3D ADVISORS

This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues
✓ **Fundamentals:** Analysis of fundamentals
Deception: Deception detection analysis

As Headwinds Build, Executive Behaviors Revealing Equity LifeStyle Properties Inc. (NYSE:ELS)

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Business Description

Equity LifeStyle Properties Inc. is a publicly owned real estate investment trust (REIT). The firm engages in the ownership and operation of lifestyle oriented properties. Its portfolio of properties include various amenities and common facilities, such as a clubhouse, a swimming pool, laundry facilities, and cable television service, sauna/whirlpool spas, golf courses, tennis, shuffleboard and basketball courts, and exercise rooms. The firm leases developed sites to owners of manufactured homes referred to as resort homes, park models referred to as resort cottages, and recreational vehicles. It primarily invests in the markets of the United States. The firm was founded in 1992 and is based in Chicago, Illinois with additional offices in Clearwater, Florida, Phoenix, Arizona, and Aurora, Colorado.

Key Statistics

Sector:	Last Close:	Market Cap:	Avg Vol (3m):
Financial	**$44.27**	**$1.34B**	**375,720**
Industry:	52 Wk Range:	Trailing P/E:	Shrs Out:
REIT - Residential	**$22.61-$54.00**	**62.53**	**30.32M**
F/T Employees:	FYE:	Forward P/E:	Short % of Float:
3,000	**31-Dec**	**12.83**	**8.30%**

Summary of 3DAdvisors Findings for ELS

- **Fundamentals:** Recession has created multiple obstacles to near-term growth
- **Accounting:** Despite obfuscation, offering was to bolster weak balance sheet
- **Fundamentals:** Acquisition leads to more RV exposure, accounting questions
- **Accounting:** Reclassification of inventory looks like effort to avoid impairment
- **Insider Trading:** In a rare convergence of action, insiders cut exposure to shares
- **Governance:** Related-party and compensation issues lead list of questions

Discussion of 3DAdvisors Findings for ELS

The description alone of ELS, whose operations include providing developed sites to owners of manufactured homes and recreational vehicles, raised a few eyebrows among us even before we commenced our detailed analysis of the Company. Never mind the extremely rare convergence of insider selling, both before and after the Company's August secondary and its long list of "interesting" related-party dealings involving the likes of **Sam Zell** (largest ELS shareholder) and President **Joe McAdams** with whom the Company recently completed a thinly-disclosed acquisition. The condition of the Company's balance sheet, in addition to the tenuous nature of operating a business such as this in the current economic climate, tells quite a story which may go a long way in explaining the recent pickup in insider selling into a flat stock price.

Figure 1. ELS Daily Closing Price, 01/03/08 through 09/25/09. Source: Reuters.

The Company markets its offerings as "lifestyle oriented properties" designated for "retirees, empty-nesters, vacationers and second home owners". In the Company's SEC Form 10-K filings, however, it also mentions that "certain of our Properties focus on affordable housing for families". A look into the Company website does little to describe the lower tier of renter implied by this alternative classification. Indeed, a glance at the Company's website (www.equitylifestyle.com) provides nothing short of a showcase of resort venues, replete with golf courses, beautiful views and upscale retirees enjoying their slice of The Good Life. Reality, we would submit, presents a different picture.

Company management is quick to tout its stable revenues, "our quality real estate locations, the positive demographic trend of baby boomers and retirees and the flexibility of our housing and lifestyle offerings" in its conference calls. Beneath it all, however, the Company is dealing with an environment where it has very little pricing power (read: ability to increase rents), a stagnant revenue base, tepid cash flow generation and a highly leveraged balance sheet. We start with a review of the many headwinds the current recession represents to any significant growth in the near term.

Fundamentals: Recession has created multiple obstacles to near-term growth

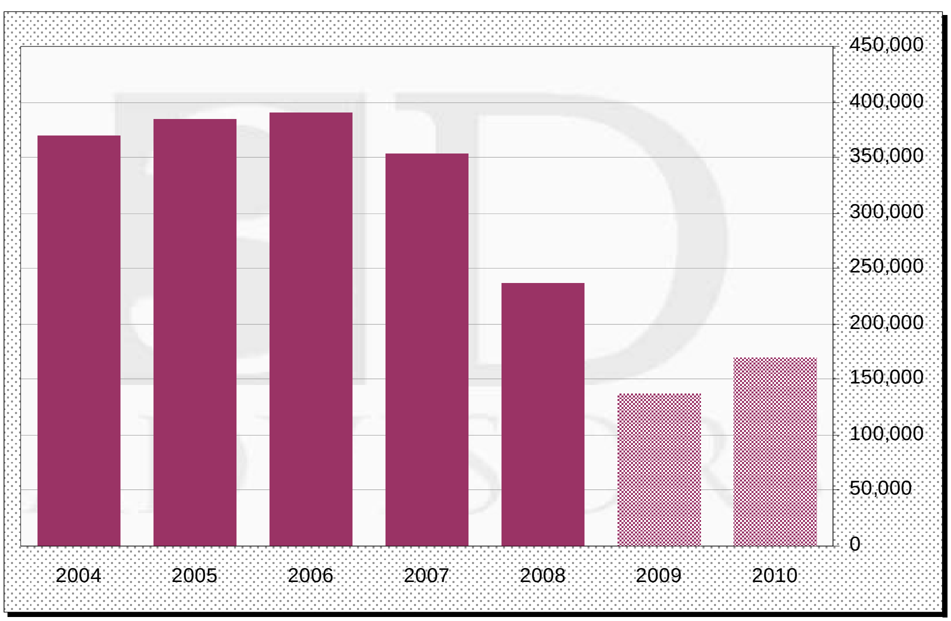
The collapse of the housing market and the severity, duration and geographic concentration of the recession have created multiple headwinds that will make it difficult if not impossible for the Company to grow revenues to any significant degree through at least 2010 and probably beyond. The Company's top brass uses a variety of negative phrases in the opening comments of most recent conference calls to describe the current operating environment including, "this continues to be a challenging environment", "we continue to assume zero occupancy growth", and "we continue to experience member attrition." Here is a brief overview of the obstacles facing the Company as it struggles to find growth in a weak economic environment.

Recreational vehicle and manufactured home markets have been decimated

Not surprising to management, nor should it be to investors, are the dynamics of the recreational vehicle (RV) market. The overall health of the RV market is important to the Company, especially since the acquisition of assets from Privileged Access in August 2008 (more on PA below). For the quarter ended 06/30/09, approximately 35% of property operations revenue was derived from RV site rentals and "right-to-use" contracts paid by RV owners to reserve site space at different times of the year.

According to the RVIA (Recreation Vehicle Industry Association) RV shipments in 2008 declined 32.9% from 2007 levels with a total of 237,000 units shipped. In 2009 only 72,700 RV units were shipped through 06/30/09; a decline of 55.3% from the same period in 2008.

Figure 2. RV Unit Shipments, 2004 through 2008; RVIA Forecasts for 2008 and 2009. Source: Recreation Vehicle Industry Association (RVIA).



Although the RVIA expects shipments to reach 137,000 for 2009 and 169,500 units in 2010, these figures are a far cry from the nearly 375,000 units that were shipped on average between 2004 and 2007. In fact, management acknowledges the difficult dynamics that the industry has been facing in its three most recent conference calls. Furthermore, similar trends are also present in the manufactured home market. CEO **Tom Heneghan** highlights on the 4Q08 conference call that "in 2008 the manufactured home lending and manufacturing complex experienced the lowest transactional volume since records were kept in 1959. And it looks like 2009 will be even worse." And even before the hit taken by the manufactured home industry in the current recession, the Company said in the 2Q09 SEC Form 10-Q that, "our [manufactured] home sales volumes and gross profits have been declining since 2005", suggesting significant problems were brewing long before the start of the current recession.

In August of 2008, ELS exercised its option to purchase the assets of a significant customer, Privileged Access (PA). The main asset acquired from PA was Thousand Trails (TT) whose primary business consisted of selling right-to-use contracts entitling purchasers to use properties, 82 of which are owned by ELS. These right-to-use Agreements relate to sites designated for the placement of recreational vehicles and were generally three years in length (more on the length of these below), and thus the PA asset acquisition substantially increased the share of revenue derived from RV rentals. They require non-refundable upfront payments (as well as annual submissions) which have allowed the Company to begin building a deferred revenue account, but this new addition comes just as the economy and the RV market were falling off a cliff.

Locations in areas hard hit by recession; characterization of clients misleading

Exacerbating the challenges facing the Company is the fact that of 308 properties it owned as of 06/30/09 that were spread across 28 states, 55% of the properties were located in Florida (28%), California (16%) and Arizona (11%). With an unhealthy geographic concentration in areas of the country most affected by the collapse of the housing market and now high levels of unemployment and depressed economic activity, we really began to wonder about growth prospects and how the Company and sell-side analysts have portrayed the typical ELS customer.

The Company touts its customer base as being comprised of upscale, mobile baby boomers at or near retirement age looking for second home opportunities or for amenity-rich RV sites in desirable, sunny locations. The pictures on the Company's website feature scenes of attractive locations and older adults playing golf, strolling well manicured grounds, etc. And while this may be an accurate depiction of some locations, it is not what we found in our small sampling of the Company's facilities. We visited four locations in Broward County, FL (Ft. Lauderdale). It would be hard to describe the renters as "upscale" or even that they are retirees; age limits did not exist at three of the four locations. Each place had much more of a "blue collar" feel and was replete with pick up trucks, pink flamingos and lawn jockeys. We also noticed numerous "for sale" signs posted.

None of the properties we visited in Florida, the state with the highest concentration of Company locations, fits the description of BMO Capital Markets senior analyst **Paul Adornato** who was quoted in an interesting puff piece on the Company published this past February:

> "They're surprisingly nice," said BMO analyst Adornato, who has visited Equity Lifestyle properties. "They're upscale retirees. These are folks that are a generally stable part of the economy." [1]

We suppose the term "upscale" could be considered relative, but it is not how we would necessarily describe an individual who pays $30,000 for a manufactured home and then putting it on a site where they pay $600 to $1,000/month. Nor would we consider a customer base as "upscale retirees" in a situation where rental increases are limited by increases in the CPI or rent control regulations (more on limitations on rent below). Although we hardly did an exhaustive investigation and thus our observations are anecdotal at best, the sites we visited in Florida were very different from the glitzy photos shown on the Company's website or the description given by management or Mr. Adornato. Most of our clients would not be surprised to learn that BMO Capital Markets was part of the syndicate in the Company's last secondary offering (more on the offering below).

Core revenue growth was flat before recession; rent increases are limited by CPI

Even before the PA acquisition, ELS had evolved into a property management company as related revenues now account for 96% of the Company's total vs. 80% in 2006, primarily due to its exit from selling manufactured homes.

Composition of ELS Revenue (millions $)*	2006	2007	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09
Property Operating Revenues	346.4	376.2	106.4	94.3	108.3	110.3	419.4	124.4	116.1
Rev from Inventory Home Sales	61.2	33.3	6.2	6.8	5.3	3.6	21.9	1.2	1.7
Brokered Resale Revenues, net	2.1	1.53	.367	.301	.237	.19	1.1	.186	.199
Ancillary Services Rev, net	3.0	2.44	1.45	-.327	.607	-.53	1.2	1.16	.418
Interest Income	2.0	1.7	.387	.294	.885	1.53	3.1	1.4	1.22
Income from other investments	20.1	22.5	6.9	6.71	2.78	0.61	17.0	2.52	1.87
Total	**434.9**	**437.7**	**121.7**	**108.1**	**118.1**	**115.7**	**463.6**	**130.8**	**121.5**

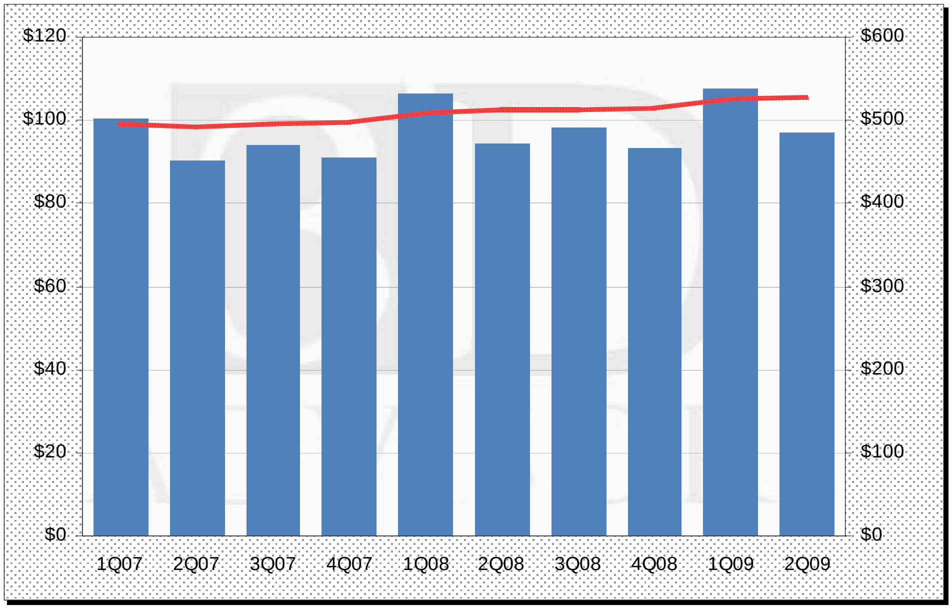
*Note all the competitors include interest income and income from other investments in total revenue. Revenue components have been taken from the financial statements corresponding to the period. Quarterly revenues disclosed in the 2008 SEC Form 10-K at times do not match subsequent 10Qs.

Clearly with property management, the ability to increase prices (i.e. rents) can be a potentially significant factor in contributing to revenue growth. However, Figure 2

[1] Shellnutt, Kate, "While Factories Fail, Owner of Manufactured-Home and RV Communities Stands Tall", Medill Reports Chicago, February 17, 2009.

below highlights how little movement there has been in both core property operating revenue (before considering the impact of the addition of Privileged Access) and average per unit rents since the 1Q07. And even if the Company had the pricing power to raise rents to generate more revenue, any increases are significantly limited by the growth in consumer prices.

Figure 2. ELS Property Operating Revenues Without Privileged Access (Blue Bars, Left Scale, Millions $), Average Rent per Unit (Red Line, Right Scale). Source: ELS SEC Filings.



CEO Tom Heneghan reminds us on the 2Q09 conference call that ELS has "about a third of our rent agreements directly tied to CPI and another third that we negotiate with homeowners' associations that in many cases have some tie to CPI as well with another third kind of market driven." On the 4Q08 conference call CEO Heneghan states in his opening comments that the CPI data for December 2008 reflected no price inflation. However, given that most of the price increases were already in place for the 2009 calendar year, the sideways to negative trend in the CPI index is expected "to be more of a 2010 issue." Later in the call an analyst specifically asks about the impact of the CPI on revenue growth [bolding is ours]:

> **Analyst:** Okay. Last question, with CPI growth having slowed substantially, looking ahead to mid-summer when you guys send out your annual rent notices for 2010 is there a floor for rent growth or could rent growth conceivably even be negative if say, CPI were to have negative growth?
>
> **Tom Heneghan, CEO:** You know that is a state-by-state and agreement-by-agreement type of analysis. But, no generally it doesn't go below zero and in many cases there are floors in place with respect to a minimum increase of say, $5 or CPI, whichever is higher, or any minimum increase of, say, 3% within the agreements we have with our customers. Without getting too much into it, please appreciate it that at July of last year it was 6% and December it's 0%. With what is going on in the monetary creation side, who knows what it's going to

be come January – or excuse me, come July of 2009. **But yes, we are focused on it and it will have an impact on our revenue growth.**

According to the recent 1Q09 and 2Q09 conference calls, ELS has begun to "model expectations of zero and even negative price changes" and perhaps brace itself for that impact on revenue growth. On both calls, management is fairly forthright in the fact that they are currently expecting zero percent occupancy growth and 1% rent growth that includes the mix of CPI agreements on rent. Interestingly, if we look at the monthly year-over-year percent changes in the unadjusted CPI (All Items) from 1999 to the present we can see that the percent changes fell into negative territory for the first time in March of 2009. The table below shows the year-over-year percent change in the CPI Index – All Items, reported monthly for the years 2008 and 2009.[2] The precipitous decline from its peak in July of 2008 is quite staggering and reinforces Heneghan's comment that price increases, or the lack thereof, will be an issue for 2010.

Unadjusted % Change in CPI Index (All Items) from Year Ago Month	2008	2009
January	4.3	0.0
February	4.0	0.2
March	4.0	-0.4
April	3.9	-0.7
May	4.2	-1.3
June	5.0	-1.4
July	5.6	-2.1
August	5.4	-1.5
September	4.9	
October	3.7	
November	1.1	
December	0.1	

With rent increases under approximately two-thirds of the Company's rental agreements limited in some fashion by the rate of inflation, the near-term outlook for achieving any growth from increasing rents is almost non-existent and in fact we wonder if rents might contract rather than grow. And even if inflation does pick up soon as many believe due to an extraordinarily accommodative monetary policy, the Company has shown it has little in the way of pricing power anyway. That does not come as a surprise

[2] U.S. Department of Commerce, Bureau of Labor Statistics, "Consumer Price Index for All Urban Consumers (CPI-U). For the August 2009 report, see: http://www.bls.gov/cpi/cpid0908.pdf

to us given that the customers appear to be of much more modest means than what the Company and sell-side analysts want us to believe.

Accounting: Despite obfuscation, offering was to bolster weak balance sheet

On May 6th of this year, ELS filed a shelf registration for the potential sale of Company shares. CFO **Michael Berman** explained the rationale behind the planned registration in the 1Q09 conference call on April 21st:

> ELS is all about financial flexibility and in this environment that needs to include raising equity capital, particularly if investment opportunities present themselves. We are one of the only REITs not to have a Shelf, and we expect to change that this quarter. We have no current intention to issue any equity securities, but want to be able to act as quickly as possible should the need arise.

Less than seven weeks after the filing of the shelf registration, the Company would sell 4.6 million shares. ELS shares, which had closed at $37.85 before the prospectus was released, submitted to pressure on the news of the deal and traded down 11% to $33.74. The offering was ultimately priced at $33.35. The 30-day lock-up period was not only short but seemed to correspond nicely with the earnings blackout period already in force due to the Company's regular trading policy. By timing the lock-up period's expiration just a few days after the close of the normal post-2Q09 earnings release trading blackout, ELS insiders effectively skirted the spirit of the normal post-secondary lock-up. Indeed, led by CFO Berman, they began selling the day after the lock-up expiration (more details below).

Since the offering, no particular "investment opportunity" seems to have surfaced to cause the sale of shares so quickly after the filing of the shelf registration. Consequently, investors who took Berman's above explanation to heart that the Company upon the filing of the registration had "no current intention to issue any equity securities" may find a more reliable justification by taking a closer look at the balance sheet, which is not much to write home about.

Highly leveraged, the Company finds itself paying out nearly half of its operating profit to interest expense. As a consequence of its heavy debt load, ELS sees only about $0.04 of every revenue dollar flowing to the bottom line. Equity represents just 4% of total assets and Mortgage Notes Payable alone is equivalent to 75% of total assets. Prior to the 2Q09 equity offering, the Company held just $16.7 million in cash and equivalents, leaving very little cushion should it suffer any significant drop in rental revenues. Carrying value of its land and related improvements before depreciation was $2.5 billion at 06/30/09 with Mortgage Notes Payable totaling $1.6 billion. The equity infusion of just under $147 million enabled the Company to pay down its 12/31/09 outstanding amount of unsecured lines of credit.

Adding some additional risk to the picture is the fact that lease agreements between the Company and most customers are month-to-month. Although there are some leases that are non-cancellable, in 2009 the minimum rents from such leases total just $72 million. Consequently, not much of the revenue stream is protected from a prolonged downturn in the economy. Half of the modest revenue increase for the first six months of 2009 has been wiped out by higher property operating and maintenance expense. Despite the equity sale, the $231 million of long-term debt due in 2010 looms large. More borrowing/refinancing or asset sales will be required. To this, it seems that loading up on debt to acquire properties that produce only modest income may have caused the Company to dig a hole that it cannot get out of. Selling equity, which worked in June, clearly cannot go on forever and the flow from the borrowing tap has slowed to a trickle.

Accounting: Acquisition leads to more RV exposure, accounting questions

The Company's reliance on the RV market took a big jump with the asset purchase of Thousand Trails (TT) from Privileged Access. The core of the TT business is selling right-to-use contracts to use certain properties that specialize in accommodating recreational vehicles, with a focus on selling contracts to existing RV owners or potential owners or renters of the vehicles. The agreements were sold through multiple sales locations and originally consisted of three-year contracts that required non-refundable upfront payments as well as annual payments.

However, with the onset of the recession, ELS has reduced the number of sales locations and has pursued various ways to increase revenues at the Thousand Trails business. One method has been to introduce shorter one-year contracts. We first read of these new shorter one-year contracts in the 1Q09 SEC Form 10-Q. These contracts require smaller upfront payments and/or annual payments. Interestingly, these one-year contracts provide a boost to deferred revenues. It is difficult to fully analyze any trends in deferred revenue due to the fact that the use of these contracts was only implemented with the acquisition of the Privileged Access assets. However, the table below shows deferred revenues since the acquisition. Note that revenues are deferred over the life of the contract.

Deferred Revenues	2Q08	3Q08	2008	1Q09	2Q09
Deferred Revenues ($m)	0.0	$4.9	$10.6	$15.8	$21.0
Percentage Change (%)	-	-	114.8%	48.7%	33.4%

Additionally, ELS is now offering the right to upgrade contracts. The upgraded contract offers longer consecutive stays at sites, ability to make earlier advance reservations and access to additional properties. Furthermore, it is disclosed in the 3Q08, 1Q09 and 2Q09 SEC Form 10-Q filings that, "**the Company may finance the upfront nonrefundable payment under any Agreement.**" This disclosure is new in the 3Q08 and comes as an interesting twist when we are reminded in the 2Q08 SEC Form 10-Q that "home sales volumes and gross profits have been declining since 2005" and that "in order to maintain and improve existing occupancy the Company is focusing on new customer acquisition projects" and "has identified a number of options for addressing occupancy including…**locating financing sources for our customers.**" Although the home sales business is a different business, the fact that ELS is offering financing to both TT customers and potential manufactured home buyers is somewhat disconcerting.

In the wake of the TT acquisition, the Company immediately began consolidating the acquired sales locations from 20 to three. The move has helped to reduced sales and marketing costs. In the 1Q09 conference call, however, management also admits that, “we have also experienced significantly lower sales volumes” and that “we need to successfully introduce new low-cost entry-level products to offset the natural attrition that occurs in the member base.” In the 2Q09 call, we see from the following exchange that despite the efforts that ELS has made to increase the operating efficiency of the Thousand Trails model, business remains difficult. In fact, CEO Heneghan himself highlights an important point – offsetting expenses at the rate that RV tour flow has declined – and it is not clear whether ELS can get ahead of the declining tour flow from an income generating perspective. Furthermore, Heneghan admits that maintaining the membership base is difficult. Perhaps this confirms why membership terms have declined and why ELS is now offering financing of some of those payments.

> **Analyst:** And then switching over to 2010, you talked about potential operating efficiencies, moving from 2009 rationalizing your platform. Where do you think there is a potential to find these efficiencies in improved margin, lower costs?
>
> **Michael Berman, CFO:** From an operating side, it’s really integrating the Thousand Trials properties. We took over operating those properties in August of 2008….I think we’ve made some great progress rationalizing the sales operation….but we think there’s an opportunity to gain some efficiencies when you start looking at cost per site…we think there’s some efficiencies to be gained. But it’s still early in the process.
>
> **Tom Heneghan, CEO:** With respect to the sales operation, boy, I’d hate to be in the same sales business that they were in, in kind of the heyday of 2007. That was a pretty high cost toward dependent business model. In today’s environment, given what’s going on with the RV dealerships and the manufacturers, it’s a given that tour flow would have declined. The question is whether or not you would have been able to offset the expenses at the rate that tour flow would have declined. What I see right now is we’ve successfully transitioned away from that business model. We now have a new one, **but it still needs to bear fruit frankly**…
>
> (Then later in the call): And the other area that we’re looking to grow is that membership base. So we’ve got two methods to try and better utilize that real estate. I think we’re going to have success on both of them. And for every 10,000 incremental members, you’re talking about $5 million incremental cash flow. **It remains to be seen – we still struggle trying to maintain that dues base in the current environment, but I’m looking to grow it in the future.**

So it appears that the intention was a good one – consolidate businesses, reduce expenses, introduce new products and start to grow revenues again. However, it seems that ELS may still be caught in a very difficult position. Revenue can not be increased by raising rents, new membership products have been introduced but have yet to bear fruit and as we take a look at the home sales business in the next section, we may even see the “massaging” of financial statements through inventory adjustments and deferred revenue.

Accounting: Reclassification of inventory looks like effort to avoid impairment

The whole discussion of inventory should be fairly straight forward in a business like ELS, but it got complicated when management announced its intention to stop selling manufactured homes by stating in the 3Q08 SEC Form 10-Q, "the continued decline in home sales activity in 2008 has resulted in our decision to significantly reduce our new home sales operations." The reduction has lead to a significant and stretched out "reclassification" of inventory. In fact, ELS began reclassifying its home inventory in the 2Q08 ($31.1 million worth) after a "task force" had been reviewing the portfolio "for opportunities to increase occupancy" since 2007. To begin with, one would think that a task force would react with a bit more speed and secondly, that in making this business decision, any such reclassification would take place all in one period. However, ELS has chosen to reclassify the inventory over more than four quarters.

In addition, it appears that the method of depreciation changed in the 2Q09. Here is how the description of depreciation of real estate reads in the 1Q09 [bolding is ours]:

> Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. We generally use a 30-year estimated life for buildings acquired and structural and land improvements (including site development), a ten-year estimated life for building upgrades and a five-year estimated life for furniture, fixtures and equipment. **Used manufactured homes held for rent are depreciated based on its model year down to a salvage value of 40% of the original costs…The used resort cottages are depreciated using a 20-year estimated life and are included in corporate and other depreciation.**

In the 2Q09 the description of depreciation, the disclosure wording now includes a method for new rental units and that the used rental units now have no salvage value. The inclusion of "no estimated salvage value" in the updated disclosure (below) implies that there may have been one in prior quarters as the wording is absent in earlier disclosures. The changed description reads as follows:

> Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. We generally use a 30-year estimated life for buildings acquired and structural and land improvements (including site development), a ten-year estimated life for building upgrades and a five-year estimated life for furniture, fixtures and equipment. **New rental units are generally depreciated using a 20-year estimated life from each model down to a salvage value of 40% of the original costs. Used rental units are generally depreciated based on the estimated life of the unit with no estimated salvage value.**

Looking at a table of the assets in inventory below we see dramatic decline, read "reclassifications", in the inventory of new homes since the 2Q08. In fact, inventory of new homes remained fairly consistent from 2006 through the 1Q08 (note: detailed inventory breakdown is not disclosed prior to 2006). Beginning in the 2Q08 we see new home inventory fell by 40% from the 1Q08 and by 84% by the end of fiscal 2008. Clearly, ELS saw the writing on the wall, so to speak, and recognized that the sale of these homes was highly unlikely in the midst of the economic crisis. As mentioned above, reclassification begins in the 2Q08 and continues in subsequent quarters until the 2Q09. By this point new homes inventory falls, or has been "reclassified", by 99.2% from its peak in 2006. Furthermore, certain inventory reserves have also been reclassified to fixed assets as well. Conveniently, this reclassification also increases the number of assets that can be depreciated and perhaps gives a boost to operating cash flow.

Composition of Inventory ($ millions)	2006	2007	1Q08	2Q08	3Q08	2008[1]	2008[2]	1Q09	2Q09
New Homes	56.9	51.1	49.5	29.9	26.8	7.9	8.4	7.3	0.5
Used Homes	10.5	10.9	11.8	0.7	0.4	0.3	0.3	0.32	0
Other	3.3	2.4	2.5	2.5	4.7[3]	5.1	4.6	4.0	3.5
Total	70.7	64.4	63.8	33.1	31.9	13.4	13.4	11.6	4.0
Reserve	0.6	0.8	1.1	0.8	0.8	0.5	0.5	1.3	-
Net Inventory	70.1	63.5	62.7	32.3	31.1	12.9	12.9	10.3	4.0

[1] As reported at 12/31/08.
[2] As reported at 03/31/09.
[3] Increase due to Privileged Access acquisition

Given that inventory has been reclassified, we thought it might be interesting to look at the provisions for inventory reserves. Reviewing the cash flow statements since 2006 we do indeed see a significant increase. More importantly, when we look at the cash flow statements from the first two quarters of 2008 we see a slight increase in reserve provisioning and with a subsequent decrease for the full-year 2008. The provisioning then increases substantially in the 1Q09 and 2Q09. Not exactly the type of practice that earns a company high marks for quality of earnings.

	2006	2007	1Q08	2Q08	3Q08	2008	1Q09	2Q09
Inc. in Provision for Inventory Reserve ($m)	0	0.25	0.31	0.33	0.06	0.06	0.86	1.07
Percentage Change (%)	-	-	24.0	6.5	-80.9	0.0	1,265.1	24.4

It seems that with this constant reclassification, there is a bit of confusion on how exactly management is analyzing its home inventory. One analyst on the 1Q09 conference call asks how management decides when to take a loss on a home. Management gives a rather general answer stating it is on a home-by-home basis, but they also admit that if there is a chance for a large loss, they would rather rent. Therefore, it seems by moving the inventory to depreciable buildings ELS has increased the inventory available for rent and has avoided the need to take large losses on home sales.

Analyst: Just a couple of questions with regard to the home sale business. Can you just walk us through how you decide when you're going to take the loss on the inventory, when you are going to convert to rental, when you're going to choose to sell at a loss? It seems like there is a mix of options and I'm not sure how you think about those things.

Michael Berman, CFO: With respect to inventory reserves, what we do on a regular basis, parts of the portfolio historically have done quarterly, is look at the sales. What we have left in our inventory were basically park model. Those few sales that we had in the quarter were indicating lower prices that we previously expected, so we added reserves based on that. With respect o the decision to sell or rent that is generally done on a home-by-home basis. In this marketplace renting has been a much easier path to gaining occupancy, and so we have generally chosen to do that. If there is an opportunity to sell a home at a large loss or keep it as a rental, we will generally defer to keeping it as a rental, rather than just taking a loss just for the sake of taking a loss.

Another analyst on the 1Q09 conference call asks about the lower price points of the inventory and how it will affect the overall mix.

Analyst: With respect to the home sale business, you mentioned that you are talking with manufacturers about delivering a lower-cost product. What was the average cost, let's say, two years ago of the homes that you are selling?

Tom Heneghan, CEO: In terms of price points we – in the early 2000, call it, probably 2000 to 2004, we were hitting price point of $60,000, $70,000. Starting around 2004 through probably 2007, we saw the price points creeping up into the $90s. And in fact on individual transactions, we were hitting sale prices of $150,000, $200,000. Today it is very difficult to get any visibility as to what will sell in the marketplace. But we are trying to put a price point on a product of about $30,000. We have talked to manufacturers. We think we can bring that product to market. We have actually ordered some homes to put into market. We think that is a pretty competitive price point…

Analyst: With respect to the mix of the homes on your properties, does this imply kind of a – well, it does imply a lower price point, but how much will this affect the overall mix? And how long do you anticipate these lower-priced homes to be added, whereas in the past you are adding, as you said, up to $200,000 homes, now essentially a fraction of that?

Heneghan: I just – what I don't want you to get the feeling of with respect to this new product is that it is visually or structurally of less quality that what we were selling a few years ago. We could take you into one of these $30,000, $40,000 homes and it still has a great look and feel. Front porch, front door. All of the stuff we have been trying to put into our communities for the last 8 to 10 years…

Heneghan doesn't really answer the mix question and instead talks about the size and the feel of the homes. However, this new inventory has got to put pressure on the overall mix, again another reason why perhaps inventory was reclassified. In fact, it is interesting to consider what ELS Chairman and well-known real estate mogul, Samuel Zell states at a conference at the end of April 2009:

"…we all drank too much Kool-Aid. Between 2003 and 2007, 50% of all commercial real estate traded. It ended up being over-leveraged…Very few who bought from 2003 to 2007 are above water…Publicly held REITs have been down 65%, arguably too far. That's real daily pricing."

Although Zell is referring to commercial real estate, his sentiments may also be applied to residential real estate. In fact, the 2004 to 2006 period is exactly when ELS sees the peak in its cost of inventory for home sales. Although the homes have been reclassified, there is still the issue of the mortgages due on those reclassified homes. Unfortunately there is no detailed disclosure in this regard.

Insider Trading: In a rare convergence of action, insiders cut exposure to shares

Insider selling at ELS is rare, so much so that the last time we had monitored a convergence of any such action was back in late 2005 when a cluster of insiders slashed holdings near all-time highs and ahead of guidance that was to be lowered. They are at it again, this time while their stock price has been going virtually sideways at prices well off historical highs. In spite of the numerous challenges facing the Company's business model in the current economic climate that we have outlined in detail above, CEO Thomas Heneghan maintained he is bullish on the Company's prospects in the recent 2Q09 earnings conference call. His actions however, along with those of other key insiders, do not match up well with his comments: Between July 27th and August 11th, five executives and one prominent board member sold just fewer than 162,000 shares in the second highest sale totals to surface in the past 15 years. Three of the six recent sellers disposed of between 35% and 72% of their actionable ownership with their transactions. Below are the details on some of the more notable sellers.

- **Howard Walker (69)** – Vice Chairman. Walker was the Company's chief executive for a six-year period up to 2003 and has held a board seat for more than ten years. During this period his most aggressive sales came in November 2005, when he sold 110,000 shares at prices up to $43. After three years of inactivity, he resurfaced earlier this year, selling a total of 16,000 shares in February and March at lower prices ($40). That was just the beginning of his diversification efforts as, between July 27th and 31st, Walker would sell 75,836 shares after the 2Q earnings release at prices comparable to those he received back in the first quarter. **All the shares came from his common holdings, including all 1,079 held in his 401(k) account, resulting in a 72% holdings reduction.** The reduction calculation excludes the 21,000 vested options he holds that are currently under water with an average strike price of $51.62. The 29,000 shares he has remaining are the lowest amount he has ever reported owning. Walker does stand to gain access to another 15,000 shares over the next 12 months but the majority of these are currently out of the money with strike prices between $43 and $55 (see Appendix A).

- **Thomas Heneghan (45)*** – Chief Executive Officer, Director. Heneghan has now sold in three consecutive quarters for the first time in his 14 years with the Company. After selling 10,000 shares on March 19th at $37 he would then sell 20,000 shares in May at similar prices. Then, following the last earnings release he sold another 20,000 shares on August 4th and August 5th at $43. **All 50,000 shares sold this year came out of his direct stock holdings (not option related) and covered 20% of his actionable ownership**. We note that Heneghan's 13 sales in the last six years have been executed at an average price of $41, making it seem as though he sees these price levels as a ceiling. He stands to vest in just 16,000 shares over the next two years so there is no chance the disposed holdings will be replaced for quite some time (see Appendix A).

- **Michael Berman (51)*** – Executive V.P., Chief Financial Officer. Between the time he joined the Company in 2005 and the end of 2008 Berman sold a total of 520 shares (June 2005). **This year he has already sold 17,531 shares, equal to 35% of his ownership, including 15,000 sold on July 29th at $40.** Berman holds no stock options, vested or unvested, so the shares came straight out of his direct common holdings. With regards to his unvested derivative equity, he currently has 8,334 restricted shares that will vest at the end of this year, but outside of that one award he does not have any other equity scheduled to become actionable in 2010 or 2011 (see Appendix A).

- **Ellen Kelleher (48)*** – Executive V.P. of Property Management, Secretary. After serving as the Company's head counsel for 12 years Kelleher was appointed to her current position in February when the Company separated its asset management and property management function. She amassed a significant ownership position during her time with the Company so the 45,000 shares she disposed between July 31st and September 14th accounted for 22% of her holdings. More important to us than the reduction, however, her participation in the most recent round of selling following the 2Q09 results marks her first sales in nearly four years. She will have just 8,334 shares becoming freely tradable in December, the only shares that will vest through the end of 2010 (see Appendix A), and so her holdings will not be replenished in the near-term.

* Indicates that the individual is a Named Executive in the Company's most recent Proxy.

Governance: Related-party and compensation issues lead list of questions

As might be expected with a Sam Zell business, related-party and compensation issues lead the list of several obvious governance issues. Perhaps the most interesting involves the acquisition of all of the assets and certain liabilities from Privileged Access (PA), the largest leaser of ELS properties, which was owned by former Company board member, Joe McAdams. Prior to the deal, Privileged Access had so many inter-related dealings with ELS it seemed to be operating as a division of the Company. In one particular instance, ELS had subordinated its lease payment for the Thousand Trails portfolio to a bank that had loaned Privileged Access $5 million. ELS acquired the loan in the PA transaction then paid off the loan.

After the deal, McAdams was made President of ELS, a position he still holds today. He received a starting annual base salary of $300,000 and a 300% incentive bonus target that is higher than CEO Tom Heneghan's 200%. At the time of the acquisition, ELS disclosed that there "may be a conflict of interest".

McAdams still owns PA and though it appears that there may be some ongoing business between it and ELS little disclosure is available. At the closing of the deal, PA put its excess cash of $4.8 million into an escrow account for liabilities that PA had retained. At 12/31/08, $3.2 million remained in the account. The amount remaining in the account, if any, is to be paid to ELS after a period of two years. PA received a $2 million note from the Company in the deal.

The Company's annual non-equity incentive (cash bonus) payouts are performance based, with 50% tied to certain performance metrics including: core revenues, core net operating income and occupancy. The other 50% is discretionary and determined by the Compensation Committee in consultation with CEO Heneghan and President McAdams, who together develop criteria upon which each executive officer is to be evaluated. Also involved in the process are executive self-evaluations against the criteria. McAdams, whose own discretionary bonus is tied to the effectiveness of his oversight of the executive officers, then holds responsibility for assessing the effectiveness of his subordinates. It is obviously in McAdams' best interest to report his lieutenants have performed at the highest level which in turn would result in a high discretionary bonus payout for everyone. CEO Heneghan's discretionary bonus is based on his own personal assessment of the fiscal year's performance in addition to the effectiveness of the executive officers. If that sounds a little circular, that's because it is.

Equity LifeStyle uses restricted stock as the primary form of long-term compensation for the executives. A footnote buried in the Proxy reveals the Company buys back the shares from the execs upon vesting so that they can receive the vested stock net of applicable taxes. This is no different than any other situation involving a company buying stock directly from the executives and it remains to be seen if ELS does so at favorable prices.

ELS leases office space from an entity affiliated with Sam Zell, paying about $700,000 per year. Additionally, in January of this year, ELS entered into a six month consulting agreement with the son of Vice Chairman, **Howard Walker** to provide assistance with the Company's web marketing strategy. The agreement, albeit not substantial, is for six months and amounts to $48,000.

Appendix A

Common Stock and Option Holdings for Selected Equity LifeStyle Properties Inc. (ELS) Insiders

Name	Actionable Position as of 9/29/09:			Derivative Equity Expected to Vest in Next 12 Months			
	Common	Options [1]	Total [2]	Grant Date	Strike Price [3]	Vesting Dates [4]	# Vesting
Michael Berman CFO	34,715	0	**34,715**	12/28/06	N/A	12/28/09	8,334
							8,334
Thomas Heneghan CEO, Director	152,071	10,000	**162,071**	05/12/09	N/A	11/12/09	667
				12/28/06	N/A	12/28/09	13,334
				05/08/08	N/A	05/08/10	1,334
							15,335
Ellen Kelleher EVP of Property Management	155,231	0	**155,231**	12/28/06	N/A	12/28/09	8,334
							8,334
Roger Maynard EVP of Asset Management	33,255	0	**33,255**	12/28/06	N/A	12/28/09	10,000
							10,000
Marguerite Nader EVP of Sales and Marketing	10,443	0	**10,443**	12/28/06	N/A	12/28/09	6,667
							6,667
Howard Walker Vice Chairman	29,145	0	**29,145**	01/31/07	$55.23	12/31/09	5,000
				01/31/08	$43.67	12/31/09	5,000
				05/08/08	$48.33	05/08/10	3,334
				01/31/09	N/A	12/31/09	1,000
				05/12/09	N/A	11/12/09	667
							15,001

[1] Total number of vested, in-the-money options.

[2] Total actionable position includes common stock plus vested in-the-money options.

[3] Strike Price N/A indicates the series is restricted stock, not options.

[4] A range of dates indicates the options vest equally on a monthly basis. The total provided is the cumultive amount of equity scheduled to vest during the date range.

Note: Red text indicates series is currently out-of-the-money