         |          |
|                           | Outstanding       |         |          | Outstanding          |         |          |
| Promissory Notes          | Principal         | Common  | Common   | Principal            | Common  | Common   |
|                           | Balance           | Stock   | OP Units | Balance              | Stock   | OP Units |
| Secured - \$1.3 million   | \$ 1,040          | 63,993  |          | \$ 1,050             | 64,586  |          |
| Secured - \$6.6 million   | 5,283             | 142,092 | 102,223  | 5,332                | 143,409 | 103,170  |
| Secured - \$1.0 million   | 818               | 75,647  |          | 826                  | 76,348  |          |
| Unsecured - \$1.0 million | 818               |         |          | 826                  |         |          |
| Unsecured - \$1.3 million | 1,040             |         |          | 1,049                |         |          |
|                           | \$ 8,999          | 281,732 | 102,223  | \$ 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 \$0.1 million for the three months ended March 31, 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 20% of Origen at March 31, 2007, and its investment is accounted for using the equity method of accounting. Equity earnings recorded through March 31, 2007, reflect the Company's estimate of its portion of the anticipated earnings of Origen for the period ending March 31, 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):

|                                                                                                                                                                                                 | <b>March 31,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|
| Collateralized term loans - CMBS, 4.93-5.32%, due July 1, 2011-2016                                                                                                                             | \$ 491,157                | \$ 492,749                   |
| Collateralized term loans - FNMA, of which \$77.4M is variable, due May 1, 2014 and January 1, 2015, at the Company's option, interest at 4.51 - 5.3% at March 31, 2007, and December 31, 2006. | 384,407                   | 385,299                      |
| Preferred OP units, redeemable at various dates through January 2, 2014, average interest at 7.2% at March 31, 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 6.2% at March 31, 2007, and December 31, 2006.                                                        | 184,045                   | 148,455                      |
|                                                                                                                                                                                                 | \$ 1,109,056              | \$ 1,080,450                 |

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The collateralized term loans totaling \$875.6 million at March 31, 2007, are secured by 87 properties comprising approximately 31,093 sites representing approximately \$592.4 million of net book value. The mortgage notes totaling \$184.0 million at March 31, 2007, are collateralized by 16 communities comprising approximately 5,863 sites representing approximately \$173.8 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 + 1.75% (7.17% at March 31, 2007). The outstanding balance on the line of credit at March 31, 2007, was \$48.6 million. In addition, \$3.4 million of availability was used to back standby letters of credit leaving a maximum of \$63.0 million available to be drawn under the facility.

In March of 2006, the Company 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 March 31, 2007, there was no outstanding balance.

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

During the quarter 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.

At March 31, 2007, the total of maturities and amortization of debt during the next five years, are approximately as follows: 2008 - \$27.1 million; 2009 - \$18.5 million; 2010 - \$32.5 million, 2011 - \$17.8 million; 2012 - \$115.8 million and \$897.4 million thereafter.

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

**6. Other Income (Loss):**

The components of other income (loss) are as follows for the three months ended March 31, 2007 and 2006 (in thousands):

|                       | <b>2007</b>   | <b>2006</b>   |
|-----------------------|---------------|---------------|
| Brokerage commissions | \$ 203        | \$ 333        |
| Disposal of assets    | 2             | 32            |
| Other                 | 45            | 104           |
|                       | <b>\$ 250</b> | <b>\$ 469</b> |



## SUN COMMUNITIES, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

7. 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 March 31, 2007                 |                                |                                   |              |
|---------------------------------------------------|--------------------------------|-----------------------------------|--------------|
|                                                   | Real<br>Property<br>Operations | Home Sales<br>and Home<br>Rentals | Consolidated |
| Revenues                                          | \$ 49,242                      | (2) \$ 10,278                     | \$ 59,520    |
| Operating expenses/Cost of sales                  | 15,820                         | 7,753                             | 23,573       |
| Net operating income <sup>(1)</sup> /Gross profit | 33,422                         | 2,525                             | 35,947       |
| Adjustments to arrive at net income (loss):       |                                |                                   |              |
| Other revenues                                    | 1,009                          | 293                               | 1,302        |
| General and administrative                        | (4,410 )                       | (1,658 )                          | (6,068 )     |
| Depreciation and amortization                     | (11,404 )                      | (3,946 )                          | (15,350 )    |
| Interest expense                                  | (16,052 )                      | (34 )                             | (16,086 )    |
| Equity income from affiliate                      | 307                            |                                   | 307          |
| Income allocated to minority interest             | (6 )                           |                                   | (6 )         |
| Net income (loss)                                 | \$ 2,866                       | \$ (2,820 )                       | \$ 46        |

| Three months ended March 31, 2006                                           |                                |                                   |              |
|-----------------------------------------------------------------------------|--------------------------------|-----------------------------------|--------------|
|                                                                             | Real<br>Property<br>Operations | Home Sales<br>and Home<br>Rentals | Consolidated |
| Revenues                                                                    | \$ 48,073                      | (2) \$ 6,192                      | \$ 54,265    |
| Operating expenses/Cost of sales                                            | 15,279                         | 4,596                             | 19,875       |
| Net operating income <sup>(1)</sup> /Gross profit                           | 32,794                         | 1,596                             | 34,390       |
| Adjustments to arrive at net income (loss):                                 |                                |                                   |              |
| Other revenues                                                              | 1,293                          | 273                               | 1,566        |
| General and administrative                                                  | (5,130 )                       | (1,587 )                          | (6,717 )     |
| Depreciation and amortization                                               | (11,503 )                      | (3,475 )                          | (14,978 )    |
| Interest expense                                                            | (15,804 )                      | (10 )                             | (15,814 )    |
| Equity income from affiliate                                                | 281                            |                                   | 281          |
| Loss allocated to minority interest                                         | 115                            |                                   | 115          |
| Income (loss) before cumulative effect of<br>change in accounting principle | \$ 2,046                       | \$ (3,203 )                       | \$ (1,157 )  |
| Cumulative effect of change in accounting principle                         | 289                            |                                   | 289          |
| Net income (loss)                                                           | \$ 2,335                       | \$ (3,203 )                       | \$ (868 )    |

<sup>(1)</sup> Investors in and analysts following the real estate industry utilize net operating income ( NOI ) as a supplemental performance measure. NOI is derived from revenues (determined in accordance with GAAP) minus property operating expenses and real estate taxes (determined in accordance with GAAP). NOI does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income (determined in accordance with GAAP) as an indication of the Company's financial performance or to be an alternative to cash flow from operating activities (determined in accordance with GAAP) as a measure of the Company's liquidity; nor is it indicative of funds available for the Company's cash needs, including its ability to make cash distributions. The Company believes that net income is the most directly comparable GAAP measurement to net operating income. Net income includes

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interest and depreciation and amortization which often have no effect on the market value of a property and therefore limit its use as a performance measure. In addition, such expenses are often incurred at a parent company level and therefore are not necessarily linked to the performance of a real estate asset. The Company believes that net operating income is helpful to investors as a measure of operating performance because it is an indicator of the return on property investment, and provides a method of comparing property performance over time. The Company uses NOI as a key management tool when evaluating performance and growth of particular properties and/or groups of properties. The principal limitation of NOI is that it excludes depreciation, amortization and non-property specific expenses such as general and administrative expenses, all of which are significant costs, and therefore, NOI is a measure of the operating performance of the properties of the Company rather than of the Company overall.

<sup>(2)</sup> Seasonal recreational vehicle revenue is included in Property Operations revenues and is approximately \$5.3 million annually. This seasonal revenue is recognized approximately 53% in the first quarter, 7% in both the second and third quarters and 33% in the fourth quarter of each fiscal year.

## SUN COMMUNITIES, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**7. Segment Reporting (amounts in thousands), continued:**

| Selected balance sheet data     | March 31, 2007 |            |              | December 31, 2006 |            |              |
|---------------------------------|----------------|------------|--------------|-------------------|------------|--------------|
|                                 | Real           | Home Sales | Consolidated | Real              | Home Sales | Consolidated |
|                                 | Property       | and Home   |              | Property          | and Home   |              |
|                                 | Operations     | Rentals    |              | Operations        | Rentals    |              |
| Identifiable assets:            |                |            |              |                   |            |              |
| Investment property, net        | \$1,023,908    | \$129,599  | \$1,153,507  | \$1,031,771       | \$129,878  | \$1,161,649  |
| Cash and cash equivalents       | 4,174          | 161        | 4,335        | 3,457             | (274)      | 3,183        |
| Inventory of manufactured homes |                | 8,830      | 8,830        |                   | 12,082     | 12,082       |
| Investment in affiliate         | 29,626         |            | 29,626       | 29,319            |            | 29,319       |
| Notes and other receivables     | 27,834         | 2,072      | 29,906       | 40,583            | 824        | 41,407       |
| Other assets                    | 40,133         | 1,448      | 41,581       | 40,921            | 1,178      | 42,099       |
| Total assets                    | \$1,125,675    | \$142,110  | \$1,267,785  | \$1,146,051       | \$143,688  | \$1,289,739  |

**8. Derivative Instruments and Hedging Activities:**

The Company has entered into four derivative contracts consisting of three interest rate swap agreements and an interest rate cap agreement. The Company's primary strategy in entering into derivative contracts is to minimize the variability that changes in interest rates could have on its future cash flows. The Company generally employs derivative instruments that effectively convert a portion of its variable rate debt to fixed rate debt and to cap the maximum interest rate on its variable rate borrowings. The Company does not enter into derivative instruments for speculative purposes.

The swap agreements were effective April 2003, and have the effect of fixing interest rates relative to a collateralized term loan due to Fannie Mae. One swap matures in July 2009, with an effective fixed rate of 4.84 percent. A second swap matures in July 2012, with an effective fixed rate of 5.28 percent. The third swap matures in July 2007, with an effective fixed rate of 3.88 percent. The third swap is effective as long as 90-day LIBOR is 7 percent or lower. The three swaps have an aggregate notional amount of \$75.0 million. The interest rate cap agreement has a cap rate of 11.79 percent, a notional amount of \$152.4 million and a termination date of May 29, 2007. Each of the Company's derivative contracts is based upon 90-day LIBOR.

The Company has designated the first two swaps and the interest rate cap as cash flow hedges for accounting purposes. The changes in the value of these hedges are reflected in accumulated other comprehensive income (loss) on the balance sheet. These three hedges were highly effective and had minimal effect on income. The third swap does not qualify as a hedge for accounting purposes and, accordingly, the entire change in valuation, whether positive or negative, is reflected as a component of interest expense. The valuation adjustment decreased interest expense by \$0.1 million and increased interest expense by \$0.04 million for the three months ended March 31, 2007 and 2006, respectively.

In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which requires all derivative instruments to be carried at fair value on the balance sheet, the Company has recorded an asset of \$0.4 million and \$0.6 million as of March 31, 2007, and December 31, 2006, respectively.

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These valuation adjustments will only be realized if the Company terminates the swaps prior to maturity. This is not the intent of the Company and, therefore, the net of valuation adjustments through the various maturity dates will approximate zero.

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**9. Income Taxes:**

The Company has elected to be taxed as a real estate investment trust ( REIT ) as defined under Section 856(c) of the Internal Revenue Code of 1986, as amended. As a REIT, the Company generally will not be subject to U.S. federal income taxes at the corporate level on the ordinary taxable income it distributes to its stockholders as dividends. SHS, the Company's taxable REIT subsidiary, is subject to U.S. federal income taxes.

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation 48, Accounting for Uncertainty in Income Taxes (FIN 48). The Company previously had accounted for tax contingencies in accordance with Statement of Financial Accounting Standards 5, Accounting for Contingencies. As required by FIN 48, which clarifies FASB Statement No. 109, Accounting for Income Taxes, the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied FIN 48 to all tax positions for which the statute of limitations remained open. As a result of the adoption of FIN 48, the Company did not recognize any increase in the liability for unrecognized tax benefits, which would have been accounted for as a decrease to the January 1, 2007 balance of retained earnings. At January 1, 2007, the Company had no unrecognized tax benefits. There have been no material changes to the unrecognized tax benefits during the 1st quarter of 2007, nor are any expected within the next twelve months.

The Company and its subsidiaries are subject to income taxes in the U.S. and various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, the Company is no longer subject to U.S. Federal, State and Local, examinations by tax authorities before 2002. Neither the IRS nor any state or local tax jurisdictions have commenced examinations of any income tax returns.

The Company's policy is to report penalties and tax-related interest expense as a component of income tax expense. As of the date of adoption, no interest or penalty associated with any unrecognized tax benefit was accrued, nor was any interest or penalty recognized during the quarter.

## SUN COMMUNITIES, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**10. Earnings (Loss) Per Share (in thousands):**

For the three months ended March 31, 2007 and 2006:

|                                                                                   | 2007   | 2006      |
|-----------------------------------------------------------------------------------|--------|-----------|
| Earnings (loss) used for basic and diluted earnings (loss) per share computation: |        |           |
| Net income (loss)                                                                 | \$ 46  | \$ (868 ) |
| Weighted average shares used for basic earnings (loss) per share                  | 17,841 | 17,534    |
| Dilutive securities:                                                              |        |           |
| Stock options and other                                                           | 144    |           |
| Diluted weighted average shares                                                   | 17,985 | 17,534    |

Diluted earnings per share reflect the potential dilution that would occur if dilutive securities were exercised or converted into common stock. The calculation of both basic and diluted earnings per share for the three month period ending March 31, 2006, is based upon weighted average shares prior to dilution, as the effect of including potentially dilutive securities in the calculation during this period would be anti-dilutive.

The Company also has the following potentially convertible securities which, if converted, may impact dilution:

| Convertible Securities      | Number of units issued | Conversion Features                                                                              |
|-----------------------------|------------------------|--------------------------------------------------------------------------------------------------|
| Series A Preferred OP Units | 1,325,275              | Convertible to common stock at \$68 per share/unit.<br>Mandatorily redeemable on January 2, 2014 |

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**11. Commitments and Contingencies:**

On April 9, 2003, T.J. Holdings, LLC ( TJ Holdings ), a member of Sun/Forest, LLC ( Sun/Forest ) (which, in turn, owns an equity interest in SunChamp LLC), ( SunChamp ), filed a complaint against the Company, SunChamp, certain other affiliates of the Company and two directors of Sun Communities, Inc. in the Superior Court of Guilford County, North Carolina. The complaint alleges that the defendants wrongfully deprived the plaintiff of economic opportunities that they took for themselves in contravention of duties allegedly owed to the plaintiff and purports to claim damages of \$13.0 million plus an unspecified amount for punitive damages. The Company believes the complaint and the claims threatened therein have no merit and will defend it vigorously. These proceedings were stayed by the Superior Court of Guilford County, North Carolina in 2004 pending final determination by the Circuit Court of Oakland County, Michigan as to whether the dispute should be submitted to arbitration and the conclusion of all appeals therefrom. On March 13, 2007, the Michigan Court of Appeals issued an order compelling arbitration of all claims brought in the North Carolina case. TJ Holdings has filed an application for review in the Michigan Supreme Court which remains pending.

As announced on February 27, 2006, the U.S. Securities and Exchange Commission (the SEC ) completed its inquiry regarding the Company s accounting for its SunChamp investment during 2000, 2001 and 2002, and the Company and the SEC entered into an agreed-upon Administrative Order (the Order ). The Order required that the Company cease and desist from violations of certain non intent-based provisions of the federal securities laws, without admitting or denying any such violations.

On February 27, 2006, the SEC filed a civil action against the Company s Chief Executive Officer, Chief Financial Officer and a former controller in the United States District Court for the Eastern District of Michigan alleging various claims generally consistent with the SEC s findings set forth in the Order. This action is currently in the discovery stage. The Company continues to indemnify such employees for all costs and expenses incurred in connection with such civil action.

The Company is involved in various other legal proceedings arising in the ordinary course of business. All such proceedings, taken together, are not expected to have a material adverse impact on our results of operations or financial condition.

SUN COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**12. Subsequent events:**

Subsequent to quarter end, 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.

**13. Recent Accounting Pronouncements:**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to US GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 157 on its consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). This statement permits, but does not require, entities to measure certain financial instruments and other assets and liabilities at fair value on an instrument-by-instrument basis. Unrealized gains and losses on items for which the fair value option has been elected should be recognized in earnings at each subsequent reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not believe SFAS 159 will have a material impact on its results from operations or financial position.

SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**OVERVIEW**

The following discussion and analysis of the consolidated financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes thereto. Capitalized terms are used as defined elsewhere in this Form 10-Q.

**SIGNIFICANT ACCOUNTING POLICIES**

The Company had identified significant accounting policies that, as a result of the judgments, uncertainties, uniqueness and complexities of the underlying accounting standards and operations involved could result in material changes to its financial condition or results of operations under different conditions or using different assumptions. Details regarding the Company's significant accounting policies are described fully in the Company's 2006 Annual Report filed with the Securities and Exchange Commission on Form 10-K. During the three months ended March 31, 2007, there have been no material changes to the Company's significant accounting policies that impacted the Company's financial condition or results of operations.

**RESULTS OF OPERATIONS**

Comparison of the three months ended March 31, 2007 and 2006

For the three months ended March 31, 2007, income from operations increased by \$1.3 million from a loss of \$(1.2) million to income of \$0.1 million, when compared to the three months ended March 31, 2006. The increase was due to increased revenues of \$5.0 million, offset by increased expenses of \$3.7 million as described in more detail below.

Income from real property increased by \$1.1 million from \$48.1 million to \$49.2 million, or 2.3 percent, primarily due to rent increases.

Revenue from home sales increased by \$2.9 million from \$3.3 million to \$6.2 million, or 87.9 percent. The Company sold 185 manufactured homes during the three months ended March 31, 2007, as compared to 71 sales during the same period in 2006. Consumer demand shifted to pre-owned homes, which resulted in a decrease in average sales price of 27.5 percent. The decrease in average sales price was more than offset by additional revenue resulting from the increase in the number of homes sold.

Rental home revenue increased by \$1.2 million from \$2.9 million to \$4.1 million, or 41.4 percent. The number of tenants in the Company's rental program increased from 4,215 at March 31, 2006, to 4,860 at March 31, 2007, resulting in additional revenue of approximately \$0.7 million. The remainder of the increase resulted from an increase in the average rental rate per home from \$653 per month at March 31, 2006, to \$697 per

month at March 31, 2007.

**SUN COMMUNITIES, INC.**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**RESULTS OF OPERATIONS, continued:**

Other income decreased by \$0.2 million from \$0.5 million to \$0.3 million due primarily to a decrease in brokerage commissions.

Property operating and maintenance expenses increased by \$0.3 million from \$11.4 million to \$11.7 million, or 2.6 percent. The increase was due to increases in payroll and health insurance costs (\$0.2 million) and property insurance cost (\$0.1 million).

Real estate taxes increased by \$0.2 million due to increases in assessments and tax rates.

Cost of home sales increased by \$2.5 million from \$2.4 million to \$4.9 million, or 104.2 percent due primarily to the increase in the number of homes sold. The Company sold 185 manufactured homes during the three months ended March 31, 2007, as compared to 71 sales during the same period in 2006. Gross profit margins decreased from 26.4 percent in the first quarter of 2006 to 19.9 percent in the first quarter of 2007 due to increased sales of pre-owned homes at lower margins.

Rental home operating and maintenance expense increased by \$0.6 million from \$2.2 million to \$2.8 million, or 27.3 percent due primarily to an increase in the number of tenants in the Company's rental program. Additional information regarding the Company's rental program is contained in the table below.

General and administrative expenses for real property decreased by \$0.7 million, from \$5.1 million to \$4.4 million, due to a decrease in payroll and benefits of \$0.4 million and a decrease in legal fees of \$0.3 million.

General and administrative expenses for home sales and rentals increased by \$0.1 million from \$1.6 million to \$1.7 million, or 6.2 percent due primarily to an increase in commissions.

Depreciation and amortization increased by \$0.4 million from \$15.0 million to \$15.4 million, or 2.7 percent, due primarily to an increase in the total rental home portfolio.

Interest expense, including interest on mandatorily redeemable debt, increased by \$0.3 million from \$15.8 million to \$16.1 million, or 1.9 percent due to an increase in average debt balances of 2.5 percent.



## SUN COMMUNITIES, INC.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## RESULTS OF OPERATIONS, continued:

## SAME PROPERTY INFORMATION

The following table reflects property-level financial information as of and for the three months ended March 31, 2007 and 2006. The Same Property data represents information regarding the operation of communities owned as of January 1, 2006, and March 31, 2007. Site, occupancy, and rent data for those communities is presented as of the last day of each period presented.

|                                                   | Same Property  |            | Total Portfolio |            |
|---------------------------------------------------|----------------|------------|-----------------|------------|
|                                                   | 2007           | 2006       | 2007            | 2006       |
|                                                   | (in thousands) |            | (in thousands)  |            |
| Income from real property                         | \$47,326       | \$ 46,151  | \$ 49,242       | \$ 48,073  |
| Property operating expenses:                      |                |            |                 |            |
| Property operating and maintenance                | 9,145          | (4) 8,907  | (4) 11,722      | 11,385     |
| Real estate taxes                                 | 4,074          | 3,875      | 4,098           | 3,894      |
| Property operating expenses                       | 13,219         | 12,782     | 15,820          | 15,279     |
| Real property net operating income <sup>(1)</sup> | \$34,107       | \$ 33,369  | \$ 33,422       | \$ 32,794  |
| Number of properties                              | 135            | 135        | 136             | 136        |
| Developed sites                                   | 47,466         | 47,442     | 47,608          | 47,584     |
| Occupied sites                                    | 38,012         | (2) 38,512 | (2) 38,039      | (2) 38,539 |
| Occupancy %                                       | 83.1           | % (3) 84.4 | % (3) 82.8      | % (3) 84.2 |
| Weighted average monthly rent per site            | \$374          | (3) \$ 360 | (3) \$ 373      | (3) \$ 360 |
| Sites available for development                   | 6,310          | 6,359      | 6,808           | 6,857      |
| Sites planned for development in next year        | 18             | 41         | 18              | 41         |

<sup>(1)</sup> Investors in and analysts following the real estate industry utilize net operating income ( NOI ) as a supplemental performance measure. NOI is derived from revenues (determined in accordance with GAAP) minus property operating expenses and real estate taxes (determined in accordance with GAAP). NOI does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income (determined in accordance with GAAP) as an indication of the Company's financial performance or to be an alternative to cash flow from operating activities (determined in accordance with GAAP) as a measure of the Company's liquidity; nor is it indicative of funds available for the Company's cash needs, including its ability to make cash distributions. The Company believes that net income is the most directly comparable GAAP measurement to net operating income. Net income includes interest and depreciation and amortization which often have no effect on the market value of a property and therefore limit its use as a performance measure. In addition, such expenses are often incurred at a parent company level and therefore are not necessarily linked to the performance of a real estate asset. The Company believes that net operating income is helpful to investors as a measure of operating performance because it is an indicator of the return on property investment, and provides a method of comparing property performance over time. The Company uses NOI as a key management tool when evaluating performance and growth of particular properties and/or groups of properties. The principal limitation of NOI is that it excludes depreciation, amortization and non-property specific expenses such as general and administrative expenses, all of which are significant costs, and therefore, NOI is a measure of the operating performance of the properties of the Company rather than of the Company overall.

<sup>(2)</sup> Occupied sites include manufactured housing and permanent recreational vehicle sites, and exclude seasonal recreational vehicle sites.

<sup>(3)</sup> Occupancy % and weighted average rent relates to manufactured housing sites, excluding recreational vehicle sites.

<sup>(4)</sup> Amounts are reported net of water and sewer utility revenues.

## SUN COMMUNITIES, INC.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## RESULTS OF OPERATIONS, continued:

On a same property basis, real property net operating income increased by \$0.7 million from \$33.4 million for the three months ended March 31, 2006, to \$34.1 million for the three months ended March 31, 2007, or 2.2 percent. Income from real property increased by \$1.1 million from \$46.2 million to \$47.3 million, or 2.6 percent, due primarily to increases in rents. Property operating expenses increased by \$0.4 million from \$12.8 million to \$13.2 million, or 3.4 percent, due to increases in real estate taxes (\$0.2 million), payroll and health benefit costs (\$0.2 million), and other (\$0.1 million), partially offset by a decrease in utility costs (\$0.1 million).

## Rental Program

The following tables reflect additional information regarding the Company's rental program for the three months ended and as of March 31, 2007 and 2006:

|                                                 | 2007                        | 2006       |
|-------------------------------------------------|-----------------------------|------------|
|                                                 | (in thousands except for *) |            |
| Rental home revenue                             | \$ 4,128                    | \$ 2,936   |
| Site rent included in Income from real property | 5,065                       | 4,186      |
| Rental program revenue                          | 9,193                       | 7,122      |
| Expenses                                        |                             |            |
| Payroll and commissions                         | 493                         | 454        |
| Repairs and refurbishment                       | 1,432                       | 957        |
| Taxes and insurance                             | 581                         | 594        |
| Other                                           | 323                         | 194        |
| Rental program operating and maintenance        | 2,829                       | 2,199      |
| Net operating income <sup>(1)</sup>             | \$ 6,364                    | \$ 4,923   |
| Number of occupied rentals, end of period*      | 4,860                       | 4,215      |
| Cost of occupied rental homes                   | \$ 144,215                  | \$ 124,007 |
| Weighted average monthly rental rate*           | \$ 697                      | \$ 653     |

<sup>(1)</sup> See Note (1) following Same Property Information

Net operating income from the rental program increased \$1.5 million from \$4.9 million in the first quarter of 2006 to \$6.4 million in the first quarter of 2007 as a result of a \$2.1 million increase in revenue offset by a \$0.6 million increase in expenses. Revenues increased due to an increase in the weighted average monthly rental rate and an increase in the number of leased rental homes. Expenses were also impacted by the increase in the number of leased rental homes.



SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's principal liquidity demands have historically been, and are expected to continue to be, distributions to the Company's stockholders and the unitholders of the Operating Partnership, capital improvements of properties, the purchase of new and pre-owned homes, property acquisitions, development and expansion of properties and debt repayment.

The Company expects to meet its short-term liquidity requirements through its working capital provided by operating activities and through its \$155.0 million lines of credit. The Company considers these resources to be adequate to meet all operating requirements, including recurring capital improvements, routinely amortizing debt and other normally recurring expenditures of a capital nature, pay dividends to its stockholders to maintain qualification as a REIT in accordance with the Internal Revenue Code and make distributions to the Operating Partnership's unitholders.

The Company has invested approximately \$0.3 million in its development communities for the three months ended March 31, 2007, consisting primarily of costs necessary to complete home site improvements such as driveways, sidewalks, piers, pads and runners. The Company plans to invest approximately \$2 to \$3 million in developments consisting of expansions to existing communities during 2007. The Company expects to finance these investments by using net cash flows provided by operating activities and by drawing upon its line of credit.

The Company continuously seeks acquisition opportunities that meet the Company's criteria for acquisition. Should such investment opportunities arise in 2007, the Company will finance the acquisitions through the temporary use of its line of credit until permanent secured financing can be arranged, through the assumption of existing debt on the properties or the issuance of certain equity securities.

The Company has also invested approximately \$3.1 million during the three months ended March 31, 2007, in homes primarily intended for its rental program. Expenditures for the remainder of 2007 will be dependent upon the condition of the markets for reposessions and new home sales, as well as the demand for rental homes.

Cash and cash equivalents increased by \$1.1 million from \$3.2 million at December 31, 2006, to \$4.3 million at March 31, 2007. Net cash provided by operating activities increased by \$0.4 million to \$16.1 million for the three months ended March 31, 2007, compared to \$15.7 million for the three months ended March 31, 2006.

The Company's net cash flows provided by operating activities may be adversely impacted by, among other things: (a) the market and economic conditions in the Company's current markets generally, and specifically in metropolitan areas of the Company's current markets; (b) lower occupancy and rental rates of the Company's properties (the "Properties"); (c) increased operating costs, including insurance premiums, real estate taxes and utilities, that cannot be passed on to the Company's tenants; and (d) decreased sales of manufactured homes. See "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.



SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**LIQUIDITY AND CAPITAL RESOURCES, continued:**

The Company anticipates meeting its long-term liquidity requirements, such as scheduled debt maturities, large property acquisitions, and Operating Partnership unit redemptions through the collateralization of its properties. From time to time, the Company may also issue shares of its capital stock, issue equity units in the Operating Partnership or sell selected assets. The ability of the Company to finance its long-term liquidity requirements in such manner will be affected by numerous economic factors affecting the manufactured housing community industry at the time, including the availability and cost of mortgage debt, the financial condition of the Company, the operating history of the Properties, the state of the debt and equity markets, and the general national, regional and local economic conditions. See "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. If the Company is unable obtain additional debt or equity financing on acceptable terms, the Company's business, results of operations and financial condition will be adversely impacted.

At March 31, 2007, the Company's debt to total market capitalization approximated 64.5 percent (assuming conversion of all Common OP Units to shares of common stock). The debt has a weighted average maturity of approximately 7.1 years and a weighted average interest rate of 5.4 percent.

Capital expenditures for the three months ended March 31, 2007 and 2006 included recurring capital expenditures of \$1.2 million and \$1.4 million, respectively.

Net cash provided by investing activities was \$6.8 million for the three months ended March 31, 2007, compared to \$(19.3) million cash used in investing activities for the three months ended March 31, 2006. The increase of \$26.1 million was due to a \$13.1 million decrease in notes receivable and officers' notes, net, and decreased investment in rental property of \$13.0 million.

Net cash used in financing activities was \$(21.7) million for the three months ended March 31, 2007, compared to \$3.4 million of cash provided by financing activities for the three months ended March 31, 2006. The difference is primarily due to a \$54.8 million increase in net repayments on lines of credit, a \$4.5 million increase in payments to retire preferred operating partnership units, a decrease in net proceeds from option exercises and the issuance of common stock and OP units, net of \$1.4 million, and increased payments for deferred financing costs of \$0.1 million, offset by an increase in net proceeds from notes payable and other debt of \$34.1 million and decreased distributions of \$1.6 million.

SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**SUPPLEMENTAL MEASURE:**

Funds from operations ( FFO ) is defined by the National Association of Real Estate Investment Trusts ( NAREIT ) as net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from sales of depreciable operating property, plus real estate-related depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. FFO is a non-GAAP financial measure that management believes is a useful supplemental measure of the Company's operating performance. Management generally considers FFO to be a useful measure for reviewing comparative operating and financial performance because, by excluding gains and losses related to sales of previously depreciated operating real estate assets and excluding real estate asset depreciation and amortization (which can vary among owners of identical assets in similar condition based on historical cost accounting and useful life estimates), FFO provides a performance measure that, when compared year over year, reflects the impact to operations from trends in occupancy rates, rental rates and operating costs, providing perspective not readily apparent from net income. Management believes that the use of FFO has been beneficial in improving the understanding of operating results of REITs among the investing public and making comparisons of REIT operating results more meaningful.

Because FFO excludes significant economic components of net income including depreciation and amortization, FFO should be used as an adjunct to net income and not as an alternative to net income. The principal limitation of FFO is that it does not represent cash flow from operations as defined by GAAP and is a supplemental measure of performance that does not replace net income as a measure of performance or net cash provided by operating activities as a measure of liquidity. In addition, FFO is not intended as a measure of a REIT's ability to meet debt principal repayments and other cash requirements, nor as a measure of working capital. FFO only provides investors with an additional performance measure. Other REITS may use different methods for calculating FFO and, accordingly, the Company's FFO may not be comparable to other REITs.

The following table reconciles net income to FFO and calculates FFO data for both basic and diluted purposes for the three months ended March 31, 2007 and 2006 (in thousands):

SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****SUPPLEMENTAL MEASURE, continued:****RECONCILIATION OF NET INCOME (LOSS) TO FUNDS FROM OPERATIONS****FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006****(Amounts in thousands, except per share/OP unit amounts) (Unaudited)**

|                                                         | <b>2007</b> | <b>2006</b> |
|---------------------------------------------------------|-------------|-------------|
| Net income (loss)                                       | \$ 46       | \$ (868 )   |
| Adjustments:                                            |             |             |
| Depreciation and amortization                           | 15,572      | 15,588      |
| Valuation adjustment <sup>(1)</sup>                     | (122 )      | 43          |
| Gain on disposition of assets, net                      | (2 )        | (32 )       |
| Income (loss) allocated to minority interest            | 6           | (115 )      |
| Funds from operations (FFO)                             | \$ 15,500   | \$ 14,616   |
| Weighted average common shares/OP Units outstanding:    |             |             |
| Basic                                                   | 20,143      | 19,857      |
| Diluted                                                 | 20,287      | 20,007      |
| FFO per weighted average Common Share/OP Unit - Basic   | \$ 0.77     | \$ 0.74     |
| FFO per weighted average Common Share/OP Unit - Diluted | \$ 0.76     | \$ 0.73     |

<sup>(1)</sup> The Company entered into three interest rate swaps and an interest rate cap agreement. The valuation adjustment reflects the theoretical noncash profit and loss were those hedging transactions terminated at the balance sheet date. As the Company has no expectation of terminating the transactions prior to maturity, the net of these noncash valuation adjustments will be zero at the various maturities. As any imperfection related to hedging correlation in these swaps is reflected currently in cash as interest, the valuation adjustments reflect volatility that would distort the comparative measurement of FFO and on a net basis approximate zero. Accordingly, the valuation adjustments are excluded from FFO. The valuation adjustment is included in interest expense.

SUN COMMUNITIES, INC.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Safe Harbor Statement**

This Form 10-Q 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. 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 the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and the Company's filings with the Securities and Exchange Commission. The forward-looking statements contained in this Form 10-Q 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.

**SUN COMMUNITIES, INC.**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company's principal market risk exposure is interest rate risk. The Company mitigates this risk by maintaining prudent amounts of leverage, minimizing capital costs and interest expense while continuously evaluating all available debt and equity resources and following established risk management policies and procedures, which include the periodic use of derivatives. The Company's primary strategy in entering into derivative contracts is to minimize the variability that changes in interest rates could have on its future cash flows. The Company generally employs derivative instruments that effectively convert a portion of its variable rate debt to fixed rate debt. The Company does not enter into derivative instruments for speculative purposes.

The Company's variable rate debt totals \$146.2 million and \$188.2 million as of March 31, 2007 and 2006, respectively, which bears interest at various Prime and LIBOR/DMBS rates. If Prime or LIBOR/DMBS increased or decreased by 1.00 percent during the three months ended March 31, 2007 and 2006, the Company believes its interest expense would have increased or decreased by approximately \$1.5 million and \$1.8 million based on the \$153.2 million and \$182.1 million average balance outstanding under the Company's variable rate debt facilities for the three months ended March 31, 2007 and 2006, respectively.

The Company has entered into three separate interest rate swap agreements and an interest rate cap agreement. One of the swap agreements fixes \$25 million of variable rate borrowings at 4.84 percent through July 2009, another of the swap agreements fixes \$25 million of variable rate borrowings at 5.28 percent through July 2012 and the third swap agreement, which is only effective for so long as 90-day LIBOR is 7 percent or less, fixes \$25 million of variable rate borrowings at 3.88 percent through July 2007. The interest rate cap agreement has a cap rate of 11.79 percent, a notional amount of \$152.4 million and a termination date of May 29, 2007. Each of the Company's derivative contracts is based upon 90-day LIBOR.

SUN COMMUNITIES, INC.

**ITEM 4. CONTROLS AND PROCEDURES**

- (a) Under the supervision and with the participation of the Company's management, including the Chief Executive Officer, Gary A. Shiffman, and Chief Financial Officer, Jeffrey P. Jorissen, the Company evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report, pursuant to Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information the Company is required to disclose in its filings with the Securities and Exchange Commission under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms, and to ensure that information required to be disclosed by the Company in the reports that it files under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.
- (b) There have been no changes in the Company's internal control over financial reporting during the quarterly period ended March 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

SUN COMMUNITIES, INC.

**PART II**

**ITEM 6. EXHIBITS REQUIRED BY ITEM 601 OF REGULATION S-K**

See the attached Exhibit Index.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SUN COMMUNITIES, INC.**

Dated: May 9, 2007

**By:**       /s/Jeffrey P. Jorissen  
              Jeffrey P. Jorissen, Chief Financial  
              Officer and Secretary  
              (Duly authorized officer and principal  
              financial officer)

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SUN COMMUNITIES, INC.

## EXHIBIT INDEX

| <u>Exhibit No</u> | <u>Description</u>                                                                                                                                                                                              |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1              | Promissory Note dated August 1, 2006 made by Sun Countryside Lake Lanier LLC in favor of ARCS Commercial Mortgage Co., L.P., in the original principal amount of \$16,850,000                                   |
| 10.2              | Deed to Secured Debt and Security Agreement dated August 1, 2006 made by Sun Countryside Lake Lanier LLC in favor of ARCS Commercial Mortgage Co., L.P.                                                         |
| 10.3              | Future Advance, Renewal and Consolidation Promissory Note dated November 15, 2006 made by Miami Lakes Venture Associates in favor of Lehman Brothers Bank, FSB in the original principal amount of \$54,000,000 |
| 10.4              | Notice of Future Advance, Mortgage Modification, Extension and Spreader Agreement and Security Agreement dated November 15, 2006 made by Miami Lakes Venture Associates in favor of Lehman Brothers Bank, FSB   |
| 10.5              | Promissory Note dated January 4, 2007 made by High Point Associates, L.P., in favor of Lehman Brothers Bank, FSB in the original principal amount of \$17,500,000                                               |
| 10.6              | Mortgage and Security Agreement dated January 4, 2007 made by High Point Associates, L.P., in favor of Lehman Brothers Bank, FSB                                                                                |
| 10.7              | Promissory Note dated January 5, 2007 made by Sea Breeze Limited Partnership in favor of Lehman Brothers Bank, FSB in the original principal amount of \$20,000,000                                             |
| 10.8              | Mortgage and Security Agreement dated January 5, 2007 made by Sea Breeze Limited Partnership in favor of Lehman Brothers Bank, FSB                                                                              |
| 31.1              | Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a)/15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                 |
| 31.2              | Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a)/15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                 |
| 32                | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                          |