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Inside this issue:

"THE INDUSTRY CONSOLIDATES"

Marty's News & Notes

Featuring news about the Factory-Built Housing Industry
And all the news that's fun to read...

Consolidation Continues

I wonder whether it was in **Jim Clayton's** (jim60@aol.com) playbook to one day assume control of Oakwood Homes? The founder and former majority owner of **Clayton Homes** is a man without limits, and I bet during his tenure at Clayton, the thought had crossed his mind.

Glossy

As Clayton and Oakwood battled throughout the 1990's, each with 10-12% of the marketplace for new homes produced, and each with a powerful lending subsidiary, like two sumo wrestlers, they vied for top billing. And in this environment, Oakwood seemed to be the slightly glossier version, winning industry awards constantly, their top personnel the toast of the industry.

Directed

Clayton on the other hand, seemed the grittier of the two, tucked away in Tennessee, plodding on to success, but not too flashy, with a reputation for frugality as a company by-word. Jim, the founder, was busy building the company and grooming his young son, **Kevin Clayton** (865-380-3000), to assume control of the Clayton Empire. As though Jim would give up control to Kevin, most people thought. Followed by suspicions that Kevin was just another young punk, force-fed with a silver spoon, a mere shadow of his father's abilities or possibilities.

I had the pleasure to meet Kevin early on and I had fewer doubts. Without any question, he is the best listener I ever dealt with. He listened and sized you up. He started cleaning toilets and his father brought him along slowly. He became infused in that incredible employee culture that exists at Clayton Homes, fostered first by Jim, but learned easily by Kevin. They were rolling at Maryville, TN, their home base, during the 90's.

Funding Needed

But the realities of 1990's MH was that lending generally required access to the asset-backed security (ABS) markets, controlled by our Wall Street friends. And since lending drove home sales, both Oakwood and Clayton used the ABS markets for money for their lending subsidiary, as $10-$16 billion of MH industry loans annually went through the chutes to investors. From 1993-1998, both Oakwood and Clayton were rolling, as was the industry.

Cracks

The cracks showed at Oakwood first. No secret that the great weakness in the vertically integrated model followed by Oakwood and Clayton, requires intense discipline to keep firewalls between sales and financing. Given an inability to control the sales department's running roughshod over financing, your days

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are numbered. After a few years of "experimental" lending by the Oakwood financing subsidiary, the three or four years of great home sales were deemed to be a failure, as the loan performance of those portfolios was a catastrophe. Failure for Oakwood came from unsurvivable lending.

Meanwhile, in Tennessee, the far more disciplined Clayton Homes ran into problems, but for different reasons. Nothing is more common in lending than having one lender doing a poor job impact negatively a lender doing a good job. As the ABS loan portfolios tanked, the Clayton finance subsidiary came under pressure to obtain consistent and reasonable priced funds to loan for their homes sales. While Clayton portfolios performed well, they were virtually alone. The baby and the bathwater went out together.

This ultimately led to the well-known purchase of Clayton Homes by **Warren Buffett**, which later led to the purchase by Clayton of what remained of Oakwood Homes, after Oakwood entered bankruptcy. It was during that bankruptcy that the same Warren Buffett loaned Oakwood $200 million+ to stay afloat. You might say that since Buffett was effectively in control of both companies, it was he that made them into one.

The Slipper Fits

But Kevin was the instrumentality in doing it and he has been at the reins as Clayton Homes has assumed a dominant role in the industry. While the Buffett liquidity is a reassuring tangible, which allows you great business strength, today I hear no doubts about Kevin's abilities. Seems as though the kid has grown into daddy's shoes and they actually are not too big for him.

Oakwood/Clayton, and their tale of amalgamation is a tale of the old MH industry. That happened for different reasons than the probable course the industry follows now. Previously the slimming was to downsize from the 350,000 annual home sales of 1994-1999, to a trend line below 250,000 homes, the long-term figure from 1975-1995. The future portends a reality check of what it needs to look like at 130,000-150,000 homes, or even lower….

Acquisition

And into this, in late August, Clayton announced it was acquiring Southern Energy Homes of Addison, Alabama. Southern Energy had already rolled up Giles Homes into them about a year ago. Once done, this will bring the #5 HUDCode builder to Clayton, and perhaps as importantly, bring **Keith Holdbrooks, Southern Energy's CEO** (koh@sehomes.com) into the Clayton fold.

Holdbrooks, a pretty magnetic guy himself, had assumed control of the management reins of SEH at a time when many thought the end was near for that builder. Through a series of moves to make the builder far more consumer friendly with far higher build quality, SEH drew back from the abyss. Holdbrooks got his stock investors a 30% premium in value in the Clayton deal and soon becomes part of the most potent company this industry has ever seen.

We discussed last month that virtually every builder in the industry is potentially available, and some far more than "potentially". Take out your Manufactured Housing Merchandiser's (312-236-3528) "Top 25" issue, and look at those above and below SEH. Any potential targets there?

All Done?

Let's see, you have an absolutely proven executive in Kevin Clayton, with Warren's money and confidence, sitting in Maryville. He's built a loyal, proficient, and profitable endeavor. Into this mix he brings 7,000 homes of SEH production and a proven and charismatic leader in Holdbrooks, with obvious talents in growing a company, and bringing and executing a business plan. Addison, eh?

I have no insider knowledge. The facts I reflect above are visible to anyone who wishes to ponder. But if the above combination of money and talent are done consolidating this industry, you need to stop reading this newsletter, as I truly know nothing.

Final Thoughts

Oh, final thought on Clayton. For those investors who battled so hard to keep Buffett from buying Clayton, not satisfied with the per share price being offered, please reflect on the following:

1. The continued cost and difficulty of getting ABS money, which Clayton's finance subsidiary requires in buckets;

2. The share value of other public MH companies and how they've performed in the interim;

3. The damage tight financing, costly money, and tighter underwriting standards would have had on the Clayton vertically integrated model;

4. The length, and depth of the industry downfall and its future prospects, as it now appears.

Might not have been such a bad deal for the shareholders, after all. And for the employees and associates of Clayton Homes, it was a wonderful opportunity.

Site Built Slump?

Kathryn Thompson (kthompson@arondalepartnersllc.com)is a smart young lady I first met when she worked with BB&T stock analyst, **John Diffendal** (jdiffendal@bbandtcm.com). She was working at the foot of the Great Diff, learning to analyze RV stocks and to a lesser degree MH. At some point a few years back Kathryn went walkabout to Avondale Partners, LLC, another equity research firm in Nashville, also home of Diffendal's firm. (And yes, Diffendal does play guitar. I don't know about Kathryn.)

She Calls

Kathryn has been used as an R.V. analyst at Avondale. A month or so ago, I heard from Kathryn as she once again had been assigned research duties in MH. Unbeknownst to me, Avondale was advising Southern Energy Homes of Addison, Alabama on their prospective sale of the company to Clayton Homes, which we've discussed above. When she called, Kathryn was calling to catch up with me and discuss the fairly grim facts surrounding the MH industry presently, and its prospective future. I sympathized with her being relegated back to covering MH, an investment field not inundated with superstar analysts or simmering investment potential, at least for the moment.

I can now see that **Mario Gabelli, of Gabelli and Company** (www.gabelli.com), the powerful investment house may well have come to MH not because he believed his substantial positions in industry companies was a great bet for profits and growth, but perhaps because he anticipated the inevitable industry consolidation occurring, with Southern Energy just another step along the thinning of the numbers of industry builders.

The Article Hits

On August 29, 2006, Kathryn mass-distributed an article by **Nouriel Roubini, New York University** (nroubini@stern.nyu.edu) economics professor entitled **"The Biggest Slump in US Housing in the Last 40 Years."…. or 53 years?**

I read the article closely and quickly drew a hot, soupy bath and got in it. I was about to unsheathe the hare kari knife for some pruning of my wrist veins, when I decided to read the article again. Since it is a lengthy article, I was probably just stalling for time.

Blunders

Thank god I did, as it gave me the opportunity to consider what the article said, and how it might affect MH. Could there be a silver lining for the industry in the apparent turmoil besetting site-built housing? I must admit a slight sense of vengeance for all those realtors and builders who have entirely eaten our MH lunch for eight years or more. We were one of the casualties of their success, although we wished them "Godspeed" to their success, as we committed a series of industry blunders during the late 1990's from which we have not recovered (some saying from which we will never recover).

And it also occurred to me that since virtually everyone in the industry lives in a site-built home, and often it constitutes a substantial portion of most everyone's financial worth, collapsing site-built home prices are not to be desired. Yes, as we look around us and see what is happening in housing, we can see all is not good, and it goes well beyond the state of our poor industry.

Contentions and Conclusions

I put the knife away and went on in the article for conclusions. The contention was that things in housing were bad, real bad, the worst in 40 years, or 53 years, depending on your outlook. What was less apparent was whether the problems identified were caused by the housing slowdown, or whether the housing slowdown was caused by $70 a barrel oil, a relentless and clueless federal reserve, and an unpopular war. My bet would be that those last factors, coupled with the very large and rapid run-up in housing supply and prices have caused the slowdown.

More importantly, what can we draw from the article, to put our business prospects into focus based on the site-built slowdown? The first and foremost conclusion is that the test is rapidly coming, when the belief of many in our industry that MH would get a big bounce from any upset in site-built housing, will be put to the best. Again, I have disbelieved that contention all along.

Unknown

The second part of the story that jumps out at you is how nominal the numbers are in terms of annual percentage decreases in conventional housing prices, new home starts, and actual sales. Site-built housing is such a large industry and affects so many in so many different ways, its impact on the economy is unavoidable. Our far more dramatic industry decrease, by any measure you wish to test, has barely created a blip outside the MH industry itself. The large MH industry decreases are unknown by the general public. In my own case, when I tell people I'm in the factory-built housing industry, the retort is invariably about how good we must be doing. Don't I wish!

Facts

Let's look at some facts the article points out:

1. Since the end of WWII, there has never been a year-on-year fall in home prices.

(The MH equivalent: In the most common home placements our homes depreciate 25-35% immediately, and not uncommonly, by 50% in less than 10 years. And site-built is worried about loss of nominal value for up to 2 years!?)

2. The median price of an existing home rose only 0.9 percent in July from a year ago.

(The MH equivalent: In chattel placements we have difficulty documenting any home value appreciation, over any period, to say nothing of a one-year period. Not impossible, but rare.)

3. Purchases of new home sales, which account for 15% of the market, dropped 4.3% to an annual pace of 1.072 million homes.

(The MH equivalent: Sales of new HUDCode housing dropped fully 65% from year ending 1998 to its current pace of not more than 130,000 homes for 2006.)

I relay the above to demonstrate how incredibly horrific our figures are in comparison with site-built housing. By any measure, the performance figures for site-built housing, even in the funk they are currently in, are exceptionally good as against HUDs. We've just become inured to incredibly bad economic performance for our housing. Performance so bad that it has rendered us asunder with the decrease in our business activity.

In Pretty Deep

This is not to suggest that site-built housing doesn't seem to have sunk into deep do-do. It has. Note the following factoids:

- In June the supply of their homes completed and available for sale stood at a record level of 132,000 – Census Bureau

- A 7.3 month supply of homes on the market is the largest supply of homes for sale since April 1993 – National Association of Realtors

- New Home builder optimism sank for a seventh consecutive month in August to its lowest level in 15 years – National Association of Home Builders

- A huge spike in foreclosures, up 25 percent this year – Realty Trac

In conclusion, as an industry, we have accepted very high home value depreciation for our homes, extremely poor consumer satisfaction, and loan performance amongst the very worst for any collateral type. The result has been an industry tailspin of unprecedented proportions, by any measure. And by "measure" I mean *actual performance figures*, not the unsubstantiated statements of pundits and cheerleaders. (And no, even though I am "our good friend up east", I was not on the grassy knoll.)

Image and More

After last month's letter went out I received substantial feedback of a very frank and considered nature, detailing thoughts and experiences of many who felt compelled to weigh in with me. The main complaint continuously referenced is that far too often as an industry we shortchange our consumer in various ways, all of which has led to consumer's now returning the favor and shortchanging us. They've done so in droves for almost 10 years as we've found the consumers we need to sell to, because they can be financed, have shunned us, with our tightened lending standards. The impact has been a decrease in HUD sales, the level of which, were it to happen in site-built, would have the country back in the Great Depression. Instead, the depression is localized to our industry, only hurricanes offering glimmers of hope, even that eventuality receding as the federales find that siting HUDCode housing, even for emergency purposes, has its challenges.

Positive Response

The image campaign I discussed in my last letter, got lots of very positive response. Few now dispute the need for it, or the companion piece advocating correcting our "Roper Study" faults. If we are to succeed, we will have to do this and I'm hopeful as I and others continue the drumbeat, that ever more industry participants cross over to help plan and execute a "grand campaign" for the salvation of HUDCode housing. And while the Home Improvement Act of 2000, and other regulatory schemes will not go unnoticed, this whole problem really is about **consumers**. Public perception and far greater acceptance of our product by consumers and regulators, ending with better buyer satisfaction of our homes in a variety of meaningful ways is the end game. If, a growing vibrant industry is our goal, then these moves are irresistible. If an industry on life support, with withering prospects is your cup of tea, then you already have a plan to accomplish that. Just continue your course unchanged.

As I wrote this, **Len Bonifeld** (elb@gate.net), the **MH Columnist for the Lakeland, (FL) Ledger** emailed me. He recently wrote an MH image article which ran in that newspaper. Result: it resonated with readers, leading to over 40 emails coming from readers in a number of states. They all agreed with the need for an MH image campaign. Understand that getting that many responses to any article is highly unusual. It indicates enormous interest in the subject. As a supporter of MH he strongly advocates the image campaign. Now!

Invoice Database Redux

Nah, Hell, we don't need no stinking database. Our mere inability to identify a resale HUDCode home easily and correctly doesn't bother anyone but the homeowner at time of sale. Why concern ourselves with that? Even if frequently the inability to identify the home causes an appraisal value substantially lower than if we could properly identify the home, who cares? Certainly not the industry. We see that daily. (Well, I guess the homeowner cares, and chances are he tells his family and friends about it. All of them.)

Cause and Effect

And if you don't believe in cause and effect, then why concern yourself with proper resale home identification? The factory and retailer already sold that home new once and don't stand to profit in any way from expediting the subsequent resale for the homeowner. Who cares?

Well, the original purchase money lender probably cares, as the inability to procure proper identification and the subsequent insufficient sales proceeds from the resale of the home is a leading cause for borrower default. In a world where properly done, default levels for 680 FICO's chattel portfolios can and do run in the 25-38% range, who needs more?

The new lender for the resale cares as well. For him maximizing the loan amount, consistent with proper home value, is of importance. He wants to lend on the highest loan amount consistent with his program guidelines. Ergo, our friends at the insurance companies and their agents. They want the right valuation, and higher is better.

And the retailer cares, as he wants to maximize his loan amount as well, to procure the greatest return on used homes he owns. And so does the community owner. Many of his problems would be over if his residents could sell advantageously, stopping defaults and making our product a desirable place to site your home which is a good value, not necessarily against a site-built house, but against an apartment.

Good Value

By definition, any purchase money loan outstanding at resale of the home, that cannot be paid by the proceeds from resale of the home, is not a "good value." That fact makes leasehold communities desirable or not, and our product as well. Recently, many have not been desirable. And you think the homeowner cares whether he can get enough back on the sale of the home to pay off his note? You bet he cares.

I hope I'm not letting the truth out by stating that the homebuilders are the real power in the industry. They build the homes, control substantial avenues of new home sales, and with their fees added to the home invoice, fund the greatest portion of industry associations' budgets, thus controlling them. Oh, you knew that already?

Some Do Care

What seems to be less well known is that not every builder in the industry does much to help with proper home identification, Some, like Fleetwood Homes are just terrific, going to great lengths to help identify the homes. They not only have a letter system built into their serial number code to positively identify the home model, but upon request will make the system codes available to lenders to assist them. They also go to great lengths to identify homes made prior to the code model designation. In this respect, Fleetwood is easily the industry leader. Some others are helpful when asked.

But many builders are not only uncooperative, but actually *charge* the consumer a fee to learn the real model designation of their home because when they built it, they didn't consider the second or subsequent owners. The fact is my friends, that often they don't care. After the new home is gone, who cares?

Pay Me Now, Or…

Those of you who have watched television the last 10-15 years are familiar with the Fram Oil filer ad of "Pay me now or pay me later." The theme, and a brilliant one it is, is a variation on Benjamin Franklin's, "a stitch in time, saves 9." They both mean that relatively small and low cost measures, done in the beginning, can save many expensive problems in the future.

This matter of home identification of resales can be fixed in the twitch of an eye, by this industry adopting either an individual serial number code that identifies the home, or better yet, an "industry standard" serial number code that does the same. Our friends over in autos, who also have serial numbers [Yah, we're not like autos. In our dreams we could be like autos.], long ago were forced by legislation to adopt a standardized code, inuring great benefit to the industry, consumers, insurers, lenders, and everyone except title tamperers, whose job suddenly got harder. (Only an Invoice Database, easily and inexpensively available to the proper parties can correct the problem for homes built before the adoption of standardized serial numbers.)

Blunt Speaking

Let me be blunt about this. Is doing this serial number series so freaking hard? Is it really? Is everything to be kept secret? Why do we continue to debase our resales? Why do we continue to shortchange subsequent owners? The easy answer is that we have been doing so for years and continue to do so, because we don't care. It's not important to us.

And guess whom the proud recipient of that type of dealing finally impacts? Why, the builder. The guys who didn't care then and don't care now and their non-caring negatively impacts the Fleetwoods who have tried to do the right thing, but can't rationalize the process by themselves. They need help from every industry builder and so does the consumer.

Oh, Fram, you think maybe the uncaring HUD builders are getting their "pay me later", in the form of a product little regarded by consumers, with new home shipments at a population-adjusted rate as low as 1961. (Yes, Virginia, they were building "trailers" then, and no, there was no HUDCode.)

Jettisoned

As an industry we have foolishly abandoned our used homes and the consumers who own them. No thought like Toyota, BMW, Honda and others that used product is the key to new product, and who make a concerted effort to support the used resales. No, for us, it's jettison the consumer time, far too often, after the first sale. Guess who's being jettisoned now?

There is hope, as I wrote this and was emailing for feedback, a major builder's CEO sent back the following: "It's the right thing to do, and very inexpensive to do, too." Yes, and yes.

Popular Housing Services

In early August, around the 7th, the wires started humming that Popular Housing Services, the Banco Popular MH lending subsidiary was exiting industry lending. Communications sent out by Pop Hsing confirmed that at a minimum, serious downsizing was occurring, and most of us were left with the early impression that the move was likely to be permanent, after due course.

I finally spoke with **Dan Baxter** (dan.baxter@popularhs.com), the pleasant head of the program, soon thereafter. Dan was concerned about helping his employees and associates find new jobs. He also went to great lengths to tell me that the Pop Hsing move was only a retrenchment back to the geographic area they know best, the Northeast. And then at an appropriate time, they would resume their nationwide lending goals.

Painful Facts

I have no reason to doubt Dan Baxter. I am hopeful that Pop Hsing will in fact resume their nationwide lending effort. But even if they don't, it is my sincere hope they will continue to support the industry in the Northeast. But I would point out some painful facts for us all to consider.

First and foremost, the total industry lending market has been stagnant for several years now. Last year the industry-dedicated MH lenders originated about $2.5 billion in loans. Even with the increased penetration by industry lenders in 2006, I do not see them originating over $3.5 billion this year, even as they steal loans from banks. To put this in perspective, note that in 2001, even after the iceberg hit, Conseco/GreenTree alone originated more than $6 billion in MH loans.

If these are the "good ole days" of MH loan quality, and I think they are, they are not in loan origination volume. Without sales growth, individual lender loan volume growth must come from taking it from other lenders. Prior to Pop Hsing's announcement, by my count, there was a group of five "national" industry lenders, all chasing essentially the same tier of business. This tier of business prizes sound borrowers over high yield, the intent being to reduce the exposure of high defaults, with their attendant need for super-servicing efforts. But this model sacrifices the high interest rate yield charged for riskier loans. While there have always been industry lenders of this stripe, I do not remember a greater percentage of them than now exists.

Pressure

The problem with this game plan is that with that number of lenders, for not more than $1 billion worth of originations being transacted, economies of scale, or lack thereof, loom large. If we want to believe that in general, about $500 million in volume is a desirable goal as a lower-end annual loan volume, for a national MH lending program, an easy calculation reveals that 1) the number of lenders available, 2) the volume available to originate reasonably efficiently, and 3) the desirable minimum annual lending origination volume, translates into two, maybe three national lenders for this tier of business, at best. These realities are in the mix today and are an important reason to try to increase new home sales volume. Otherwise, contraction still remains a threat for this type of lender, just as it does for other industry segments. For 130,000 new home sales, there is still far too much industry lending capacity.

The MHL Annual Shipments Contest

Whispers are still circulating that as recession looms, the HUDCode segment could get another body blow following the uppercut given us by the ABS markets in the early 2000's. Economist and analysts are still holding out hopes for a plus 130,000 homes year, but the current shipments lull actually has an annual rate after the latest release of shipments figures for July, of under 120,000 homes. (Will rebuilding the Gulf Coast save us?)

Again, no one is hoping for that, but the shipments action is not performing well at this point. The aforementioned site-built housing slowdown could be a new negative factor, taking us with it, and the looming recession is likely to impact many of our consumer base badly. Not a great outlook however you view it.

We'll slip the 2006 shipments pace to **125,000 homes** for the year, and if FEMA homes are included, to **128,500 homes**. My spirit won't let me capitulate to under 120,000 homes yet, but even 125,000 homes, not counting FEMA, seems a stretch, as of what we know now.

Internal Query

The query which is proceeding internally by those who follow these things, is what is the "natural business volume". That is, what number of home shipments, even with adverse conditions, will inevitably result as a minimum. While at one time it was thought to be around 130,000 homes, it's now seemingly under 100,000 homes. (Can't be, can it?)

Here's how my thinking goes on this. While 130,000 home shipments, that of the last few years without FEMA, has been believed to be very low, it was done during very good economic times with high housing demand. My concern recently is that while I focused on the negative during that time, the very low HUD shipments, perhaps I was missing the two above positive factors; 1) strong economy, 2) very strong housing demand. That means that perhaps we'll go under 100,000 because housing demand in general is softening and possible economic malaise now seems possible, even probable. How can these two impact MH positively, as some contend? They don't, they are negatives.

Constraints

Almost daily we are aware of another departing retailer. Again, this constrains the distribution chain for our homes. And because the surviving retailers in many cases are financially strapped, they haven't the means to open "super centers" selling many more homes to a far larger market geographically. So they can't pick up the slack. Again, I hate to be our negative "good friend up east", but what else can I make of these facts? Perhaps those with positive news and cheerleaders can disabuse me of the facts.

The Leaders

All contests have a leader, and at present with a guess of **124,900** HUDCode shipments, without FEMA, **Lauri Van Eyl, Senior Product Manager at Foremost Insurance Group** (lauri.vaneyl@foremost.com) was almost dead on the 125,000 pace. The next closest was **Don Scarmuzzi of Chase Manhattan Mortgage** (dscarmuzzi@aol.com), with a prediction of 124,000 homes. Don, former MH "big shot" at Chase MH and Origen Financial has been negative on industry prospects for a while. He's noted our severe industry weaknesses and lack of efforts to rationalize our business. How right he is!

In the "all in" category, with a prediction of **128,555** homes, with a run rate of 128,500, is **Don Fuquay**, **the Senior Vice-President of Sales at GreenTree Servicing** (don.e.fuqua@gtservicing.com), the MH lender and servicer. No one else was within 1,000 homes on this prediction, so I can't name a runner-up.

Footnote: In the non-FEMA category, **Cam Lavin**, lawyer-boy of Temecula, CA and all around good son of Marty Lavin, lawyer-dad, was dead on at 125,000 homes predicted. I'll make note, give him high praise, but no relatives need apply for this contest. And that's the way it may be in HUDCode Housing as of August 2006. Maybe. (Hedge, hedge.)

Call Today!

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