

## FORM 10-Q

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2000

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER: 1-11718

MANUFACTURED HOME COMMUNITIES, INC.  
(Exact name of registrant as specified in its Charter)

MARYLAND  
(State or other jurisdiction of  
incorporation or organization)

36-3857664  
(I.R.S. Employer  
Identification No.)

TWO NORTH RIVERSIDE PLAZA, SUITE 800, CHICAGO, ILLINOIS  
(Address of principal executive offices)

60606  
(Zip Code)

(312) 279-1400  
(Registrant's telephone number, including area code)

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 (X) 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:

20,833,896 shares of Common Stock as of October 31, 2000.

MANUFACTURED HOME COMMUNITIES, INC.

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MANUFACTURED HOME COMMUNITIES, INC.  
CONSOLIDATED BALANCE SHEETS  
AS OF SEPTEMBER 30, 2000 AND DECEMBER 31, 1999  
(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

	SEPTEMBER 30, 2000 (UNAUDITED)	DECEMBER 31, 1999
	-----	-----
<b>ASSETS</b>		
Investment in real estate:		
Land .....	\$ 271,822	\$ 285,337
Land improvements .....	834,627	876,923
Buildings and other depreciable property .....	106,093	102,083
	-----	-----
	1,212,542	1,264,343
Accumulated depreciation .....	(173,067)	(150,757)
	-----	-----
Net investment in real estate .....	1,039,475	1,113,586
Cash and cash equivalents .....	6,277	6,676
Notes receivable .....	3,297	4,284
Investment in and advances to affiliates .....	18,413	11,689
Investment in joint ventures .....	9,331	9,501
Rents receivable .....	1,070	1,338
Deferred financing costs, net .....	6,659	5,042
Prepaid expenses and other assets .....	13,259	8,222
	-----	-----
Total assets .....	\$ 1,097,781	\$ 1,160,338
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Mortgage notes payable .....	\$ 557,623	\$ 513,172
Unsecured term loan .....	100,000	100,000
Unsecured line of credit .....	40,900	107,900
Other notes payable .....	3,209	4,192
Accounts payable and accrued expenses .....	29,108	20,780
Accrued interest payable .....	4,560	5,612
Rents received in advance and security deposits .....	7,016	6,831
Distributions payable .....	11,009	11,020
Due to affiliates .....	32	33
	-----	-----
Total liabilities .....	753,457	769,540
	-----	-----
Commitments and contingencies		
Minority interest - Common OP Units and other .....	48,070	54,397
Minority interest- Perpetual Preferred OP Units .....	125,000	125,000
Stockholders' equity:		
Preferred stock, \$.01 par value 10,000,000 shares authorized; none issued .....	---	---
Common stock, \$.01 par value 50,000,000 shares authorized; 20,876,070 and 22,813,357 shares issued and outstanding for 2000 and 1999, respectively	209	229
Paid-in capital .....	233,389	275,664
Deferred compensation .....	(4,669)	(6,326)
Employee notes .....	(4,366)	(4,540)
Distributions in excess of accumulated earnings .....	(53,309)	(53,626)
	-----	-----
Total stockholders' equity .....	171,254	211,401
	-----	-----
Total liabilities and stockholders' equity .....	\$ 1,097,781	\$ 1,160,338
	=====	=====

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

MANUFACTURED HOME COMMUNITIES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE QUARTERS AND NINE MONTHS ENDED SEPTEMBER 30, 2000 AND 1999  
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)  
(UNAUDITED)

	QUARTERS ENDED		NINE MONTHS ENDED	
	2000	SEPTEMBER 30, 1999	2000	SEPTEMBER 30, 1999
<b>REVENUES</b>				
Base rental income .....	\$ 47,218	\$ 45,601	\$ 141,776	\$ 135,646
RV base rental income .....	560	1,728	5,435	6,841
Utility and other income .....	4,973	4,747	15,701	15,595
Equity in income of affiliates .....	857	909	1,649	1,165
Interest income .....	267	552	731	1,127
<b>Total revenues .....</b>	<b>53,875</b>	<b>53,537</b>	<b>165,292</b>	<b>160,374</b>
<b>EXPENSES</b>				
Property operating and maintenance .....	14,653	14,424	44,471	43,173
Real estate taxes .....	4,119	4,186	12,807	12,560
Property management .....	2,072	2,078	6,631	6,194
General and administrative .....	1,346	1,408	5,006	4,567
Interest and related amortization .....	13,169	13,965	39,654	40,830
Depreciation on corporate assets .....	291	252	839	732
Depreciation on real estate assets and other costs .	8,510	8,807	25,934	25,351
<b>Total expenses .....</b>	<b>44,160</b>	<b>45,120</b>	<b>135,342</b>	<b>133,407</b>
<b>Income from operations .....</b>	<b>9,715</b>	<b>8,417</b>	<b>29,950</b>	<b>26,967</b>
Gain on sale of Properties and other .....	---	---	12,053	---
<b>Income before allocation to Minority Interests and extraordinary loss .....</b>	<b>9,715</b>	<b>8,147</b>	<b>42,003</b>	<b>26,967</b>
(Income) allocated to Common OP Units .....	(1,451)	(1,509)	(6,822)	(4,862)
(Income) allocated to Perpetual Preferred OP Units .	(2,813)	(31)	(8,439)	(31)
<b>Income before extraordinary loss on early extinguishment of debt .....</b>	<b>5,451</b>	<b>6,877</b>	<b>26,742</b>	<b>22,074</b>
Extraordinary loss on early extinguishment of debt (net of \$264 allocated to minority interests) .	---	---	1,041	---
<b>NET INCOME .....</b>	<b>\$ 5,451</b>	<b>\$ 6,877</b>	<b>\$ 25,701</b>	<b>\$ 22,074</b>
Income per share before extraordinary loss - basic .	\$ 0.26	\$ 0.27	\$ 1.23	\$ .85
Income per share before extraordinary loss - diluted	\$ 0.25	\$ 0.27	\$ 1.21	\$ .84
Net income per Common Share - basic .....	\$ 0.26	\$ 0.27	\$ 1.18	\$ .85
Net income per Common Share - diluted .....	\$ 0.25	\$ 0.27	\$ 1.16	\$ .84
Distributions declared per Common Share .....	\$ 0.4150	\$ 0.3875	\$ 1.245	\$ 1.1625
Weighted average Common Shares outstanding - basic .....	21,166	25,613	21,775	25,846
Weighted average Common Shares outstanding - diluted (see Note 2) .....	27,077	31,586	27,706	31,915

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

MANUFACTURED HOME COMMUNITIES, INC.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2000 AND 1999  
 (AMOUNTS IN THOUSANDS)  
 (UNAUDITED)

	SEPTEMBER 30, 2000	SEPTEMBER 30, 1999
	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 25,701	\$ 22,074
Adjustments to reconcile net income to cash provided by operating activities:		
Income allocated to Minority Interests .....	14,997	4,893
Gain on sale of Properties and other .....	(12,053)	---
Depreciation and amortization expense .....	26,526	26,556
Equity in income of affiliates .....	(1,649)	(1,165)
Amortization of deferred compensation and other .....	1,657	1,238
Decrease (increase) in rents receivable .....	268	(552)
(Increase) decrease in prepaid expenses and other assets .....	(3,298)	1,613
Increase in accounts payable and accrued expenses .....	7,275	6,988
Increase in rents received in advance and security deposits ....	185	1,577
	-----	-----
Net cash provided by operating activities .....	59,609	63,222
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Contributions and advances to affiliates .....	(5,174)	(1,911)
Collection of notes receivable .....	987	11,524
Investment in joint ventures .....	(197)	(1,997)
Collection of escrow proceeds, net .....	10,500	---
Proceeds from disposition of assets .....	44,329	---
Acquisition of rental properties .....	(3,481)	(29,305)
Improvements:		
Improvements - corporate .....	(357)	(471)
Improvements - rental properties .....	(5,366)	(6,520)
Site development costs .....	(4,250)	(2,665)
	-----	-----
Net cash used in (provided by) investing activities .....	36,991	(31,345)
	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from stock options and employee stock purchase plan ...	2,501	2,866
Net proceeds from issuance of Preferred OP units .....	---	121,890
Distributions to common stockholders and minority interests .....	(42,503)	(25,354)
Repurchase of Common Stock .....	(50,711)	(26,772)
Collection of principal payments on employee notes .....	174	79
Proceeds from line of credit and refinancing mortgage notes payable	199,953	41,584
Repayments on line of credit and refinancing mortgage notes payable	(204,156)	(133,896)
Debt issuance costs .....	(2,257)	(846)
	-----	-----
Net cash used in financing activities .....	(96,999)	(20,449)
	-----	-----
Net (decrease) increase in cash and cash equivalents .....	(399)	11,428
Cash and cash equivalents, beginning of period .....	6,676	13,657
	-----	-----
Cash and cash equivalents, end of period .....	\$ 6,277	\$ 25,085
	=====	=====
<b>SUPPLEMENTAL INFORMATION:</b>		
Cash paid during the period for interest .....	\$ 39,739	\$ 39,932
	=====	=====

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

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DEFINITION OF TERMS:

Capitalized terms used but not defined herein are as defined in the Company's Annual Report on Form 10-K for the year ended December 31, 1999 (the "1999 Form 10-K").

PRESENTATION:

These unaudited Consolidated Financial Statements of Manufactured Home Communities, Inc., a Maryland corporation, and its subsidiaries (collectively, the "Company"), have been prepared pursuant to the Securities and Exchange Commission ("SEC") rules and regulations and should be read in conjunction with the financial statements and notes thereto included in the 1999 Form 10-K. The following Notes to Consolidated Financial Statements highlight significant changes to the Notes included in the 1999 Form 10-K and 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 the prior periods' financial statements in order to conform with current period presentation.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas, and major customers. The adoption of SFAS No. 131 did not affect the results of operations or financial position of the Company. The Company has one reportable segment, which is the operation of manufactured home communities.

NOTE 2 - EARNINGS PER COMMON SHARE

Earnings per common share is based on the weighted average number of common shares outstanding during each period. In 1997, the Company adopted SFAS No. 128, "Earnings Per Share". SFAS No. 128 replaces the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. The conversion of Operating Partnership Units ("OP Units") has been excluded from the basic earnings per share calculation. The conversion of an OP Unit to a share of common stock will have no material effect on earnings per common share since the allocation of earnings to an OP Unit is equivalent to the allocation of earnings to a share of common stock.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 2 - EARNINGS PER COMMON SHARE (CONTINUED)

The following table sets forth the computation of basic and diluted earnings per share for the quarters and nine months ended September 30, 2000 and 1999 (amounts in thousands):

	QUARTERS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30, 2000	1999	SEPTEMBER 30, 2000	1999
<b>NUMERATOR:</b>				
Numerator for basic earnings per share -				
Net income.....	\$ 5,451	\$ 6,877	\$ 25,701	\$ 22,074
Effect of dilutive securities:				
Income allocated to Common OP Units (net of extraordinary loss on early extinguishment of debt incurred in the second quarter of 2000) ...	1,451	1,509	6,558	4,862
Numerator for diluted earnings per share- income available to common shareholders after assumed conversions.....	\$ 6,902	\$ 8,386	\$ 32,259	\$ 26,936
	=====	=====	=====	=====
<b>DENOMINATOR:</b>				
Denominator for basic earnings per share -				
Weighted average Common Stock outstanding.....	21,166	25,613	21,775	25,846
Effect of dilutive securities:				
Weighted average Common OP Units.....	5,583	5,647	5,606	5,725
Employee stock options.....	328	326	325	344
Denominator for diluted earnings per share- adjusted weighted average shares and assumed conversions.....	27,077	31,586	27,706	31,915
	=====	=====	=====	=====

## NOTE 3 - COMMON STOCK AND RELATED TRANSACTIONS

On April 14, 2000, July 14, 2000 and October 13, 2000, the Company paid a \$.415 per share distribution for the quarters ended March 31, 2000, June 30, 2000 and September 30, 2000, respectively, to stockholders of record on March 31, 2000, June 30, 2000 and September 29, 2000, respectively.

In accordance with the Common Stock repurchase plan approved by the Company's Board of Directors, the Company repurchased 500,000 shares of Common Stock during the quarter ended September 30, 2000. Additionally, the Company repurchased 670,000 shares of Common Stock in a privately negotiated transaction approved by the Company's Board of Directors. Altogether, the Company has repurchased 1,070,000 shares during the quarter ended September 30, 2000 and 2,065,100 shares during the nine months ended September 30, 2000. The Company has repurchased approximately 6.5 million shares since the plan was approved. The Common Stock repurchase plan allows for the repurchase of an additional 500,000 shares during the quarter ending December 31, 2000.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 4 - REAL ESTATE

In March 2000, in accordance with SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of", MHC Acquisition One LLC, a consolidated subsidiary of the Company, recorded an impairment loss on the DeAnza Santa Cruz water and wastewater service company business. Recent negotiations for the sale of the business as well as management's estimates indicated that the undiscounted future cash flows from the business would be less than the carrying value of the business and its related assets. The Company recorded an asset impairment loss of \$701,000 (or \$.02 per fully diluted share) which is included in other income on the accompanying statements of operations. This loss represents the difference between the carrying value of the DeAnza Santa Cruz water and wastewater service company business and its related assets and their estimated fair market value.

On February 29, 2000, MHC Systems, Inc., a consolidated subsidiary of the Company, disposed of the water and wastewater service company and facilities known as FFEC-Six in a cash sale. Net proceeds from the sale of approximately \$4.2 million were used to pay down the Company's line of credit and a gain on the sale of \$719,000 (or \$.02 per fully diluted share) was recorded in other income on the accompanying statements of operations.

In April 2000, the California Superior Court approved a settlement agreement (the "Settlement") in connection with the dissolution proceeding of Ellenburg Capital Corporation and its affiliated partnerships. The Company had previously purchased 37 properties (the "Ellenburg Properties") in connection with the dissolution proceeding. As part of the Settlement, the Company sold three communities - Mesa Regal RV Resort, Mon Dak and Naples Estates - for an aggregate sales price of \$59.0 million including cash proceeds of \$40.0 million and assumption of debt of \$19.0 million in a non-cash transaction. The Company recorded a \$9.1 million gain on the sale of these properties. Also as part of the Settlement, the Company received the return of \$13.5 million previously held in escrow in connection with the purchase of the Ellenburg Properties and recorded \$3.0 million of interest income related to these funds. Proceeds from the Settlement were used to pay down the Company's line of credit. See Note 8 for further discussion of the Settlement.

The Company is actively seeking to acquire additional manufactured home communities and currently is engaged in negotiations relating to the possible acquisition of a number of manufactured home communities. At any time these negotiations are at varying stages which may include contracts outstanding to acquire certain manufactured home communities which are subject to satisfactory completion of the Company's due diligence review.

## NOTE 5 - NOTES RECEIVABLE

At September 30, 2000 and December 31, 1999, the Company had approximately \$3.3 million and \$4.3 million in notes receivable, respectively. On January 10, 2000, \$1.1 million in purchase money notes receivable were repaid to the Company. The Company has a \$3.3 million loan receivable outstanding, which bears interest at the rate of approximately 8.5%, is collateralized by the property known as Trails West and matures on June 1, 2003.



MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - LONG-TERM BORROWINGS

As of September 30, 2000 and December 31, 1999, the Company had outstanding mortgage indebtedness of approximately \$557.6 million and \$513.2 million, respectively, encumbering 73 and 72 of the Company's Properties, respectively. As of September 30, 2000 and December 31, 1999, the carrying value of such Properties was approximately \$633.7 million and \$638 million, respectively.

On June 30, 2000, the Company completed \$110 million in debt financing consisting of two mortgage notes - one for \$94.3 million and one for \$15.7 million - secured by seven Properties as discussed below. The proceeds of the financing were used to repay \$60 million of mortgage debt secured by the seven Properties, to repay amounts outstanding under the Company's line of credit and for working capital purposes. The Company recorded a \$1.3 million charge in connection with the early repayment of the \$60 million of mortgage debt.

The outstanding mortgage indebtedness consists of:

- - A \$265.0 million mortgage note (the "\$265 Million Mortgage") collateralized by 29 Properties beneficially owned by MHC Financing Limited Partnership. The \$265 Million Mortgage has a maturity date of January 2, 2028 and pays interest at 7.015%. There is no principal amortization until February 1, 2008, after which principal and interest are to be paid from available cash flow and the interest rate will be reset at a rate equal to the then 10-year U.S. Treasury obligations plus 2.0%. The \$265 Million Mortgage is recorded net of a hedge of \$3.0 million which is being amortized into interest expense over the life of the loan.
- - A \$66.7 million mortgage note (the "College Heights Mortgage") collateralized by 18 Properties owned in a joint venture formed by the Company and Wolverine Investors, LLC. The College Heights Mortgage bears interest at a rate of 7.19%, amortizes beginning July 1, 1999 over 30 years and matures July 1, 2008.
- - A \$94.0 million mortgage note (the "DeAnza Mortgage") collateralized by 6 Properties beneficially owned by MHC-DeAnza Financing Limited Partnership. The DeAnza Mortgage bears interest at a rate of 7.82%, amortizes beginning August 1, 2000 over 30 years and matures July 1, 2010.
- - A \$23.1 million mortgage note (the "Bay Indies Mortgage") collateralized by one Property beneficially owned by MHC-Bay Indies Financing Limited Partnership. The Bay Indies Mortgage bears interest at a rate of 7.48%, amortizes beginning August 1, 1994 over 27.5 years and matures July 1, 2004.
- - A \$15.7 million mortgage note (the "Date Palm Mortgage") collateralized by one Property beneficially owned by MHC Date Palm, L.L.C. The Date Palm Mortgage bears interest at a rate of 7.96%, amortizes beginning August 1, 2000 over 30 years and matures July 1, 2010.
- - Approximately \$95.2 million of mortgage debt on 18 other various Properties, which was recorded at fair market value with the related discount or premium being amortized over the life of the loan using the effective interest rate. Scheduled maturities for the outstanding indebtedness are at various dates through November 30, 2020, and fixed interest rates range from 7.25% to 9.05%. Included in this debt are two mortgages which were entered into on February 24, 2000, with combined principal of \$14.6 million at an interest rate of approximately 8.3%, maturing on March 24, 2010. In addition, the Company has a \$2.4 million loan recorded to account for a direct financing lease entered into in May 1997.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 6 - LONG-TERM BORROWINGS (CONTINUED)

On August 9, 2000, the Company amended its unsecured line of credit with a bank (the "Credit Agreement") bearing interest at the London Interbank Offered Rate ("LIBOR") plus 1.125%. Among other things, the amendment lowered the total facility under the Credit Agreement to \$150 million and extended the maturity to August 9, 2003. The Company pays a quarterly fee on the average unused amount of such credit equal to 0.15% of such amount. As of September 30, 2000, \$40.9 million was outstanding under the Credit Agreement.

The Company has a \$100 million unsecured term loan (the "Term Loan") with a group of banks with interest only payable monthly at a rate of LIBOR plus 1.0%. The Term Loan maturity has been extended to April 3, 2002.

The Company has approximately \$3.2 million of installment notes payable, secured by a letter of credit, each with an interest rate of 6.5%, maturing September 1, 2002. Approximately \$1.9 million of the notes pay principal annually and interest quarterly and the remaining \$1.3 million of the notes pay interest only quarterly.

In July 1995, the Company entered into an interest rate swap agreement (the "1998 Swap") fixing LIBOR on \$100 million of the Company's floating rate debt at 6.4% for the period 1998 through 2003. The value of the 1998 Swap was impacted by changes in the market rate of interest. The Company accounted for the 1998 Swap as a hedge. Payments and receipts under the 1998 Swap were accounted for as an adjustment to interest expense. On January 10, 2000, the Company terminated the 1998 Swap and received \$1.0 million of proceeds which is being amortized as an adjustment to interest expense through March 2003.

## NOTE 7 - STOCK OPTIONS

Pursuant to the Amended and Restated 1992 Stock Option and Stock Award Plan as discussed in Note 14 to the 1999 Form 10-K, certain officers, directors, employees and consultants have been offered the opportunity to acquire shares of common stock of the Company through stock options ("Options"). During the nine months ended September 30, 2000, Options for 83,869 shares of common stock were exercised.

## NOTE 8 - COMMITMENTS AND CONTINGENCIES

## DEANZA SANTA CRUZ MOBILE ESTATES

The residents of DeAnza Santa Cruz Mobile Estates, a Property located in Santa Cruz, California (the "City") previously brought several actions opposing certain fees and charges in connection with water service at the Property. The trial of the ongoing utility charge dispute with the residents of this Property concluded on January 22, 1999. This summary provides the history and reasoning underlying the Company's defense of the residents' claims and explains the Company's decision to continue to defend its position, which the Company believes is fair and accurate.

DeAnza Santa Cruz Mobile Estates is a 198 site community overlooking the Pacific Ocean. It is subject to the City's rent control ordinance which limits annual rent increases to 75% of CPI. The Company purchased this Property in August 1994 from certain unaffiliated DeAnza entities ("DeAnza"). Prior to the Company's purchase in 1994, DeAnza made the decision to submeter the Property for both water and sewer in 1993 in the face of the City's rapidly rising utility costs.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Under California Civil Code Section 798.41, DeAnza was required to reduce rent by an amount equal to the average cost of usage over the preceding 12 months. This was done. With respect to water, not looking to submit to jurisdiction of the California Public Utility Commission ("CPUC"), DeAnza relied on California Public Utilities Code Section 2705.5 ("CPUC Section 2705.5") to determine what rates would be charged for water on an ongoing basis without becoming a public utility. This statute provides that in a submetered mobilehome park, the property owner is not subject to regulation and control of the CPUC so long as the users are charged what they would be charged by the utility company if users received their water directly from the utility company. In Santa Cruz, customers receiving their water directly from the city's water utility were charged a certain lifeline rate for the first 400 ccfs of water and a greater rate for usage over 400 ccfs of water, a readiness to serve charge of \$7.80 per month and tax on the total. In reliance on CPUC Section 2705.5, DeAnza implemented its billings on this schedule notwithstanding that it did not receive the discount for the first 400 ccfs of water because it was a commercial and not a residential customer.

A dispute with the residents ensued over the readiness to serve charge and tax thereon. The residents argued that California Civil Code Section 798.41 required that the park owner could only pass through its actual costs of water (and that the excess charges over the amount of the rent rollback were an improper rent increase) and that CPUC Section 2705.5 was not applicable. DeAnza unbundled the utility charges from rent consistent with California Civil Code Section 798.41 and it has generally been undisputed that the rent rollback was accurately calculated.

In August 1994, when the Company acquired the Property, the Company reviewed the respective legal positions of the Santa Cruz Homeowners Association ("HOA") and DeAnza and concurred with DeAnza. Their reliance on CPUC Section 2705.5 made both legal and practical sense in that residents paid only what they would pay if they lived in a residential neighborhood within the city of Santa Cruz and permitted DeAnza to recoup part of the expenses of operating a submetered system through the readiness to serve charge.

Over a period of 18 months from 1993 into May of 1995, a series of complaints were filed by the HOA and Herbert Rossman, a resident, against DeAnza, and later, the Company. DeAnza and the Company demurred to each of these complaints on the grounds that the CPUC had exclusive jurisdiction over the setting of water rates and that residents under rent control had to first exhaust their administrative remedies before proceeding in a civil action. At one point, the case was dismissed (with leave to amend) on the basis that jurisdiction was with the CPUC and, at another point, Mr. Rossman was dismissed from the case because he had not exhausted his administrative remedies.

On June 29, 1995, a hearing was held before a Santa Cruz rent control officer on the submetering of both water and sewer. The Company and DeAnza prevailed on all issues related to sewer and the rent rollback related to water, but the hearing officer determined that the Company could only pass through its actual cost of water, i.e., a prorated readiness to serve charge and tax thereon. The hearing officer did not deal with the subsidy being given to residents through the quantity charge and ordered a rebate in a fixed amount per resident. The Company and DeAnza requested reconsideration on this issue, among others, which reconsideration was denied by the hearing officer.

The Company then took a writ of mandate (an appeal from an administrative order) to the Superior Court and, pending this appeal, the residents, the Company and the City agreed to stay the effect of the hearing officer's decision until the Court rendered judgment.

In July 1996, the Superior Court affirmed the hearing officer's decision without addressing concerns about the failure to take the subsidy on the quantity charge into account.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Company requested that the City and the HOA agree to a further stay pending appeal to the court of appeals, but they refused and the appeals court denied the Company's request for a stay in late November 1996. Therefore, on January 1, 1997, the Company reduced its water charges at this Property to reflect a pass-through of only the readiness to serve charge and tax at the master meter (approximately \$0.73) and to eliminate the subsidy on the water charges. On their March 1, 1997 rent billings, residents were credited for amounts previously "overcharged" for readiness to serve charge and tax. The amount of the rebate given by the Company was \$36,400. In calculating the rebate, the Company and DeAnza took into account the previous subsidy on water usage although this issue had not yet been decided by the court of appeals. The Company and DeAnza felt legally safe in so doing based on language in the hearing officer's decision that actual costs could be passed through.

On March 12, 1997, the Company also filed an application with the CPUC to dedicate the water system at this Property to public use and have the CPUC set cost based rates for water usage. The Company believed it was obligated to take this action because of its consistent reliance on CPUC Section 2705.5 as a safe harbor from CPUC jurisdiction. That is, when the Company could no longer charge for water as the local serving utility would charge, it was no longer exempt from the CPUC's jurisdiction and control under CPUC Section 2705.5.

On March 20, 1997, the court of appeals issued the writ of mandate requested by the Company on the grounds that the hearing officer had improperly calculated the amount of the rebate (meaning the Company had correctly calculated the rent credits), but also ruling that the hearing officer was correct when he found that the readiness to serve charge and tax thereon as charged by DeAnza and the Company were an inappropriate rent increase. The court of appeals further agreed with the Company that the city's hearing officer did not have the authority under California Civil Code Section 798.41 to establish rates that could be charged in the future.

Following this decision, the CPUC granted the Company its certificate of convenience and necessity on December 17, 1998 and approved cost based rates and charges for water that exceed what residents were paying under the Company's reliance on CPUC Section 2705.5. Concurrently, the CPUC also issued an Order Instituting Investigation ("OII") confirming its exclusive jurisdiction over the issue of water rates in a submetered system and commencing an investigation into the confusion and turmoil over billings in submetered properties. Specifically, the OII states: "The Commission has exclusive and primary jurisdiction over the establishment of rates for water and sewer services provided by private entities." The CPUC has issued a tentative opinion in the OII stating its belief that legislation is necessary to clarify the issue

Specifically, the CPUC ruling regarding the Company's application stated: "The ultimate question of what fees and charges may or may not be assessed, beyond external supplier pass-through charges, for in-park facilities when a mobile home park does not adhere to the provisions of CPUC Section 2705.5, must be decided by the Commission."

After the court of appeals decision, the HOA brought all of its members back into the underlying civil action for the purpose of determining damages, including punitive damages, against the Company. The trial was continued from July 1998 to January 1999 to give the CPUC time to act on the Company's application. Notwithstanding the action taken by the CPUC in issuing the OII in December 1998, the trial court denied the Company's motion to dismiss on jurisdictional grounds and trial commenced before a jury on January 11, 1999.

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Not only did the trial court not consider the Company's motion to dismiss, the trial court refused to allow evidence of the OII or the Company's CPUC approval to go before the jury. Notwithstanding the Company's strenuous objections, the judge also allowed evidence of the Company's and DeAnza's litigation tactics to be used as evidence of bad faith and oppressive actions (including evidence of the application to the CPUC requesting a \$22.00 readiness to serve charge). The Company's motion for a mistrial based upon these evidentiary rulings was denied. On January 22, 1999, the jury returned a verdict awarding \$6.0 million of punitive damages against the Company and DeAnza. The Company had previously agreed to indemnify DeAnza on the matter.

The Company has bonded the judgment pending appeal in accordance with California procedural rules, which require a bond equal to 150% of the amount of the judgment. Post-judgment interest will accrue at the statutory rate of 10.0% per annum.

On April 19, 1999, the trial court denied all of the Company's and DeAnza's post-trial motions for judgement notwithstanding the verdict, new trial and remittitur. The trial court also awarded \$700,000 of attorneys' fees to plaintiffs. The Company has appealed the jury verdict and attorneys' fees award and this appeal has been fully briefed. The Company is awaiting notice from the court of appeal setting oral argument in the jury verdict appeal. The jury verdict appeal raises several arguments for reversal of the punitive damage award or for a new trial. One of the arguments raised by the Company in the jury verdict appeal is that punitive damages are not available in a case brought under Section 798.41 of the California Mobilehome Residency Law ("MRL") since the MRL contains its own penalty provisions. The court of appeal granted the Company's request for judicial notice of the legislative history of the applicable MRL sections, which indicates to the Company that the court of appeal is receptive to this argument. Although no assurances can be given, the Company believes the appeal will be successful.

In two previously disclosed related appeals challenging the result of the earlier litigation and an attorney's fee award of approximately \$100,000 to the plaintiffs, the court of appeal in July 2000 rejected the Company's arguments that the CPUC had exclusive jurisdiction over the issue of water rates in submetered mobilehome parks. The Company's request that the Supreme Court of California to review this matter was denied and the Company paid the attorney's fees awarded, including interest at the statutory rate thereon and appellate fees, in an amount of approximately \$185,000.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

On September 29, 1995, the United States Environmental Protection Agency ("USEPA") issued its Findings of Violations and Order for Compliance with respect to the National Pollution Discharge Elimination System ("NPDES") Permit governing the operation of the onsite waste water treatment plant at one of the Properties. On October 6, 1995, the USEPA issued its Findings of Violation and Order for Compliance with respect to the NPDES Permit governing the operation of the onsite wastewater treatment plant at another of the Properties. The Company and the USEPA have reached agreement on a resolution of the matter in which the operation of the remaining waste water treatment plant will be subject to a consent decree that will provide for fines and penalties in the event of future violations and the Company will pay a fine. The Company does not believe the impact of the settlement will be material and the Company believes it has established adequate reserves for any amounts that may be paid.

ELLENBURG COMMUNITIES

The Company and certain other parties entered into a Settlement which was filed with the Court in February 2000. In April 2000, the Court approved the Settlement which resolved substantially all of the litigation and appeals involving the Ellenburg Properties and the Settlement closed on May 22, 2000 (see also Note 4).

MANUFACTURED HOME COMMUNITIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

In connection with the Ellenberg Acquisition, on September 8, 1999, Ellenburg Fund 20 ("Fund 20") filed a cross complaint in the Ellenburg dissolution proceeding against the Company and certain of its affiliates alleging causes of action for fraud and other claims in connection with the Ellenburg acquisition. The Company subsequently successfully had the cross complaint against the Company and its affiliates dismissed with prejudice by the California Superior Court. However, Fund 20 has appealed. The Company believes Fund 20's allegations are without merit and will vigorously defend itself.

## CANDLELIGHT PROPERTIES, L.L.C.

In 1996, 1997 and 1998, the Lending Partnership made a loan to Candlelight Properties, L.L.C. ("Borrower") in the principal amount of \$8,050,000. The loan is secured by a mortgage on Candlelight Village ("Candlelight"), a Property in Columbus, Indiana, and is guaranteed by Ronald E. Farren ("Farren"), the 99% owner of Borrower. The Company accounts for the loan as an investment in real estate and, accordingly, Candlelight's results of operations are consolidated with the Company's for financial reporting purposes. Concurrently with the funding of the loan, Borrower granted the Operating Partnership the option to acquire Candlelight upon the maturity of the loan. The Operating Partnership notified Borrower that it was exercising its option to acquire Candlelight in March 1999, and the loan subsequently matured on May 3, 1999. However, Borrower failed to repay the loan and refused to convey Candlelight to the Operating Partnership.

Borrower filed suit in the Superior Court of Bartholomew County, Indiana ("Court") on May 5, 1999, seeking a declaratory judgment on the validity of the exercise of the option. The Lending Partnership filed suit in the Court the next day, seeking to foreclose its mortgage, and the suits were consolidated (collectively, the "State Court Litigation") by the Court. The Court issued an Order on December 1, 1999, finding, among other things, that the Operating Partnership had validly exercised the option. Both parties filed motions to correct errors in the Order, and on May 15, 2000, the Court issued judgments against Borrower and Farren and in favor of the Operating Partnership in the option case and the Lending Partnership in the foreclosure case. Borrower and Farren have appealed both judgments, and the court has stayed the judgments pending such appeals. The Operating Partnership and the Lending Partnership intend to continue vigorously pursuing this matter and believe that, while no assurance can be given, such efforts will be successful.

On May 3, 2000, Hanover Group, Inc. ("Hanover") and Farren filed suit against the Company and certain executive and senior officers of the Company in the United States District Court for the Southern District of Indiana, Indianapolis Division. The complaint alleges violations of securities laws and fraud arising from the loan transaction being litigated in the State Court Litigation and seeks damages, including treble damages. The Company believes that the complaint is related to rulings made by the Court and is without merit. The Company has filed a motion for judgment on the pleadings, and will vigorously defend itself and the officers of the Company.

On May 24, 2000, Hanover and Farren filed suit against the Operating Partnership in the Superior Court of Marion County, Indiana. The complaint seeks declaratory relief and specific performance with respect to the Operating Partnership's alleged obligation to reconvey to Hanover the Operating Partnership's 1% ownership interest in Borrower. The Company believes that the complaint is related to rulings made by the Court and is without merit. The parties have agreed to a stay in this proceeding pending the outcome of the appeals in the State Court Litigation.

The Company is involved in various other legal proceedings arising in the ordinary course of business. All proceedings herein described or referred to, taken together, are not expected to have a material adverse impact on the Company.

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

OVERVIEW

The following is a discussion of the interim results of operations, financial condition and liquidity and capital resources of the Company for the three months and nine months ended September 30, 2000 compared to the corresponding period in 1999. It should be read in conjunction with the Consolidated Financial Statements and Notes thereto included herein and the 1999 Form 10-K. The following discussion may contain certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect management's current views with respect to future events and financial performance. Such forward-looking statements are subject to certain risks and uncertainties, including, but not limited to, the effects of future events on the Company's financial performance, the adverse impact of external factors such as inflation and consumer confidence, and the risks associated with real estate ownership.

RESULTS OF OPERATIONS

COMPARISON OF THE QUARTER ENDED SEPTEMBER 30, 2000 TO THE QUARTER ENDED SEPTEMBER 30, 1999

Since December 31, 1998, the gross investment in real estate has decreased from \$1,237 million to \$1,213 million. The total number of sites owned or controlled has decreased from 53,391 as of December 31, 1998 to 51,437 as of September 30, 2000. These changes reflect the following property acquisitions and dispositions (the sale of FFEC-Six had no effect on the number of sites owned or controlled):

- (i) The Meadows - acquired on April 1, 1999
- (ii) Coquina Crossing - acquired on July 23, 1999
- (iii) FFEC-Six (water and wastewater service company) - sold on February 29, 2000
- (iv) Mesa Regal RV Resort - sold on May 19, 2000
- (v) Naples Estates - sold on May 19, 2000
- (vi) Mon Dak - sold on May 19, 2000

The Company defines its core manufactured home community portfolio ("Core Portfolio") as manufactured home properties owned as of the beginning of both periods of comparison. Excluded from the Core Portfolio are the aforementioned acquisitions and dispositions and also the recreational vehicle ("RV") properties which, together, are referred to as the "Non-Core" Properties.

The following table summarizes certain weighted average statistics for the quarters ended September 30, 2000 and 1999.

	CORE PORTFOLIO		TOTAL PORTFOLIO	
	2000	1999	2000	1999
Total sites	45,888	45,807	46,718	47,073
Occupied sites	43,438	43,148	44,093	44,251
Occupancy %	94.7%	94.2%	94.4%	94.0%
Monthly base rent per site	\$357.85	\$344.44	\$356.95	\$343.50

## RESULTS OF OPERATIONS (CONTINUED)

Base rental income (\$47.2 million) increased \$1.6 million or 3.5%. For the Core Portfolio, base rental income (\$46.6 million) increased approximately \$2.0 million or 4.6%, primarily due to increased base rental rates. The remaining \$430,000 decrease in base rental income reflects an increase of \$146,000 attributable to the Properties acquired in 1999 and a decrease of \$577,000 related to the Properties sold in 2000.

Monthly base rent per site for the total portfolio increased 3.9%, reflecting a 3.9% increase in monthly base rent per site for the Core Portfolio and slightly higher monthly base rents for the Properties acquired in 1999.

Weighted average occupied sites for the total portfolio decreased by 158 sites resulting in a 0.4% increase in occupancy, due to the disposition of Mesa Regal RV Resort, Naples Estates and Mon Dak. Core Portfolio occupancy increased 0.5% reflecting an increase in weighted average occupied sites of 290 sites.

RV base rental income (\$560,000) decreased \$1.2 million or 67.6% primarily due to the sale of Mesa Regal RV Resort.

Utility and other income (\$4.9 million) increased \$226,000 or 4.8%. Within the Core Portfolio, utility and other income (\$4.6 million) increased \$598,000 primarily due to higher utility income - an increase which is reflected in higher utility expense for the quarter for the Core Portfolio. This increase is offset by a \$372,000 decrease attributable to the net effect of properties sold in 2000.

Interest income (\$267,000) decreased \$285,000 or 51.6%, primarily due to the repayment of certain notes receivable and a decrease in interest earned on short-term investments. Short-term investments had average balances for the quarters ended September 30, 2000 and 1999 of approximately \$1.2 million and \$1.6 million, respectively, which earned interest income at an effective rate of 6.8% and 5.3% per annum, respectively. As of September 30, 2000, the Company had cash and cash equivalents and short-term investments of \$6.3 million.

Property operating and maintenance expenses (\$14.7 million) increased \$229,000 or 1.6% reflecting a \$708,000 decrease attributable to the Properties sold in 2000 and a \$132,000 increase attributable to Properties acquired in 1999. Expenses at the Core Portfolio (\$13.8 million) increased \$813,000 or 6.2%. Property operating and maintenance expenses represented 27.2% of total revenues in 2000 and 26.9% in 1999.

Real estate taxes (\$4.1 million) decreased \$67,000 or 1.6%, which was primarily attributable to the Non-Core Properties. Core Portfolio real estate tax expense (\$3.9 million) increased \$16,000 or 0.4%. Real estate taxes represented 7.6% of total revenues in 2000 and 7.8% in 1999.

Property management expenses (\$2.1 million) decreased \$6,000 or 0.3%. The decrease was primarily due to management staffing changes and partially offset by incremental management costs. Property management expenses represented 3.8% of total revenues in 2000 and 3.9% in 1999.

General and administrative expense ("G&A") (\$1.3 million) decreased \$63,000 or 4.5%. G&A represented 2.5% of total revenues in 2000 and 2.6% in 1999.



## RESULTS OF OPERATIONS (CONTINUED)

Interest and related amortization (\$13.2 million) decreased \$796,000 or 5.7%. The decrease was due to lower weighted average outstanding debt balances during the period, partially offset by a slightly increased effective interest rate. The weighted average outstanding debt balances for the quarters ended September 30, 2000 and 1999 were \$690.3 million and \$761.3 million, respectively. The effective interest rates were 7.5% and 7.3%, respectively. Interest and related amortization represented 24.4% of total revenues in 2000 and 26.1% in 1999.

Depreciation on corporate assets (\$291,000) increased \$39,000 or 15.5%. The increase was due to fixed asset purchases related to computer software upgrades. Depreciation on corporate assets represented 0.5% of total revenues in both 2000 and 1999.

Depreciation on real estate assets and other costs (\$8.5 million) decreased \$297,000 or 3.4% as a result of the disposition of Properties in 2000. Depreciation on real estate assets and other costs represented 15.8% of total revenues in 2000 and 16.4% in 1999.

## COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2000 TO THE NINE MONTHS ENDED SEPTEMBER 30, 1999

The following table summarizes certain weighted average statistics for the nine months ended September 30, 2000 and 1999.

	CORE PORTFOLIO		TOTAL PORTFOLIO	
	SEPTEMBER 30, 2000	SEPTEMBER 30, 1999	SEPTEMBER 30, 2000	SEPTEMBER 30, 1999
Total sites	45,855	45,810	47,043	46,789
Occupied sites	43,267	43,077	44,262	43,992
Occupancy %	94.4%	94.0%	94.1%	94.0%
Monthly base rent per site	\$357.11	\$343.57	\$355.90	\$343.62

Base rental income (\$141.8 million) increased \$6.1 million or 4.5%. For the Core Portfolio, base rental income (\$139 million) increased approximately \$5.9 million or 4.4%, due primarily to increased base rental rates. The remaining \$272,000 increase in base rental income reflects an increase of \$1.0 million attributable to the Properties acquired in 1999 and a decrease of \$737,000 related to the Properties sold in 2000.

Monthly base rent per site for the total portfolio increased 3.6%, primarily due to increased monthly base rent per site for the Core Portfolio.

Weighted average occupied sites for the total portfolio decreased by 270 sites creating a 0.1% increase in occupancy. Core Portfolio occupancy increased 0.4% reflecting an increase in weighted average occupied sites of 190 sites.

RV base rental income (\$5.4 million) decreased \$1.4 million or 20.5% primarily due to the sale of Mesa Regal RV Resort.

## RESULTS OF OPERATIONS (CONTINUED)

Utility and other income (\$15.7 million) increased \$107,000 or 0.7%, primarily attributable to the Core Portfolio. Within the Core Portfolio, utility and other income (\$13.5 million) increased \$400,000 primarily due to increased real estate pass through and other income. Other income includes a gain on the sale of FFEC-Six of \$719,000, partially offset by an impairment loss on the DeAnza Santa Cruz water and wastewater service company of \$701,000 as discussed in Note 4 to the Consolidated Financial Statements.

Interest income (\$731,000) decreased \$396,000 or 35.1%, primarily due to the repayment of certain notes receivable and a decrease in interest earned on short-term investments. Short-term investments had average balances for the nine months ended September 30, 2000 and 1999 of approximately \$1.5 million and \$3.1 million, respectively, which earned interest income at an effective rate of 5.9% and 4.6% per annum, respectively.

Property operating and maintenance expenses (\$44.5 million) increased \$1.3 million or 3.0% reflecting a \$1.2 million decrease attributable to the Properties sold in 2000 and a \$687,000 increase attributable to Properties acquired in 1999. Expenses at the Core Portfolio (\$40.5 million) increased \$1.9 million or 4.9%. Property operating and maintenance expenses represented 26.9% of total revenues in both 2000 and 1999.

Real estate taxes (\$12.8 million) increased \$246,000 or 2.0%, which was primarily attributable to the Core Portfolio. Core Portfolio real estate tax expense (\$12.2 million) increased \$209,000 or 1.7%. Real estate taxes represented 7.8% of total revenues in both 2000 and 1999.

Property management expenses (\$6.6 million) increased \$438,000 or 7.1%. The increase was primarily due to management staffing changes and incremental management costs related to the addition of Properties acquired in 1999 and 1998. Property management expenses represented 4.0% of total revenues in 2000 and 3.9% in 1999.

General and administrative expense ("G&A") (\$5.0 million) increased \$439,000 or 9.6%. The increase was primarily due to timing of certain public company costs, legal costs related to an effort to obtain an IRS ruling regarding income from RV Properties and increased payroll. G&A represented 3.0% of total revenues in 2000 and 2.8% in 1999.

Interest and related amortization (\$39.7 million) decreased \$1.2 million or 2.9%. The decrease was due to lower weighted average outstanding debt balances during the period, partially offset by a slightly increased effective interest rate. The weighted average outstanding debt balances for the nine months ended September 30, 2000 and 1999 were \$720.0 million and \$750.6 million, respectively. The effective interest rates were 7.2% and 7.2%, respectively. Interest and related amortization represented 24.0% of total revenues in 2000 and 25.5% in 1999.

Depreciation on corporate assets (\$839,000) increased \$107,000 or 14.6%. The increase was due to fixed asset purchases related to computer software upgrades. Depreciation on corporate assets represented 0.5% of total revenues in both 2000 and 1999.

Depreciation on real estate assets and other costs (\$25.9 million) increased \$583,000 or 2.3% as a result of the addition of the Properties purchased in 1999. Depreciation on real estate assets and other costs represented 15.7% of total revenues in both 2000 and 15.8% in 1999.

## LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents decreased by \$399,000 when compared to December 31, 1999.

Net cash provided by operating activities decreased \$3.6 million from \$63.2 million for the nine months ended September 30, 1999 to \$59.6 million for the nine months ended September 30, 2000. This decrease reflects an extraordinary loss on early retirement of debt of \$1.3 million, a gain of \$12.0 million on the sale of Properties and other, increased prepaid expenses and other non-cash items, and a \$4.8 million decrease in funds from operations ("FFO"), as discussed below.

FFO was redefined by the National Association of Real Estate Investment Trusts ("NAREIT") in October 1999, effective January 1, 2000, as net income (computed in accordance with generally accepted accounting principles ["GAAP"]), before allocation to minority interests, excluding gains (or losses) from sales of property, plus real estate depreciation and after adjustments for unconsolidated partnerships and joint ventures. The Company computes FFO in accordance with the NAREIT definition, which may differ from the methodology for calculating FFO utilized by other equity REITs and, accordingly, may not be comparable to such other REITs. Funds available for distribution ("FAD") is defined as FFO less non-revenue producing capital expenditures and amortization payments on mortgage loan principal. The Company believes that FFO and FAD are useful to investors as a measure of the performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, they provide investors an understanding of the ability of the Company to incur and service debt and to make capital expenditures. FFO and FAD in and of themselves do not represent cash generated from operating activities in accordance with GAAP and therefore should not be considered an alternative to net income as an indication of the Company's performance or to net cash flows from operating activities as determined by GAAP as a measure of liquidity and are not necessarily indicative of cash available to fund cash needs.

## LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

The following table presents a calculation of FFO and FAD for the quarters and nine months ended September 30, 2000 and 1999 (amounts in thousands):

	QUARTERS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30, 2000	1999	SEPTEMBER 30, 2000	1999
<b>COMPUTATION OF FUNDS FROM OPERATIONS:</b>				
Income before extraordinary loss on early extinguishment of debt .....	\$ 5,451	\$ 6,877	\$ 26,742	\$ 22,074
Income allocated to Common OP Units .....	1,451	1,509	6,822	4,862
Gain on sale of Properties and other .....	---	---	(12,053)	---
Depreciation on real estate assets and other costs .....	8,510	8,807	25,934	25,351
Funds from operations .....	<u>\$ 15,412</u>	<u>\$ 17,193</u>	<u>\$ 47,445</u>	<u>\$ 52,287</u>
Weighted average Common Shares outstanding - diluted .....	<u>27,077</u>	<u>31,586</u>	<u>27,706</u>	<u>31,915</u>
<b>COMPUTATION OF FUNDS AVAILABLE FOR DISTRIBUTION:</b>				
Funds from operations .....	\$ 15,412	\$ 17,193	\$ 47,445	\$ 52,287
Non-revenue producing improvements - rental properties .....	(2,470)	(2,901)	(5,366)	(6,519)
Funds available for distribution .....	<u>\$ 12,942</u>	<u>\$ 14,292</u>	<u>\$ 42,079</u>	<u>\$ 45,768</u>
Weighted average Common Shares outstanding - diluted .....	<u>27,077</u>	<u>31,586</u>	<u>27,706</u>	<u>31,915</u>

Net cash provided by (used in) investing activities increased \$68.3 million from \$(31.3) million for the nine months ended September 30, 1999 to \$36.9 million for the nine months ended September 30, 2000 primarily due to the Settlement regarding the Ellenburg Properties (see Note 4 and Note 8 to the Consolidated Financial Statements) whereby the Company received total cash proceeds of \$53.5 million, the sale of the FFEC-Six water and wastewater service company and the acquisition of Properties in 1999, partially offset by the repayment of notes receivable in 1999 and increased contributions to affiliates in 2000.

Capital expenditures for improvements were approximately \$9.9 million for the nine months ended September 30, 2000 compared to \$9.7 million for the nine months ended September 30, 1999. Of the \$9.9 million, approximately \$5.4 million represented improvements to existing sites. The Company anticipates spending approximately \$2.3 million on improvements to existing sites during the remainder of 2000. The Company believes these improvements are necessary in order to increase and/or maintain occupancy levels and maintain competitive market rents for new and renewing residents. The remaining \$4.5 million represented \$4.2 million in costs to develop expansion sites at certain of the Company's Properties and \$357,000 of other corporate headquarters costs. The Company is currently developing an additional 10 sites which should be available for occupancy in 2000.

Net cash used in financing activities increased \$76.6 million from \$20.4 million for the nine months ended September 30, 1999 to \$96.9 million for the nine months ended September 30, 2000, primarily due to the timing of distributions to Common Stockholders and Common OP Unitholders and net repayments on the line of credit with proceeds from the Settlement.

## LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

Distributions to Common Stockholders and Common OP Unitholders increased approximately \$17.1 million due to the timing of the fourth quarter 1999 dividend payment. On April 14, 2000, July 14, 2000 and October 13, 2000, the Company paid a \$.415 per share distribution for the quarters ended March 31, 2000, June 30, 2000 and September 30, 2000, respectively, to stockholders of record on March 31, 2000, June 30, 2000 and September 29, 2000, respectively. Return of capital on a GAAP basis was \$0.135 per share, \$0.00 per share, and \$.0155 per share for the first, second and third quarters of 2000, respectively.

The Company expects to meet its short-term liquidity requirements, including its distributions, generally through its working capital, net cash provided by operating activities and availability under the existing line of credit. The Company expects to meet certain long-term liquidity requirements such as scheduled debt maturities, property acquisitions and capital improvements by long-term collateralized and uncollateralized borrowings including borrowings under its existing line of credit and the issuance of debt securities or additional equity securities in the Company, in addition to working capital.

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement No. 133 ("SFAS No. 133"), "Accounting for Derivative Instruments and Hedging Activities", which is required to be adopted in years beginning after June 15, 1999. SFAS No. 133 permits early adoption as of the beginning of any fiscal quarter after its issuance. In June 1999, the FASB issued Statement No. 137 which deferred the effective date of SFAS No. 133 to all fiscal quarters for fiscal years beginning after June 15, 2000. The Company has not yet determined the date at which it will adopt SFAS No. 133. SFAS No. 133 will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company has not yet determined what the effect of SFAS No. 133 will be on the earnings and financial position of the Company, when implemented.

## PART II - OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

(see Note 8 of the Consolidated Financial Statements contained herein)

## ITEM 5. OTHER INFORMATION

On May 9, 2000, the Board of Directors of the Company appointed Thomas P. Heneghan as the Company's President and Chief Operating Officer. Mr. Heneghan, 36, has served for the last five years as the Company's Chief Financial Officer. Gary Powell, the Company's Executive Vice President of Property Operations became President and Chief Executive Officer of the Company's sales and marketing affiliate, Realty Systems Inc. In addition, the Board of Directors of the Company appointed John M. Zoeller as Vice President and Chief Financial Officer of the Company. Mr. Zoeller, 39, has over 18 years of accounting experience including 12 years with various affiliates of Equity Group Investments. Mr. Zoeller, a CPA, holds a BS in Accounting from the University of Illinois, Champaign - Urbana.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

## (a) Exhibits:

27 Financial Data Schedule

## (b) Reports on Form 8-K:

None.

## 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.

MANUFACTURED HOME COMMUNITIES, INC.

BY: /s/ John M. Zoeller  
-----  
John M. Zoeller  
Vice President, Treasurer and  
Chief Financial Officer

BY: /s/ Mark Howell  
-----  
Mark Howell  
Principal Accounting Officer and  
Assistant Treasurer

DATE: November 10, 2000

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