AFFORDABLE RESIDENTIAL COMMUNITIES INC
Form 424B3
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Registration No. 333-129254

PROSPECTUS

$96,600,000

AFFORDABLE RESIDENTIAL COMMUNITIES LP

AFFORDABLE RESIDENTIAL COMMUNITIES INC.

71⁄2% Senior Exchangeable Notes due 2025

and

Shares of Common Stock Issuable Upon Exchange of the Notes

Affordable Residential Communities LP, or the Partnership, issued $96,600,000 aggregate principal amount of 71⁄2% Senior Exchangeable Notes due 2025, which are referred to in this prospectus as the Notes , in private placements in August 2005. This prospectus will be used by selling securityholders to resell their Notes and the common stock of the Partnership s general partner, Affordable Residential Communities Inc., or ARC, issuable upon exchange of their Notes. Unless the context otherwise requires or indicates, references in this prospectus to we, our company, the company, our and us refer collectively to Affordable Residential Communities Inc., a Maryland corporation, which we refer to in this prospectus as ARC, and Affordable Residential Communities LP, a Delaware limited partnership, which we refer to in this prospectus as the Partnership, together with their subsidiaries.

The Notes bear interest at the rate of 71⁄2% per year, payable in cash semiannually in arrears on February 15 and August 15 of each year, beginning February 15, 2006. The Notes will mature on August 15, 2025. The Notes are the Partnership s senior unsecured obligations and rank equal in right of payment with the Partnership s other senior unsecured indebtedness and effectively rank junior in right of payment to all of the Partnership s secured indebtedness, to the extent of the value of the assets securing such indebtedness, and to the indebtedness and all other liabilities of the Partnership s subsidiaries. As of December 31, 2005, the Partnership had outstanding $122.4 million of senior unsecured indebtedness, $5.0 million of other unsecured indebtedness and $1,025.6 million of secured indebtedness, and the Partnership s consolidated subsidiaries had outstanding an aggregate of $99.5 million of other liabilities.

Subject to the conditions described in this prospectus, holders may exchange at any time on or prior to maturity or redemption any outstanding Notes (or portions thereof) into shares of ARC common stock, initially at an exchange rate of 69.8812 shares of ARC common stock per $1,000 principal amount of Notes (equivalent to an initial exchange price of $14.31 per share of ARC common stock). If a holder elects to exchange its Notes in connection with certain specified fundamental changes, as described in this prospectus, that occur prior to August 20, 2015, the holder will be entitled to receive additional shares of ARC common stock as a make-whole premium upon exchange. In lieu of delivery of shares of ARC common stock upon exchange of all or any portion of the Notes, we may elect to pay holders surrendering Notes for exchange an amount in cash per note (or a portion of a note). In this prospectus, we sometimes refer to the shares of ARC common stock issuable or issued upon exchange of the Notes as the shares, and to the Notes and the shares, according to the context, as the securities.

Holders may require the Partnership to repurchase for cash all or a portion of their Notes on August 15, 2010, August, 15, 2015 and August 15, 2020 at a purchase price equal to 100% of the principal amount of the Notes to be repurchased plus accrued and unpaid interest, if any, to the repurchase date. In addition, if a fundamental change, as described in this prospectus, occurs at any time prior to maturity, holders of Notes may require the Partnership to repurchase their Notes in whole or in part for cash equal to 100% of the principal amount of the Notes to be repurchased plus accrued and unpaid interest, if any, to the repurchase date.

Prior to August 20, 2010, the Notes will not be redeemable at the Partnership s option. Beginning on August 20, 2010, the Partnership may redeem the Notes in whole or in part at any time at a redemption price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest, if any, on the Notes to the redemption date if the closing price of ARC common stock has exceeded 130% of the exchange price for at least 20 trading days in any consecutive 30-day trading period.

There is no public market for the Notes and we do not intend to apply for listing of the Notes on any securities exchange or for quotation of the Notes through any automated quotation system. The Notes currently trade on the Private Offerings, Resales and Trading through Automated Linkages, or PORTAL, system of the National Association of Securities Dealers, Inc. ARC s common stock is listed on the New York Stock Exchange under the symbol ARC. On April 28, 2006, the last quoted sale price of ARC s common stock was $9.18 per share.

Neither the Partnership nor ARC will receive any proceeds from the sale by the selling securityholders of the Notes or the common stock issuable upon exchange of the Notes. The selling securityholders may offer the Notes or the underlying common stock in negotiated transactions or otherwise, at market prices prevailing at the time of sale or at negotiated prices. In addition, the common stock may be offered from time to time through ordinary brokerage transactions on the New York Stock Exchange. Certain selling securityholders may be deemed to be underwriters as defined in the Securities Act of 1933. If any broker-dealers are used by selling securityholders, any commissions paid to broker-dealers and, if broker-dealers purchase any Notes or common stock as principals, any profits received by such broker-dealers on the resale of the Notes or common stock, may be deemed to be underwriting discounts or commissions under the Securities Act of 1933. In addition, any profits realized by the selling securityholders may be deemed to be underwriting commissions. Other than selling commissions and fees and stock transfer taxes, we will pay all expenses of registering the Notes and common stock and certain other expenses.

Investing in the Notes and the common stock issuable upon their exchange involves risks.

See Risk Factors beginning on page 19.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is May 8, 2006

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission, or the SEC, using a shelf registration process. Under this shelf registration process, the selling securityholders may, from time to time, offer for sale the Notes owned by them or shares of ARC common stock issuable upon exchange of the Notes. Each time the selling securityholders offer Notes or shares for sale under this prospectus, they will provide a copy of this prospectus and, if applicable, a copy of a prospectus supplement to prospective purchasers. You should read both this prospectus and, if applicable, any supplements thereto.

You should rely only on the information contained in this prospectus and, if applicable, any supplement hereto. We have not and the selling securityholders have not, authorized anyone to provide you with different information. Neither the Notes nor any shares of ARC common stock issuable upon exchange of the Notes are being offered in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus speaks only as of the date of this prospectus, unless otherwise specified.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Forms S-11 and S-3 under the Securities Act of 1933 with respect to the Notes and the ARC common stock issuable upon exchange of the Notes, respectively. This prospectus does not contain all of the information set forth in the registration statement and exhibits and schedules to the registration statement. For further information with respect to us and the securities offered hereby, reference is made to the registration statement, including the exhibits and schedules to the registration statement. Statements contained in this prospectus regarding the contents of any contract or other document referred to in this prospectus are not necessarily complete and, where that contract or other document is an exhibit to the registration statement, each statement is qualified in all respects by reference to the exhibit to which the reference relates. Copies of the registration statement, including the exhibits and schedules to the registration statement, may be examined without charge at the public reference room of the SEC, 100 F Street, NE, Room 1580, Washington, D.C. 20549. Information about the operation of the public reference room may be obtained by calling the SEC at 1-800-SEC-0300. Copies of all or a portion of the registration statement can be obtained from the public reference room of the SEC upon payment of prescribed fees. Our SEC filings, including our registration statement, also are available to you on the SEC s website at *www.sec.gov*.

ARC is, and as a result of the offering of the Notes, the Partnership will become, subject to the information and reporting requirements of the Securities Exchange Act of 1934, as amended, or Exchange Act, and, in accordance with these requirements, ARC files and the Partnership will file reports and other information with the SEC. We are required to file electronic versions of these documents with the SEC. Our reports, proxy statements and other information can be inspected and copied at prescribed rates at the public reference facilities maintained by the SEC as described above and are available on the SEC s website.

The SEC allows ARC to incorporate by reference certain of the information required by this prospectus, which means that ARC can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be a part of this prospectus, and information that ARC files later with the SEC will automatically update and supersede information contained in documents filed earlier with the SEC or contained in this prospectus. ARC incorporates by reference in this prospectus the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act until all of the securities offered hereby are sold:

- Annual Report on Form 10-K for the fiscal year ended December 31, 2005;

- Current Reports on Form 8-K filed on January 18, March 8, March 15 and April 10, 2006;
- Proxy Statement on Schedule 14A for 2005 annual meeting filed on May 1, 2006; and
- Description of ARC s capital stock contained in its registration statement on Form 8-A filed on February 9, 2004.

Upon receipt of an oral or written request we will provide, free of charge, to any person to whom a prospectus is delivered, a copy of any or all of the information that has been incorporated by reference in the prospectus but not delivered with the prospectus. Please direct your written requests to: Investor Relations, Affordable Residential Communities Inc., 7887 East Belleview Avenue, Suite 200, Englewood, Colorado 80111. Please direct your oral requests to: Investor Relations at 1-866-847-8931.

In addition, for as long as any of the Notes remain outstanding and during any period in which we are not subject to Section 13 or Section 15(d) of the Exchange Act, we will make available to any prospective purchaser or beneficial owner of the securities in connection with the sale thereof that information required by Rule 144A(d)(4) under the Securities Act.

FOR NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION OR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE UNIFORM SECURITIES ACT WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED TO SELL SECURITIES IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

MARKET AND INDUSTRY DATA

Market data used or incorporated by reference in this prospectus is based on the good faith estimates of our management, which estimates are based upon their review of internal surveys, independent industry publications and other publicly available information. Although we believe these sources are reliable, we do not guarantee the accuracy or completeness of statements regarding the market and industry data presented or incorporated by reference in this prospectus. Our estimates involve risks and uncertainties and are subject to change based on various factors, including those discussed under the heading Risk Factors.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act, as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this prospectus that address results or developments that we expect or anticipate will or may occur in the future, where statements are preceded by, followed by or include the words *believes*, *expects*, *may*, *will*, *would*, *could*, *should*, *seeks*, *approximately*, *intends* *estimates* or *anticipates* or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our ability to obtain future financing arrangements, estimates relating to our future distributions, our understanding of our competition, market trends, projected capital expenditures, the impact of technology on our products, operations and business, are forward-looking statements.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, business plan, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. These risks, along with the risks disclosed in the section of this prospectus entitled Risk Factors and the following factors, could cause actual results to vary from our forward-looking statements:

- competition from other forms of single or multifamily housing;
- changes in market rental rates, supply and demand for affordable housing, the cost of acquiring, transporting, setting or selling manufactured homes;
- the availability of manufactured homes from manufacturers;
- the availability of cash or financing for us to acquire additional manufactured homes;
- the ability of manufactured home buyers to obtain financing;
- our ability to maintain rental rates and maximize occupancy;
- the level of repossessions by manufactured home lenders;
- the adverse impact of external factors such as changes in interest rates, inflation and consumer confidence;
- the ability to identify acquisitions, have funds available for acquisitions, the ability to close acquisitions, the pace of acquisitions and/or dispositions of communities and new or rental homes;
- our corporate debt ratings;
- demand for home purchases in our communities and demand for financing of such purchases;

- demand for rental homes in our communities;
- the condition of capital markets;
- actual outcome of the resolution of any conflict;
- our ability to successfully operate existing or newly acquired properties;
- our decision and ability to sell additional communities and the terms and conditions of any such sales and whether any such sales actually close;
- issues arising from our decision not to continue to maintain our status as a real estate investment trust, or REIT;
- the impact of the tax laws on our balance sheet and business operations in light of the above;
- our ability to pay dividends or make other distributions to ARC s stockholders and the Partnership s partnership unitholders;
- environmental uncertainties and risks related to natural disasters;
- our ability to comply with the terms of our various loan agreements;
- changes in and compliance with real estate permitting, licensing and zoning laws including legislation affecting monthly leases and rent control and increases in property taxes; and
- changes in and compliance with licensing requirements regarding the sale or leasing of manufactured homes.

Consequently, all of the forward-looking statements made in this prospectus are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized, or even substantially realized, and that they will have the expected consequences to or effects on us and our business or operations. Forward-looking statements made in this prospectus speak as of the date hereof or as of the date specifically referenced in any such statement set forth herein. We undertake no obligation to update or revise any forward-looking statements in this prospectus.

SUMMARY

This summary is not complete and does not contain all of the information that you should consider before investing in the Notes and the shares of ARC common stock issuable upon exchange of the Notes. You should read the entire prospectus carefully, including Risk Factors and our historical financial statements and the Notes to those financial statements, which are included or incorporated by reference in this prospectus, and the other financial information appearing elsewhere or incorporated by reference in this prospectus. Unless otherwise indicated, the information contained in this prospectus is as of December 31, 2005.

Affordable Residential Communities LP

Overview

The Partnership is a Delaware limited partnership whose sole general partner is ARC. As of December 31, 2005, ARC owned approximately 95.7% of the Partnership s outstanding partnership interests. ARC is a Maryland corporation which was organized as a fully integrated, self administered and self managed real estate investment trust, or REIT, for U.S. Federal income tax purposes through the years ended December 31, 2005. On March 7, 2006, ARC s board of directors announced its decision to revoke ARC s election as a REIT beginning the year ending December 31, 2006.

We acquire, renovate, reposition and operate primarily all-age manufactured home communities. We also conduct certain complimentary business activities focused on maintaining and improving occupancy in our communities. These activities include leasing with the option to purchase, renting and selling manufactured homes, financing sales of manufactured homes and acting as agent in the sale of homeowners insurance and other related insurance products, all exclusively to residents and prospective residents in our communities.

As of December 31, 2005, we owned and operated 278 manufactured home communities in 24 states containing 57,578 homesites, exclusive of communities held for sale as discontinued operations. These properties are located in 59 markets across the United States. Our five largest markets are Dallas/Fort Worth, Texas, with 12.4% of our total homesites; Atlanta, Georgia, with 8.6% of our total homesites; Salt Lake City, Utah, with 6.6% of our total homesites; the Front Range of Colorado, with 5.7% of our total homesites; and Kansas City Lawrence Topeka, Kansas/Missouri, with 4.2% of our total homesites.

Beginning in 1995, ARC s predecessor companies were formed under the name Affordable Residential Communities. ARC was formed in 1998. In the first quarter of 2004, ARC completed its initial public offering, or IPO, of 25,300,209 shares of ARC common stock (including 2,258,617 shares sold by selling securityholders) and 5,000,000 shares of ARC s 8.25% Series A cumulative redeemable preferred stock. In conjunction with the IPO, we also completed a financing transaction involving Merrill Lynch Mortgage Capital Inc., an affiliate of the initial purchaser of the Notes, consisting of $500 million of new mortgage debt and the repayment of some of our existing indebtedness. We used a portion of the proceeds from ARC s IPO and the financing transaction to acquire 90 manufactured home communities from Hometown America, L.L.C., or Hometown.

Our principal executive, corporate and property management offices are located at 7887 East Belleview Avenue, Suite 200, Englewood, Colorado 80111, and our telephone number is (303) 291-0222. Our internet address is *www.aboutarc.com*. The information contained on our website is not part of this prospectus.

Our Business Objectives, Property Management and Operating Strategies

Our principal business objectives are to achieve sustainable long-term growth in cash flow and to maximize returns to our investors. We believe that we can provide a clean, attractive and affordable place for our residents to live that is competitive with other forms of housing, provides real value and service to our residents and generates profits for our investors. We have undertaken a detailed, bottom-up budgeting process that focuses on operating effectiveness at the community level. Our primary goals are, first, to reassess expense levels and income opportunities and, second, to indentify opportunities for profitable growth with the liquidity we expect to attain from the sale of the communities we currently hold for sale, as and when such sales are consummated. In regard to our business objectives, we have focused on rent levels and control and recovery of utility cost and other operating expenses.

We have further made a determination to focus on profitable programs in the sale and leasing of homes. As a result, we have implemented procedures to increase the pricing of our home and leasing transactions while attempting to keep them competitively priced as compared to the market. Our primary tools remain (i) our rental home program, including our lease with option to purchase program, (ii) our for-sale inventory and (iii) our consumer finance program.

We have taken steps to down-size our sales and marketing organization and terminated over 150 employees in the fourth quarter of 2005, primarily in these functions. We now operate our sales and marketing initiatives within our community operations utilizing training achieved to-date. Our focus is to utilize our community managers, sales staff and independent sales professionals to make (i) cash sales of less expensive, vacant used homes, used rental homes coming off lease and newly purchased repossessions, (ii) sales of higher priced new and used homes for cash or supported by financing to new residents through our Enspire finance subsidiary, (iii) home leases with option to purchase, and (iv) standard home leases.

We have also made a determination to align our expense structure to one that fits a downsized company once our communities held for sale have been sold. We will address this in due course while continuing to work to maintain effective controls over our business activities.

We evaluate our aggregate community asset pool to determine whether any communities do not meet the established market and asset criteria enumerated above and/or whose cost of operating, development, refurbishment or occupancy fill we consider inordinately high. Historically, ARC has and may continue to acquire such communities in order to facilitate multiple community acquisitions we believe to be essential to planned, strategic growth. In selling communities, we have focused on communities that are in isolated markets where we cannot readily achieve economies of scale, that cannot be readily reached by district management, or that require extensive expenditures of capital and management time in relation to the potential benefit. We also consider the benefits we may obtain from the liquidity provided in the sale that we can better deploy in other development activities elsewhere. As such, we may consider selling those communities that are fully developed and offer little growth prospects or those communities where we believe we will receive a premium price on sale in addition to those that require excess capital investment in relation to the future benefit.

Our key operating objectives include the following:

Customer Satisfaction and Quality Control. Our goal is to meet the needs of our residents or prospective residents for housing alternatives in a clean and attractive environment at affordable prices. We approach our business with a consumer product focus having an emphasis on value and quality for our residents and prospective residents. We have quality assurance programs executed through employee training and adherence to guidelines developed by our senior management, based in part upon surveys of our customers. Our customer focus and quality controls are designed to provide consistency and quality of product and to enable our community managers to effectively market our communities and improve occupancy and resident retention across our portfolio.

Presence in Key Markets. As of December 31, 2005, approximately 74% of our homesites were located in our 20 largest markets. We believe we have a leading market share in 15 of these markets, based on number of homesites. Increasing our presence and market share enables us to (i) achieve operating efficiencies and economies of scale by leveraging our local property management infrastructure and other operating overhead over a larger number of communities and homesites, (ii) provide potential residents with a broader range of affordable housing options in their market, (iii) increase our visibility and brand recognition and leverage advertising costs, and (iv) obtain more favorable terms and faster turnaround time on construction, renovation, repairs and home installation services. We believe the continuing significant size and geographic diversity of our portfolio reduces our exposure to risks associated with geographic concentration, including the risk of economic downturns or natural disasters in any one market in which we operate.

Management of Occupancy. In response to challenging industry conditions, particularly the shortage of available consumer financing for the purchase of manufactured housing, we have developed and implemented a range of programs aimed primarily at maintaining and increasing our occupancy, improving resident satisfaction and retention, increasing revenue and improving our operating margins. We focus on converting long-term renters into homeowners and improving occupancy through the sale of older homes for cash, the sale for cash or financing of newer homes and the leasing of newer homes with an option to purchase.

Community Renovation and Repositioning. While community acquisition opportunities have historically been a significant focus of our activities, we are currently significantly less focused on such opportunities and more focused on community operations, as discussed above. We have historically utilized a comprehensive process to renovate and reposition the communities we acquire and improve their operating performance. In this process we have focused on (i) identifying and making the acquisition of the community, (ii) improving the physical infrastructure and resident quality, (iii) increasing occupancy levels, and then, (iv) managing the ongoing, long-term operations. Our prior acquisitions generally have targeted communities that demonstrate opportunities for improvement in operating results due to (a) below market rate leases, (b) high operating expenses, (c) poor infrastructure and quality of residents, (d) inadequate capitalization, or (e) a lack of professional management.

Key Programs and Initiatives

Rental Programs. Our real estate segment revenue consists of homeowner rental income, home renter rental income and utility and other income. We receive homeowner rental income from homeowners who lease homesites in our communities, and we receive home renter rental income from persons who rent manufactured homes and homesites from us in our communities pursuant to our home rental and our home lease with option to purchase programs. For the years ended December 31, 2005 and 2004, home renter rental income totaled $48.5 million, or approximately 23% of our total real estate revenue, and $37.7 million, or approximately 20% of our total real estate revenue, respectively, and homeowner rental income totaled $142.8 million, or approximately 67% of our total real estate revenue, and $133.7 million, or approximately 71% of our total real estate revenue, respectively. At December 31, 2005, we owned a total of 9,328 homes that are in our communities with acquisition and improvement costs of $261.5 million, which are rented, available for rent or for sale. These homes had an occupancy rate, at December 31, 2005, of approximately 80.3% in our communities which are not held for sale and 80.5% in our communities overall, including those held for sale. We intend to continue our home rental and lease with option to purchase program in the future.

Home Lease with Option to Purchase. Our home lease with option to purchase program was initiated in 2004 to address the demand for home ownership in that segment of the population that might not otherwise qualify to finance the purchase of a home or pay cash. Under this program, a resident enters into a long term lease of a home, typically 24 to 72 months. Over the term of the lease, the resident makes rental payments for the home, and makes additional monthly payments which, if the resident elects to exercise the purchase option, are applied to the purchase price of the home. The resident pays a non-refundable option fee at the time of execution of the home lease. The lease may be terminated at any time by the payment of a termination fee by the resident as provided in the lease, and in the event of such

termination, under the terms of the program the resident is to forfeit all additional payments made through the date of termination of the lease. The resident has the right to purchase the home at any time during the term of the lease for a stated purchase price as provided in the lease. The resident also executes a separate homesite lease as part of this program, and agrees that upon the exercise of the purchase option to maintain the home in our community for an additional period of at least 24 months. This program is only offered on homes we own located in our communities.

In-Community Retail Home Sales and Consumer Financing Initiative. Our retail home sales business consists of the sales of manufactured homes in our communities to residents and prospective residents at competitive prices. Through our consumer financing initiative, we provide loans to qualified residents and prospective residents to facilitate purchases of manufactured homes which will remain located in our communities for the longer of the term of the loan or 24 months. We will acquire additional manufactured home inventory on an as needed basis for sale in coordination with the sale of our existing inventory.

Our Industry

The manufactured housing industry represents a meaningful portion of the U.S. housing market. In 2002, there were an estimated 22 million people living in manufactured homes in the United States. The manufactured housing industry is primarily focused on providing affordable housing to moderate-income customers. A manufactured home is a single-family house constructed entirely in a factory rather than at a homesite, with generally the same materials found in site-built homes and in conformity with federal construction and safety standards.

Each homeowner in a manufactured home community leases a homesite from the owner of the community. The manufactured home community owner owns the underlying land, utility connections, streets, lighting, driveways, common area amenities and other capital improvements and is responsible for enforcement of community guidelines and maintenance of the community. Generally, each homeowner is responsible for the maintenance of their home and upkeep of their leased site.

We believe that manufactured home communities have several characteristics that make them an attractive investment when compared to some other types of real estate, particularly multi-family real estate, including the following:

- significant barriers to the entry of new manufactured home communities into the market;
- large and growing demographic group of potential customers;
- comparatively stable resident base;
- fragmented ownership of communities;
- comparatively low recurring capital requirements;
- improved economies of scale in operation of multiple sites; and
- affordable homeowner lifestyle.

The manufactured housing industry faces a challenging operating environment, which has resulted in losses, exits from the industry and significant curtailment of activity among manufacturers, retailers and consumer finance companies. According to Manufactured Housing Institute, or MHI, industry shipments (a measure of manufacturers home production and wholesale sales) have declined from 372,843 homes in 1998 to 130,802 in 2004. We believe this dramatic decline in production and sales is largely the result of an oversupply of consumer credit from 1994 to 1999, which led to over stimulation in the manufacturing, retail and finance sectors of the industry. Current industry conditions are further exacerbated by low mortgage interest rates and less stringent credit requirements for the purchase of entry-level site built homes, thereby reducing the price competitiveness of manufactured housing.

We expect industry conditions to remain difficult for the foreseeable future, based partly on overall economic conditions throughout the United States and a continued shortage of available consumer financing for manufactured home buyers. We anticipate that demand for manufactured housing and manufactured home communities will improve if home mortgage interest rates return to higher historical levels, which should reduce the pricing differential between home mortgage interest rates and interest rates for financing the purchase of a manufactured home.

Revocation of ARC s REIT Election

Commencing with its taxable year ending December 31, 1998, ARC elected to be taxed as a REIT, pursuant to the Internal Revenue Code of 1986, as amended, (the Code). As a REIT, ARC was entitled to a deduction for the dividends that it paid and was therefore generally not subject to U.S. Federal corporate income tax on its taxable net income that it distributed to its stockholders. Under the Code, the proceeds from ARC s community sales would likely have been subject to a U.S. Federal income tax equal to 100% of the net income from such sales as prohibited transactions without offset for net operating losses or capital losses from other transactions. Since ARC has substantial net operating losses, the board of directors of ARC announced on March 7, 2006 that it had determined that it was in the best interest of ARC to revoke its election to be taxed as a REIT for U.S. Federal income tax purposes, as permitted pursuant to ARC s charter, beginning with its tax year ending December 31, 2006 so that such net income could be offset by ARC s net operating losses. As a result of the board s decision, ARC filed a statement with the Internal Revenue Service (IRS) revoking its election to be taxed as a REIT on March 30, 2006 (which election is retroactively effective to January 1, 2006).

Effective with such revocation, ARC is taxed as a corporation for U.S. Federal income tax purposes and its net income is subject to taxation at regular (or alternative minimum) corporate rates without the benefit of a dividends paid deduction. As noted above, net operating loss carryforwards from prior years are expected to offset substantially ARC s taxable income, if any, for at least the next five years. ARC may, however, incur some alternative minimum tax liability since net operating loss carryforwards may only offset 90% of alternative minimum taxable income. This will result in some increased U.S. Federal income, state and local tax liability to ARC and, therefore, ARC s net earnings available for investment, debt service and distribution may be reduced. However, ARC does not expect any increase in the amount of its tax liability as a result of the revocation to be material. Under current law, ARC may re-elect REIT status for U.S. Federal income tax purposes beginning with its 2011 tax year. There can be no assurance, however, that the law will not change or that ARC will, if able, elect to be taxed as a REIT at such time. Under current law, in the event that ARC should choose to re-elect REIT status, ARC would have to distribute earnings and profits generated while it was a regular corporation and would be subject to a corporate tax at the highest corporate income tax rate then applicable on the net appreciation at the time of the conversion back to a REIT in its assets disposed of during the next 10 year period.

As a result of the revocation, ARC is no longer be subject to certain stockholder ownership tests imposed on a REIT. Thus, the limitations set forth in ARC s charter that were designed to ensure that ARC would be able to meet with this and other requirements no longer apply. These limitations provided that no individual could own more than 7.3% in value or number, whichever is more restrictive, of the outstanding shares of ARC s common stock or more than 7.3% in value of the outstanding shares of ARC s capital stock.

Further, ARC is no longer required to comply with the REIT income, asset and distribution requirements under the Code, including that ARC distribute annually at least 90% of its REIT taxable income. Thus, ARC will not be compelled to make dividend distributions to its stockholders and, therefore, holders of ARC common stock may receive less in dividend distributions from ARC than if ARC had maintained its REIT status. In addition, holders of ARC common stock will no longer be able to receive dividends designated by ARC for taxation as capital gain dividends within the meaning of the Code.

Investments in ARC common stock will be taxed under the general rules applicable to investments in stock of corporations. Distributions in respect of ARC common stock will be taxed as dividends to the extent of ARC s current and accumulated earnings and profits. Distributions in excess of ARC s current or accumulated earnings and profits will be treated first as nontaxable return of capital reducing a holder s adjusted U.S. tax basis and thereafter as capital gains. However, certain restrictions applicable to the taxation of stockholders of REITs will no longer apply, including:

- Dividends paid by ARC will now be eligible for the preferential tax rates available to U.S. individual stockholders for certain qualified dividend income;

- Subject to certain limitations, dividends paid by ARC to corporate stockholders will be eligible for the dividends received deduction; and

- The special rules applicable to holders of ARC common stock that are U.S. tax-exempt entities will not apply, including rules regarding pension-held REITs.

Nevertheless, because of ARC s substantial investment in U.S. real property, non-U.S. holders may still be subject to taxation on the disposition of Notes or ARC common stock under the Foreign Investment in Real Property Tax Act of 1980, or FIRPTA, in certain circumstances. For more information, see Certain U.S. Federal Income and Estate Tax Considerations Non-U.S. Holders Sale, Exchange or Redemption of the Notes and Certain U.S. Federal Income and Estate Tax Considerations Non-U.S. Holders Gain on Disposition of ARC Common Stock.

Recent Developments

We had the following changes in executive management

On September 22, 2005, we announced that Larry D. Willard, a member of our board of directors, had assumed the additional position of Chairman of the board of directors and Chief Executive Officer of ARC and that director James F. Kimsey had become President and Chief Operating Officer of ARC. On that date, Scott D. Jackson, our former Chairman and Chief Executive Officer, assumed the position of a Vice Chairman of ARC s board of directors. Messrs. Willard and Kimsey also resigned their positions on the Audit Committee, which caused ARC to fail to be in compliance with the requirements of the New York Stock Exchange (NYSE) with respect to the makeup of audit committees.

On November 4, 2005, John G. Sprengle, a Vice Chairman of our board of directors, entered into a separation and release agreement with ARC and resigned from ARC s board of directors effective as of that date. Under the agreement, Mr. Sprengle resigned his employment with ARC and its affiliates as of November 30, 2005. Pursuant to the agreement, Mr. Sprengle received a lump sum payment of $750,000, subject to standard withholding, on the separation date and is covered under our health benefit plan in accordance with COBRA for a period of eighteen months following his separation date. Pursuant to the agreement, Mr. Sprengle is also bound by certain non-competition and non-solicitation provisions for a two-year period.

On December 13, 2005, Scott D. Jackson, a Vice Chairman of our board of directors and our former Chairman and Chief Executive Officer, entered into a separation and release agreement with ARC and resigned from ARC s board of directors and as an employee of ARC and its subsidiaries as of that date. Pursuant to the agreement, Mr. Jackson received a lump sum payment of $2.0 million as of January 3, 2006, subject to standard withholding, and is covered under our health benefits plan in accordance with COBRA for a period of 18 months following his separation date. Pursuant to the agreement, Mr. Jackson is also bound by certain non-competition and non-solicitation provisions for a two year period.

We had the following changes to our board of directors

At the 2005 annual stockholders meeting held on June 30, 2005, W. Joris Brinkerhoff, Gerald J. Ford, James F. Kimsey, James R. Randy Staff and Carl B. Webb were elected as directors of ARC. Randall A. Hack, Charles Santos-Busch and James L. Clayton were not seeking re-election and ended their service with the board of directors effective that date.

On August 16, 2005, Michael Greene resigned his position on ARC s board of directors.

On October 28, 2005, Charles R. Cummings was elected to ARC s board of directors and was appointed Chairman of the board s Audit Committee and designated an audit committee financial expert.

On November 10, 2005, one of ARC s independent directors, Eugene Mercy, Jr., resigned his position on ARC s board of directors.

On November 29, 2005, Rhodes Bobbitt was elected to ARC s board of directors and was appointed as a member of the board s Audit Committee. His appointment brought ARC back into compliance with the requirements of the NYSE with respect to the makeup of audit committees.

We had modifications to our debt agreements as follows

In March 2005, we secured an additional $100.0 million in financing commitments, consisting of $25.0 million in unsecured trust preferred securities, and a $75.0 million lease receivables facility (subsequently amended to $150.0 million) secured by substantially all of ARC s rental homes and the related leases. The $25.0 million trust preferred securities were issued and sold on March 15, 2005, mature in 30 years, and bear interest at 3-month LIBOR plus 3.25% (7.79% at December 31, 2005).

In September 2005, we amended our revolving credit mortgage facility to extend the maturity of the facility to September 2006. As amended, the facility bears interest at the rate of one-month LIBOR plus 2.75% (7.14% at December 31, 2005).

In October 2005, we amended our lease receivables facility to increase the size of the facility from $75 million to $150 million. The amendment also (i) increased the limit on borrowings under the lease receivables facility from an amount equal to approximately 55% of the net book value of the eligible manufactured housing units owned by two of our indirect wholly owned subsidiaries, ARC Housing LLC and ARC HousingTX LP (collectively, Housing) and located in our communities, to 65%, subject to certain other applicable borrowing base requirements, (ii) increased the interest rate on borrowings under the facility from 3.25% plus one-month LIBOR to 4.125% plus one-month LIBOR (8.52% at December 31, 2005), and (iii) extended the maturity of the facility from March 31, 2007 to September 30, 2008.

On November 11, 2005, we amended our floorplan line of credit to provide borrowings of up to $35.0 million, secured by manufactured homes in inventory. Under the amended lines of credit, the lender will advance 75% of the purchase cost of manufactured homes. Repayments of borrowed amounts are due upon sale or lease of the related manufactured home. Advances under the amended lines of credit will bear interest ranging from the prime rate plus 0.75% to the prime rate plus 4.00% (averaging 8.00% at December 31, 2005) based on the length of time each advance has been outstanding. Monthly curtailment payments are required for unsold homes beginning 360 days following the purchase of the home. The required curtailment payment will be between 3.00% and 5.00% of the home s original invoice amount depending on the type of home and the number of months since the home s purchase. The amended lines of credit require us to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of $15.0 million, all as defined in the agreement. As amended, the minimum tangible net worth required is $425.0 million from September 30, 2005 through December 31, 2006, and $385.0 million from January 1, 2007 through September 13, 2007. We are in compliance with all financial covenants of the line of credit as of December 31, 2005. The line of credit is subject to a commitment fee of $250,000, an unused line fee of 0.25% per annum and a termination fee of 1.00% to 3.00%, based on the termination date.

On February 10, 2006, we extended the due date of our senior variable rate mortgage due 2006 to February 11, 2007. At our option and subject to certain conditions, we may extend the Senior Variable Rate Mortgage due 2006 for two additional 12-month periods. In connection with the second and third extensions, we would be required to pay extension fees of 0.25% and 0.375% of the outstanding principal balance, respectively.

On April 5, 2006, we entered into a second amendment to our lease receivables facility. The second amendment (i) eliminates the margin increase requirements for failure to meet certain sales volume requirements for new homes, (ii) increases the allowable age requirements for the collateral portfolio from 4 years to 4.5 years, and (iii) provides an opportunity to purchase an extension of the timeframe to realize $85 million in net proceeds from our community sales process from October 14, 2006 to December 31, 2006.

Our board of directors authorized community sales

On September 22, 2005, ARC s board of directors authorized the sale of up to 79 communities in 33 markets, either at auction or through various negotiated sales. On December 15, 2005, we offered 71 of these communities for sale at auction. Eight other properties are being actively marketed and are anticipated to be sold in private party transactions or through brokers. Upon completion of the auction, we have accepted contracts on 30 of the properties and we determined that we would continue to operate 41 of the 79 properties, which would no longer b