Volume 6, Issue 7

JULY 2006

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"SEEPING IN"

Marty's News & Notes

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

Meeting in Washington, D.C.

It's pretty hot everywhere this year. Washington DC in mid-July, 2006 was no exception as Manufactured Housing Institute (MHI) held its **Summer Meeting.** This meeting seems to be the least attended of the year. I'm not sure why, but the lack of a "resort" destination and summer vacations no doubt impact.

A more disturbing trend is the oft-heard criticism by so many that at this point MHI has almost become irrelevant. While there continues to be association loyalty by most members, there is a serious undercurrent of concern that the many problems the industry faces go unanswered, that the association lacks a direction or answers. There seems little consensus as to a corrective course of action and the few attempts at a new course have led nowhere. It even reached the point recently where industry big-shots convened in Chicago to discuss how the industry could speak with one voice to our regulators, which could have endangered MHI. I reported those developments in last month's letter and subsequent feedback and analysis determined my report was accepted by some and rejected by others.

Right or wrong?

I spoke in D.C. with two prominent industry builders, both who had been at the Chicago meeting. One said that his take on what happened there was significantly different than I reported. Never mind that my report was a condensation of a number of conversations with others who attended the same meeting. He didn't think it captured the moment.

Another chap, also there, said my newsletter with the Chicago report was so well written and so well crystallized the events and conflicts there that he had put it aside for future reference. In these two prevailing and contradictory opinions is neatly portrayed the very state of affairs that hold sway within the industry today. There is no consensus and precious little leadership in forming one.

Oh, yes, we've had numerous meetings and retreats to attempt to formulate an industry-wide response to our numerous problems, but the results have been feeble and disjointed. The most notable attempt at self-rescue has been the adoption of a Consumer Satisfaction Index (CSI), which apparently is underway, but it's progress is underreported and its entire purpose still in flux. While I absolutely think this is an extremely important initiative, I wish we would prioritized our customers as much as we seem to prioritize our regulators. I see scant evidence our regulators are putting us out of business, but see daily evidence our customers and our image with the public continue to constrict us as a boa constricts a rabbit. Our air gets more compressed daily.

Progress?

I hear the initial work towards the CSI led to some early bobbles, the effort not inaugurated smoothly. That all comes from hearsay as I do not remember a status report from MHI to the general membership, in spite of the fact that around $195,000 of membership funds have been allocated to the project. Presumably the effort is on double-secret status with results available only on a need-to-know basis.

Of course, you begin to wonder whether the industry has any ability to get it right the first time. Whether we are to blame or not, too often our efforts continue much of the public perception that our housing is the "default" choice, cheaper but not as good and not as well done as our site-built, wealthier cousins.

We hurry to build FEMA homes, and a sea of roofs remain in storage. The easy answer is that FEMA screwed that one up. Heaven knows they did and that we should have expected no less from our friends at government. They excel at spending money and are deficient at getting results. You might say spending someone else's money ultimately can lead to no other result.

Yet those roofs are from homes we built and the reason they are not sited is a problem with getting an easy siting approval process. Even the government can't seem to do it without difficulties. Oh, you say that's not the problem? There didn't seem to be much problem siting those formaldehyde infested RVs. Many thousands of them. Our homes were resisted or outright banned. I'm not sure FEMA is at fault for that.

Another leg down?

And now as 2006 drones on, a new home shipments low in the mid 125,000 home range beckons on the horizon. And barring a spate of significant "new" and "easy" money entering the retail loan market, little catalyst for re-energizing the industry is evident as housing in general slows down, and we go with it.

Yah, but, you say that bad news at site-built generally signals good news for HUDCode housing? Well, happy days, we are delivered from the grasp of the boa. I'll keep an eye on that one but as housing in general has slowed, our modular shipments have followed them, HUDs are stuck in non-FEMAland, and the realities of retail lending to the credit tier most attracted to buying our housing haven't changed for the better. I ask you, can you point me to a catalyst for rapid change, increasing our home sales?

Again, for the umpteenth time, an industry conversation must arise with the entire industry model included. Paying more and better attention to the way the industry builds, sells, sites, guarantees and finances its product might be a good start. Continuing the conversation monthly, with measurable moves could help. A small, powerful group of industry power brokers could act decisively to "encourage" us to do a far better job than we seem to be doing.

But to hold ourselves blameless for the difficulties FEMA encountered is just a little too clever. The industry's actions and record over the last 50 years have created an image of who and what we are, that is hampering our every effort to succeed in fulfilling America's affordable housing needs. Even in Katrinaland, where people are living in the street, under the bridge and in the back seat of their cars, the authorities view our homes better located in Arkansas holding-lots than on homesites, housing their afflicted residents. Ooo-kaay. That tells you something.

Drastic action needed

Since 1998 when unneeded homes built up at retailer lots and a spate of unsound lending preceded that year's 373,000 HUDCode home shipments, to the

2003-2005 era when we dropped to about 125-130,000 purchaser-desired homes, the industry response has been feeble at best. The response has been a combination of Alfred E. Neumann, using the opportunity to acquire market share from others, meetings without purpose, and the self-delusion that providing affordable housing is of itself a noble endeavor and our responsibility ends there. Our customers and regulators seem not to see it that way.

Industry Czars could take charge. A small group needs to chart a new course. Wide-ranging industry changes and initiatives should arise. MHI could be the point guard to set up the plays and then later the instrument to effect the overall program.

Likely to happen, you ask? Were I a betting man I would place all my money on a continued stagnant industry, consolidations being the order of the day, with stealing market share from other industry competitors the end game. And assuming the process continues along its seemingly predictable path, absent any new, material ingredients being introduced, this seems the game most likely to be played out. There is little evidence industries self-regulate or change their industry model. More commonly regulators and class action lawyers force changes.

Our regulators have been restraining our ability to operate under the same ole rules since the early 1970's, the tromp of their goose-steps signaling an ever-reduced ability to place homes with little resistance, reaching even to Ray Naginland (Louisiana). And some of the best MH markets are states with some form of rent control for landlease communities. Boy, does that throw sand down your throat. But it should give cause to reflect. How come?

No consensus

So, industry participants, like the two builders who spoke with me about the Chicago meeting, are deeply divided as to what to do. They breakdown fairly neatly into the Deck Chair Movers, and the Revolutionaries, the first think things are not OK, but why change because they could get worse or just wait, we'll be OK. And the second group believes worse lies just on the horizon and any change is better than meekly waiting for the boa's curls to touch each other in the middle. At this point the Deck Chair crowd is still in control. One day however, they will have to find a way to stop eating themselves in the industry, as we play out what is likely to be a zero-sum game.

I sense everyday that the state of our industry, its true potential, its future growth status and its heavy limitations as currently constituted, is seeping into the industry reality. Who has heard anyone say with conviction that we are likely to again reach the 245,000 average annual HUDCode home shipments figure of the 1975-1994 period? Who thinks we'll get to 190,000 homes next year? I've spoken with **no one** who believes or even says these things for years now. Most are merely now saying the industry will always have 100-120,000 homes of volume no matter what. Quite a change from 1998, eh?

Last year's FEMA sales seemingly hid the real direction of our housing and put in retrospect it seems probable we could have broken below the 130,000 home support level of the two previous years. We have no real way to know, but there is a strong possibility we were under 130,000 home shipments for non-FEMA demand in 2005. AND, the previous two years, '03 and '04 definitely were under 130,000 homes if you remove FEMA sales.

Perception and image

There would have been a time when most of us would have accepted that FEMA needed us and that as hurricanes tossed around all types of housing, HUDs would be needed to shelter those afflicted. I suggest, and numerous others have done the same to me, that after Katrina/Rita and the sea of roofs at Hope, AR, New Orleans' Mayor Nagin's vocalizations blew the cover off using HUDs for that purpose. Again, public perception, leading to blocking the placement of our homes, torpedoing the industry. And you tell me we don't need to 1)act immediately against that misperception with vigor or 2) change those defects in our industry model which reduce consumer satisfaction, but can be corrected by us?

Seeping in

It's seeping in. Everyday I speak with more people asking for action on these two fronts. The first is to create a professional image campaign, funded by a $200 charge on each floor shipped, or whatever, to raise a large pot of money to fuel a campaign to educate Americans on the valuable role factory-built housing can play in this country and to tout the advantages of building homes in a factory.

Can't be done on that sort of budget you say? Please don't tell me Ensyte and Bob have a bigger budget to talk about male hard-on deficiency than this whole industry has to speak of its homes. Is there someone out there who hasn't been exposed to Bob? Even some Mickey Mouse male enhancement product of dubious effect has created a campaign to reach all of America. We can as well, and hopefully with a product of greater worth to society. (I got to think about that one!)

The second step is the industry's obligation to walk the talk. You know, delivering a home with value to the consumer. I think it's telling that the "Chicago meeting" was more about how to deal with our regulators than how to please our customers. Seriously, I mean seriously, do you really think we are headed for what could be well under 130,000 home shipments because of our regulators? You mean to tell me that government is the problem and not the way our product is perceived by the public, lenders, and yes, even our regulators. Get the Home Improvement Act right and the "boo-boo" will be all right? Deliver me, please, Lord.

Timing

There are those who say to me, "No Marty, we have to get our act together before we think about starting any image campaign." Let's see, it took 35 years after the industry top of 580,000 homes shipped in 1973 to get us back to 130,000 homes last year (less than 1963). Correcting our industry deficiencies in nice gradual steps and then letting the word filter to the public, should easily take the next 35 years. Is that what I'm hearing we should do? Sounds like a plan to me.

Many seemingly against this image campaign seem invested in the belief that industry relief is just around the corner. The totality of our situation has not seeped in to all. Or it may be the continued defense of turf in being against this is because I have railed in favor of this for so long and so loud. And, of course, as can happen, I could be completely deranged. An image campaign and betterment of our consumer satisfaction might well not work. It's possible. (Hmmnn, that would really spell trouble. . . .)

Advertising misguided?

You mean all the items being peddled by slick advertising on TV are all misguided money misspent? Billy Mays, Matthew Lesko, Carleton Sheets and Bob of Ensyte tell me I'm right, and they are selling **nothing**. We sell homes, places where people live, raise a family, leave for school and work, eat meals together, have parties, and enjoy life in general. We don't have more and better to sell than Bob or "free government money" from Matthew Lesko? (The crazy bastard with the yellow suit with question works all over it.)

The end game

All I suggest is necessary to assure our customers, the public and our regulators that we are a fair industry; that we treat people right, that our product is well built, sited and guaranteed; that within its limitations, our homes provide value; and that we understand we have not always done the best job in these regards. The Roper Report told us that.

Don't think this makes sense? What is your answer, waiting at the bus stop for the Easy Money Street bus to come by? It ain't running anymore.

The River Flows

Money returns seeking a return

Money is always seeking a return. I claim no special knowledge on what's out there or how much there is, but I know it's a lot. Money for MH loans is readily available for retail lending. Our MH lenders tell us that. It is, however, expensive and available only for certain credit tiers and primarily with certain home placement types.

No news here that the closer the home is allied with a piece of real estate, the more accessible and cheaper the loans for the homes are. In descending order, the loans are considered best by lenders as follows, generally: Fully conforming mortgages, non-conforming fully real estate secured, MH land/home, scattered-site chattel secured, and chattel loans in landlease communities. Did I miss something?

Investment funds

Into this universe of MH investing, there has arisen a recent move, seemingly picking up steam from “investment” funds looking for industry opportunities. I’ve heard of a number of contacts from “investors” recently from other industry members and have had three separate solicitations seeking industry opportunities directed at me. Where can we invest in the industry? Well, in an industry where most everything is for sale, finding places to invest should be easy.

There is no question this interest has picked up steam and some investments have already been made. Others may have occurred, but have not been announced.

This renewed investor interest is positive news for the industry, as money is needed for virtually every business enhancement any company contemplates. You can only cut costs and circle the wagons for so long before your seat at the business table becomes uncomfortable.

Lack of revenue growth for companies is an obvious problem. Seeking it is a necessity and constant endeavor. There is little question revenue growth in the industry has been challenged since 1998. Recently, revenue growth has come primarily from stealing market share from others or buying it. I would expect that process to continue.

There are bright spots

But, wonder of wonders, several MH industry lenders are reporting to me substantial loan growth this year, being done without any “softening” of their underwriting standards. In some cases the growth is dramatic, as reported by both Triad Financial of Jacksonville, FL (800-522-2013) and 21st Mortgage of Knoxville, TN (800-955-0021). And amazingly, this growth does not seem to be coming at the expense of other industry lenders. And even more puzzling, it’s coming in the face of a flat, to down shipments year. What’s happening?

Actually it’s easier to explain than first thought. I know from reports from the field that as the large MH lenders expired or withdrew from lending in the early 2000’s, local banks and credit unions, feeling comfortable with their knowledge of their local MH market, began or increased their lending on our product. Those who did so judiciously, had knowledge, and who selected good industry partners, got a good result and are still involved.

How large a market?

If you go to my MH market study which I released to certain industry members in January, I concluded, in round figures, that total new and resale home volume for 2006 in dollars, was on the order of \$30-\$32 billion, at least potentially. In a world where our industry lenders cumulatively weren’t doing more than \$2.5 billion of it, who was doing the rest?

MH home purchases are financed by a very large and diverse number of methods. Some pay cash, others get owner financing, etc; but without doubt, the huge number of banks and credit unions were accounting for the greatest share of this business.

I see lending proposals from these people at times. Almost without exception, they comprehend from the beginning that lending on our product is “different” from their other loan products. Yet, too often, in practice, people do what they know best, and the program is commenced using conforming mortgages methods and mentalities. Often, no real MH knowledge is onboard initially. You’ve already started off setting yourself up for failure.

Defects

The first 2-3 years, as the portfolio grows, and loans are still fresh, things look good. Let's do more! But as the reality of loan performance settles in, the challenges of the servicing our product requires starts to bite. Absent good industry partnerships, banks and credit unions have not demonstrated across-the-board adeptness at doing this. Yes, some are very good, others less so. In general, their culture and philosophy are ill suited for the special knowledge and hard work MH requires.

I know that some banks have tightened their standards and/or increased their interest rates, slowing their MH lending volume in 2006. I suspect the industry lenders' loan growth we are seeing, in the face of a flat to down market, is coming at the expense of banks and credit unions. I expect this trend to continue with industry lenders growing their percentage of MH loans originated as a percent of total market, and increases in dollars originated. Not dramatically, mind you, but still increases. And I expect some banks doing MH lending without good industry partners or good internal knowledge, to encounter the "Heart Break Hill" realities of lending on this product.

This does not mean you shouldn't call on your local bank for retail financing. You should, but your main role will be to keep them out of trouble. On their own, many will fumble the ball. You can create a mutually beneficial program in conjunction with them.

Eye Opener

Think Marty's full of crap? O.K., here are some exact quotes from a July Earnings report from one of our MAJOR industry companies. Their President and CEO made these remarks, which I have quoted verbatim:

"MARKET CONDITIONS & STRATEGIES"

"A. Highlights:

1. During 1Q06 call, "The Company" expressed concerns about the underlying trends in the HUD Code business.

2. As the Co. enters 2006, there was a great deal of optimism that the industry-wide production of FEMA units had displaced production of day-to-day business and as a result there was pent up demand.

a. This together with the permanent replacement of homes destroyed by Hurricane Katrina would rekindle growth in the industry.

b. This has turned out not to be the case as there was no pent up demand and while business has certainly improved in the Gulf region it was more than offset by deterioration elsewhere in the country.

3. If one excludes FEMA shipments from 4Q05 and the spill over into 1Q06, the industry declined 3.9% in 2005, and continued to decline at the same rate for the first five months of this year.

a. Unless this trend reverses soon, which does not appear likely, industry shipments for 2006 may not even reach 130,000 units, even including the 4,000 FEMA units that were shipped in 1Q06.

b. For "The Company", this slowdown occurred in every region of the country with the exception of the Gulf Coast and Texas, resulting in a 14% reduction in HUD Code shipments, shipped this qtr. vs. last year, and the lowest per plant backlog levels since 1Q03.

c. This in turn reduced "The Company's" overall plant utilization to 62%, which negatively impacted manufacturing margins...."

Analyst's question:

"I'm wondering if there's not a cannibalization of HUD-code by modular, what other variables might be at play that are driving demand trends to be so low?"

Response by President and CEO:

"I think there is no question there is some cannibalization of HUD-code by modular and some of it is now getting back some of the market that the site builders took. But, I mean, I think the bottom line is you still have to look to financing and the high cost of financing as being the primary reason I still believe that the HUD-code business is down. And I think it will remain down for that reason.

People now have choices. Even though the sticker price on a HUD-code home may still be lower than a modular home or site-built home, you can still, on a monthly payment basis, get a much better value proposition by buying modular or even a low-end site-built home.

Resale is still an issue with HUD-code homes. Even if you do land home financing, the spread above mortgage rates isn't as high, but you still pay a premium. Terms are still often shorter. I mean, its plagued the industry for a number of years and despite, again, a lot of optimism, nothing has changed.

There are no new financing players and even if there were new financing players, it would require somebody to do something foolish to start financing people that probably don't deserve to be financed, which is what's happened in past cycles. And which is why I think we're not seeing it in this cycle."

Analyst's question:

"I know you said that you see a lot of weakness in the HUD-code market. Do you guys see any recovery there over the next four or five years, I mean, or do you think it'll be a pretty weak market at least for the medium-term?"

Response by President and CEO:

"I think it's going to continue to be a weak market. I mean, who knows what the future holds that far out, but it's going to need a significant inflection point for those trends to reverse and I don't see any out there at all, because I think it's going to have to be led by financing. And I don't think there's any way that will change, unless there is a legislative change in the HUD-code itself.

I mean, fundamentally, by definition, it is a portable structure and as a portable structure, never going to get the same kind of financing and resale opportunities and value-creation as something that's permanently affixed. So, I mean, I think that's an issue and I don't think that's going to change any time soon."

Marty's Note: Sounds like the President/CEO reads my newsletter, or at least agrees with it.

The MHL Shipments Contest

July saw a clearer picture arising as to the probable direction of our home shipments for 2006. Shipments continued with no real strength or evidence of rebound in sight. Shipments pundits alerted their readers that a lower shipments call for 2006 was highly likely.

While there was no desire to start a stampede for the doors, lower shipments calls are the equivalent of hollering "fire!" in a crowded theater. Yet, with big FEMA shipments months of 2005 ahead to match, and last year's actual total for non-FEMAs at 130,000 homes or less, and a continued drift lower, what are we to conclude?

Concerns are whispered

Within the week I spoke with a large number of industry participants, most people at or near the top of their companies. Clearly stated concerns that we are headed for an **under** 120,000 homes shipments year are now beginning to circulate. No one wants that to happen and all are holding their breath, but the mood is to not be shocked were it to happen. I do not expect us to test those lows, being in the belief that we are more likely to be between 121,000 and 125,000 homes.

But, as I concluded long ago in writing to my readers, the likelihood we would see a rebound in MH shipments as conventional housing softened was faint at best. There is no current evidence of the formerly oft-repeated truism of MH taking off as conventional housing interest rates increased. Today, MH seems nothing more than a small subset of housing and its days of being 17-22% of all new housing starts seem dead for the foreseeable future.

It's beginning to look like the 2006 shipments pace at present is running at **133,500** homes, "all-in", and around **130,000** homes without FEMA. Since the FEMA-heavy first quarter of '06, there has been a constant downward trend as we wait for it to settle.

The Predictors

I looked at the Shipments Contest predictions, and closest to the "all-in" number now running at 133,500 is **Chip Asch, the Sr. V.P. at US Bank's** MH lending arm, with a spot-on prediction of 133,500 homes.

Chip's an old friend who lives in LaJolla, CA and has been involved in MH lending for many years with a number of MH lenders. Well done, Chip!

In the non-FEMA home category, with the current run rate at 130,000 shipments, the contest leader was – holy craps – its **Chip Asch** again, with exactly 130,000 homes. Chip is right on the annual shipments rate for both parts of the contest, something never done before and demonstrating significant acumen. I'm impressed.

In the "all-in" category, **Terry Dullaghan, the National Account Manager for Senco Products**, was runner-up with a prediction of 133,836 homes. And in the non-FEMA homes category, **Bill Donnelly of Land/Home Financial, in Orange, Florida**, was a little light at 129,550 homes, but he's in the chase right now.

I again reviewed the 2006 predictions consensus and for non-FEMA home shipments the contestants predicted 131,299 homes for the year. As it now stands, a very good guess. Where the consensus breaks down is when you include total sales, counting FEMA, where the consensus was 143,018. I must say that as the contest entries came in and the "all-in" total was so high, I was highly skeptical of that number. Already the significant problems with our homes FEMA was experiencing were manifest. It seemed highly unlikely FEMA would need more if they couldn't use the substantial number they already had. Plus, who wants to buy more problems?

And if Katrina/Rita, with its unprecedented destruction, in formerly HUD-friendly areas wouldn't allow placement of these homes, what made anyone believe more would be wanted? It appears FEMA homes for 2006 will total not more than 3,500, only what was left over from 2005 orders, and delivered this year. (Tom Beers,MHI economist says the 2006 FEMA total is less than that.) That's the way it stands as of now.

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