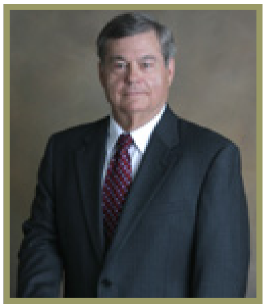
Volume 6, Issue 11

Volume 6, Issue 11

"PARTING ADVICE"

NOVEMBER 2006



Martin V. Lavin

Inside this issue:

Marty's News & Notes

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

PARTING ADVICE

I see Chris

We discussed last month that at the October MHI convention in Tucson, Chris Stinebert, former MHI President attended his final industry meeting in his departing role as former leader of the largest industry association. I asked Chris whether his address to the crowd there would include any parting advice. Chris, ever the politician, and a good one at that, allowed that he did have parting advice, but didn't feel this was the right forum.

Instead, his final column as MHI President would appear in "The Journal's" November issue and would offer his views as to what he thought the industry should do to create an improved industry. I am going to cover the eight points Chris offers the industry, in detail, offering my commentary to each point thereafter.

Muzzled?

But I want to preface my remarks on Chris' points by saying in clear terms that MHI leadership needs to intensively review its operational philosophy. What led to an intelligent man like Chris Stinebert being involved for eight years and unable (or unwilling) during his tenure to mouth the parting advice he proffers in The Journal editorial? What gag order is present in the hierarchy which failed to allow a clear discussion of the issues Chris identifies? No one is contending Chris formulated these concepts in the less than 30-day interval since he resigned and, authored this piece, right? So he knew these concepts for some time before he left, and for whatever reason, (I suggest fear of losing his job), never was able to verbalize his thoughts.

I don't blame Chris, but what a shame. It is this mode of censure that keeps the industry from an open discussion of vital issues which should have started years ago when the industry broke down through the 160,000 home shipments support level and it became obvious to any clear thinker that aspects of the industry model were clearly askew. Still nothing. Silence. Inaction.

Open discussion

Past MHI chairman, **Dennis Jones** made a stab at it about a year ago giving a most pragmatic speech at an MHI conference that to my mind was so enlightened that I thought an industry renaissance was beginning. It never happened. I can only assume that while Dennis' speech was 100% on point, he must have received a deafening silence from the leadership. "Let's not tread there", must have been the evident response. It reminds me of the Spanish inclination of "que diran?". What will they say? Meaning that the fear of what third parties will say imprisons many needed thoughts, which would lead to discussion, and ultimately translate into action. We didn't speak it, didn't vet it, didn't do it.

So the industry's fear of talking openly about our problems because the world might discover our malaise was deemed a success because there is little note of our industry condition in print. As usual, the industry misinterpreted the result, confusing the lack of reporting as being created by our silence, when in fact it was created by public and investor disinterest. Most no one cared.

So after 1998 we quickly melted away 35% of our business, and no one stirred. We then passed the 55% decrease support level of 2002, and nothing was done. We reached the 65% decrease level and retreats occurred, polls were commissioned and their results reported, even though everyone in the industry knew what the results would be before the poll.

I reported details of these developments to you in this letter as they occurred. Many applauded my efforts, but certainly not all. Frankly many would just as soon have seen me quiet rather than muse on these subjects, in spite of the fact that my predictions and observations have been far, far more right than wrong.

The Two Big Ones

At the Chicago Meeting a couple of years back I stated that the industry needed to deal with the two issues below and deal with them quickly and firmly, to the extent possible:

1. **The Roper Report elements**, which are the deficiencies with which we deal with our customers (and again exposed recently by the J. D. Power consumer survey), and,

2. **Home value depreciation**, which without substantial correction deems this to be a very small, niche industry. "Oh, heavens no!", I heard. Then the blackboard was filled with things that were the results of home value depreciation, but masked the culprit.

The two above, my friends, ***are the big problems***, and the whole industry dysentery results from them. Failure to correct them gives notice of an endangered housing form.

Years ago I reported to you that the industry was attempting to "escape upwards" changing their focus on bigger, better homes. All of this done to seek more effective financing to escape the "chattel trap" set up in home-only financing after the ABS markets meltdown. If as an industry we couldn't finance homes in the old predominantly chattel fashion, we would instead join the site-builders at the conforming mortgage table. As evidence as how that is working I draw your attention to the recently reported 2006 annual modular shipments ***decrease*** of 7+% for the year, off from a previous high of 43,000+ modulars for the biggest volume year ever. At play now after all the hoopla is whether building modulars to compete against the site-builders is a business plan or a stunt. The jury is still out. Can modulars capture more than just a sliver of the housing market?

The Eight Points

Oh, Chris Stinebert? He did write a column in the November "The Journal", right? Ah, yes he did. Let's go through Chris's **eight points** individually to see what we can gleam from his parting advice.

Without further editorializing, let's get to Stinebert's parting "comments", which really can be construed as advice to the industry. I'll cover them in the same order as he, on the thought he prioritized their importance, although that is pure conjecture on my part.

Stinebert: "So here is my list of issues and practices that I would change if I had eight wishes – or if I had a magic wand I could wave over the industry."

1. Stinebert: Manufacturers would step up and take control of the marketplace.

"For too long, manufacturers have served as "enablers," permitting retailers to continue their faulty practices, lowering the bar for all competing retailers and perpetrating a negative image for our industry with potential customers."

Marty: OK, so what is the dispute here? Our industry is well known for the very poor practices at our sales locations, including, but not limited to loss of deposit or even the full purchase price, lack of posted prices, instigation of customer loan fraud, a high gross profit/low volume of sales model and many other ills. These aren't rare examples, they are daily occurrences. And it is caused by far too many inexperienced retailers being in business, a large percentage of which are undercapitalized. Combine these two elements and the witch's brew of deficiencies is born. Since the manufacturers determine who will represent them in the marketplace, they are as Stinebert says, "enablers".

The bad news for the manufacturers is that the marketplace today is doing what it usually does: ruthlessly selecting sound business models for survival and destroying irrational ones. Oh, I already hear it coming! Yah, but Marty, this model worked for 50 years, and worked well!

Worked well?

Really? Worked well for whom? I admit it worked well for many retailers. Remember the average $1.7 million paid by major manufacturers for retail sales lots in the middle 90's, just before the collapse? A retail sales lot, most really worth two worn tires and two used prophylactics, sold for $1.7 million?

And it worked well for many factories, their output peaking at levels almost as great as early 1970's levels, with heights unknown in a generation. Yes it worked for them. And most everyone else in the food chain certainly profited, the suppliers, community owners, insurers and others.

So what is the problem if everyone profited? Well not everyone did. Certainly the huge number of homebuyers who lost their homes to repossession during the destruct phase didn't benefit. Buried in their highly over-priced and over-financed home, unable to resell their home when needed, the keys were returned, children dropped out of school, marriages dissolved, jobs were lost and a whole generation understood the reality of factory-built housing.

And the lenders, and their investors, they certainly did not benefit from the high volume of home sales in that period. Through ill-informed and mistaken lending (characterizing it in a charitable light), their losses subsidized the entire failed industry model, a model which essentially is still not drastically changed. That 115,000 new home shipments you hear is the sound of the volume possible for this industry using the same industry model as was used in 1950.

Illogical and irrational behavior must be subsidized in order to exist. Why so many homeless in the land of plenty as jobs go unfilled? Because the condition of homelessness goes on through the subsidy of charity, government or family. Try to find homelessness in poor countries without a war going on.

So yes, Chris, if the manufacturers had help from lenders as enablers in the past, they are on their own now, their current model stuck in low volume/low profit, as lenders withdrew their subsidy.

2. Stinebert: Manufacturers should assume the responsibility for customer satisfaction.

"As various market research projects have told us, better customer satisfaction is critical to improving the appeal of manufactured housing to new homebuyers. Without better customer service, the industry will remain a boutique, cottage industry mired forever in the 120,000 annual production range."

Marty: Yah got to give it to Chris, he really is an optimist. 120,000 homes! As the industry settles under that figure, with an early prediction for an under 100,000 shipments pace for 2007, the time may come when 120,000 homes will look good. The industry attempt to "escape upward" through modular production has hit the predicted result I foretold years ago. (The Land/Home Conundrum and What Business Are We In?, both on my website.) Shipments into land-lease communities are sparse, and there are only so many "back 40 acres" where we can site modest HUDs on Dad's land. Good business, no doubt, but not much of it, or at least, not enough of it.

Deadly combination

Combine high interest rates, high gross margins, high value depreciation, with high default rates and high consumer product dissatisfaction, what do you get? The HUDCode home industry. Note that lack of consumer satisfaction feeds on all of the above, and that they are all impacted by that factor. You cannot resurrect the industry without strong measures in this area, the correction of which is not entirely appreciated, nor accepted by the industry. In fact many want no part of dealing with customer satisfaction. Want a primer on how to do it? Study **Skyline Homes'** response as a starter for the "right stuff".

3. <u>Stinebert:</u> The industry needs to launch a national advertising offensive spotlighting the tremendous benefits of owning and living in a factory-built home.

<u>Marty:</u> I have stridently and consistently advocated an "industry image campaign" to inform our potential consumers, regulators, and the world at large of the benefits of factory-built housing and its role in the housing mix, particularly as "affordability" is a concern. I cannot say much more than I already have in the past, but I have proposed a "per floor" charge calculated to raise about $22 million annually from HUD and mod production, which is sufficient to fuel a professional, national media campaign.

I draw your attention to two points to consider in the mix:

a. The last time the per floor charge to pay for MHI dues was considered there was a significant discussion about raising the fee from $14 to $17, resisted by some and decried by most. In the interim, this fee has not been increased for several years, as the association cuts personnel, reduces programs, lobbies less and is starved for funds. A per floor charge which is an **infinitesimally** small percentage of the average home cost goes without increase, even as state association charges, VIPs and other invoice items add hundreds, or even thousands of dollars to the invoice. Most of those fees will do precious little to salvage the industry but are paid willingly. It remains to be seen how the $200.00 per floor for the "advertising offensive" will fare. I'm not entirely convinced it will happen as some of the retail lenders have indicated some hesitancy to finance the "advertising" fee. Couple that with the concern last time in raising the fee from $14 to $17, and you fill in the blanks.

Does this "advertising offensive" need to be done? You're kidding, right, when you ask that? It is crucial.

Risk/Reward

4. <u>Stinebert:</u> It's also time for this industry to finally start sharing the risks and the rewards.

"Lenders, including new lenders, are much more likely to lend money to potential homeowners if the retailer and manufacturer are more willing to share some of the risk."

<u>Marty:</u> To the extent the "sharing of risk" means things like the manufacturer taking responsibility for proper home installation or the community owner assisting with repossession upon borrower default and home refurbishing and remarketing, I entirely agree. These types of actions can be most beneficial.

To the extent sharing of risks means recourse for loss upon loan default, except for fraud or negligence, I part company with Chris. Too often, recourse facilitates faulty lending because someone else other than the lender will take the loss. This changes lender buying and servicing protocols. Recourse seldom lasts because one party, not the lender, is being asked to take on losses, which could cripple the lender. Instead the other party has the obligation to stand the losses and be crippled. Recourse being what it is, self preservation will ultimately lead to an argument over the obligation for the loss, there generally being more than enough blame on both sides to fuel a good lawsuit, instead of writing recourse checks.

The greatest "sharing of risk" the industry could confer on lenders is to take those actions oft discussed but never implemented to reduce both frequency and severity of losses so a lender could make an intelligent analysis of how much the losses are likely to be and charge a loan interest rate commensurate with that known risk. After all, that is what they do in conforming mortgage and auto lending with generally good results for the lender, their industry, and the consumer. We need to focus on the same, to create a known and survivable lending environment in HUD-Code housing, especially at the chattel segment.

5. <u>Stinebert:</u> Manufacturers and retailers should be more open about making pricing information more available to potential consumers.

"It's time to stagger out of the dark ages and discard the long held philosophy that "an

educated consumer is manufactured housing's worst consumer."

Marty: We spoke about our 1950's-style industry last month, which we still are, and about someone subsidizing our deficient industry behavior above. Barring the return of stupid money to subsidize the industry, the industry must and will change this behavior, leaving open whether there is enough industry to benefit when this is all rectified. In an industry where posted home prices are still controversial, you have to have cause for concern. The financiable customers of today are not boobs and treating them as such is highly destructive to the industry.

Help from Washington

6. Stinebert: Focus on the issues of real importance and stop looking to Washington to solve all of our problems.

"HUD, Fannie Mae, and Freddie Mac did not cause your world to collapse and they are not going to be your salvation either."

Marty: Yes, most regulators and individuals are unusually tough on HUDCode housing. What is there about building a home in a factory that causes such lack of enthusiasm for us and a general failure of communication with our industry? As Cassius said to Brutus, "the fault dear Brutus, is not in our stars, but in ourselves, that we are underlings." Yes, we might try a little more hat-in-hand politeness, giving and keeping our word with our outside "partners" and consumers, and be substantially less quarrelsome with in-your-face confrontation and demands. We don't have a strong enough hand in our favor to treat our "partners" and customers in that fashion. As we need them, they avoid us. Take that!

7. Stinebert: Stop tilting after windmills... go after those things that can be realistically achieved.

"We don't need to become like Don Quixote tilting after windmills – fighting battles that cannot be won."

Marty: We need to become the world's biggest compromisers. We need to bend over backwards to overcome an image of unreasonableness and intransigence. We need to stop looking to "for profit" companies to give us a subsidy. They didn't like it when they did it unknowingly and sure as hell won't do it knowingly. If you want a subsidy, get it from your "PAC" friends in Washington (Talk about tilting at windmills!) Meanwhile, a little compromising humility and ***keeping your word*** as an industry, could create a far better attitude than now exists.

Laser beam focus

8. Stinebert: The entire industry must focus on one goal – increasing the value proposition to the homeowner.

"If we cannot offer our homeowners real value for their housing dollar, how do we expect to compete in the marketplace?"

Marty: That is the crux, isn't it? Providing a value proposition. In the past, aside from reasonable and inexpensive housing provided, our biggest attribute was "ease of transaction". We made it easy for a customer to get into our homes. There is no question this was a leading HUDCode advantage. What we did not provide was a painless way ***out*** of the deal. Too often, once you were in your house, you were trapped there, unable to resell advantageously enough to pay off your remaining balance.

Those with postage and a conscience, mailed the keys back to the lender as they departed. Those without postage and/or a conscience simply got into their vehicle, packed with their belongings, and moved along with their life. They, of course, left the home behind. Another repo.

While I would agree homebuyers would like to profit upon the resale of their home, most chattel buyers would be satisfied to be able to sell their home and simply repay the note. Just that would go a long way toward creating a far better value proposition for the HUDCode homeowner and take a giant step towards industry recovery. For most HUD housing, getting to that point will require many things to change, most of which presently are barely blips on the radar screen and the betting by the industry is that the blips are not icebergs.

Thank You Chris

Personally, I thank Chris Stinebert for his parting advice. I don't think Chris came up with all these points since he resigned his position at MHI. Of all the people in the world who would know a lot about the state of the HUDCode housing industry, the MHI President would be at the top of the list. Everything in the industry, good or bad will ultimately channel through his office. His ability to be plugged into all facets of industry conditions is unrivaled.

Yet, with a few exceptions, the candor he demonstrated in his column was never apparent within the industry. I frankly was shocked Chris was as tuned into the real industry state of affairs. I was always checking for that Kool Aid ring around his mouth. His parting advice reveals why I never saw it; he never did drink the Kool Aid.

More importantly, I ask the power brokers running MHI how big a waste they created by having an effective, intelligent leader like Stinebert in charge of MHI and keeping him effectively muzzled for eight years. Instead of discussing the above points candidly and leading a determined effort for industry-saving change in the last five years, he went to industry meetings and was forced to watch a bunch of fools running ourselves into oblivion by failing to act, doing a circle-jerk of incomplete ideas, no consensus for change ever emerging. It must have been enough to turn his stomach. (Mine heaved some.)

As the effort to replace Stinebert proceeds along its course, I hope the new person will be given far more leeway to tell us what we need to know, and not just when he resigns. What a pity.

SUBSIDY

In my opinion, the industry settled into an industry model that seemingly worked well for many years, all driven by easy financing money, especially for chattel loans. While there was significant volume turbulence, still the industry averaged about **245,000** HUD homes per year from the advent of the modern era, 1976, until 1995, the last year before The Big Blow-Out Cycle.

During that period, volume went over **300,000** homes and under **200,000** homes, both of which numbers look perfectly delicious today. All during that time retail lenders came and went, lured by "big returns" and chased by "big losses."

But the extent of the losses always seemed quietly controlled, the lender dropping by the wayside without big national attention. While their experience did not go unnoticed within the industry, it was never quantified with extensive data. Industry lending was "challenging" but still viewed as "profitable". The cycle played itself out repeatedly.

Mountains of data

Then came the Great Meltdown of 1999-2003. For the first time the reality of all forms of MH lending was dutifully tabulated and reported. Now anyone who cared to know the data had mountains of it to study. What it revealed was disconcerting in the extreme: losses that were mind-numbing, with little hope of sizeable chattel success, and even conforming mortgages were challenging.

The industry transformation that occurred as this realization dawned changed the industry abruptly and continues to constrict any reasonable hope of 200,000 home shipments years, to say nothing of 300,000 plus. Today the figure of 100,000 shipments is on everyone's mind.

The lending from the earliest industry days in the 60's and 70's, through to 1998 allowed a "failed model" to exist and operate in the industry. It is not a model that can exist without substantial losses to both lenders and borrowers, although the former usually takes the losses of the latter. A poor industry model was being subsidized to exist. Once the subsidy was withdrawn, the model stopped working.

Comprehension

It took the industry some time to comprehend the new lending reality, but the pattern now seems settled. Only strong credits can be lent money for chattel placements and they will be at high interest rates and demand "guerilla servicing"; quick acting, highly concentrated action to deal with delinquencies and defaults. In any event, the new model would result in far fewer home shipments and sales, as chattel atrophied.

The industry is immobilized by this new reality. All the things Stinebert discussed above, which now need correction, were possible to avoid confronting for many years because of the lender subsidy, which did not require the industry to abandon its "failed model" and replace it with a rational one. Instead, many avoided accepting the new reality, while others who accepted it were unsettled by the many things that needed to be done. So much was needed. Where do you start? Others thought nothing needed to be done, it would self-correct. The industry did little and leadership was lacking.

Today, the only questions on the table are whether the industry wants to make changes to reduce the market constraints, or whether they want to continue to accept what remains of the old industry, as the remaining sales markets are ever more closed to HUD housing, even the Southeast on a short string.

Out of the niche

And perhaps, just maybe, the question that needs to be answered is whether any changes are indeed possible that will propel the industry out of the housing "niche" into which it has fallen. It may be that some industry players have concluded the safe harbor is a highly reduced industry with less volume (far less) and fewer players (far fewer).

I can only suggest that unless we can do what Stinebert mentions, or at least attempt to do it, the market will have its way. It always does. What you see is what you'll get. The only unknown now is the extent of the industry reduction.

NO HELP THIS YEAR

Wouldn't you know it. Just when the industry could have used a good hurricane season, in the hope our recent Katrina/FEMA debacle could have gone unnoticed, the 2006 hurricane season was a complete bust. Just after everyone was convinced that "global warming" would likely create another destructive hurricane season, with multiple killer storms tossing housing around, no hurricanes hit the continental U.S. Amazing. So much hype and so little action.

On the other hand, FEMA still has a good on-hand supply of misused HUDCode homes in inventory. Because FEMA's incompetence handled the Katrina affair so poorly, they resorted to blaming HUDCode housing for its lack of utility for disaster housing, to take the pressure off themselves.

You might also conclude our political action stopping FEMA from disposing of their unused HUDs into the market did precious little for us while further ingraining in FEMA the poor choice HUDs are for disaster housing. We failed to sell one less home because of our FEMA action, forcing them to keep their HUD home inventory at full, reinforcing what a complete pain in the ass we are to deal with. After selling the homes to FEMA at full retail, we then told them how to use the homes, forcing them to continue to bear the media buzz of the homes in storage and what a bad idea it was to buy those homes in the first place. We join New Orleans's Mayor Nagin in the "big fool" department. Bravo.

THE ANNUAL MHL SHIPMENTS CONTEST

The results are in

As the October shipments results came pouring in the news was so grim it was depressing. With a comparison to last October's figures, when Katrina production began, we were off to a stunning **46.7%**. Since no hurricanes aided our production this year, one could back out the "hurricane" production and compare only normal, non-FEMA production for last October. Still down double digits at minus **11.1%**. Double grim.

I do hope the people running this industry and association are acting with greater urgency in their own businesses than their action as an association. In the face of unimagined and unimaginable home shipments decreases, Roman Emperor Nero looks positively daring as he fiddled while Rome burned, in comparison to this industry's non-response. We seem frozen, our fiddles lost.

The big three items at present at the industry table seem to be **1) the search** for a new MHI President, **2) the merger** with MHARR, and 3) the Industry Image **Campaign**. (The MHIA of 2000 just rolls along and means little.)

The J.D. Power Survey now apparently goes on the back burner until the next poll. I don't expect too much excitement there as I'm not sure yet whether we are going to gain builders joining the survey or lose some. Until all builders are ***involved***, the results are ***made public*** and every builder is ***committed*** to leading the results, the survey is nothing more than an expensive toy. Yes, I favor its use greatly, but we have to accelerate its use and its positive results. We haven't' the luxury of time the auto industry had when they embarked on their J. D. Power survey.

The New One

The new MHI President will no doubt be carefully selected, but what sort of "prodigy" will it take to come into this failing industry and lead it out of the wilderness? (Someone with the initials J.C. might help.) As the new MHI President comes aboard he will not only deal with an industry-threatening episode, but struggle to find the location of the bathroom and his parking space for a while (if the association goes outside to hire).

And then he or she has an industry merger to oversee, then a meshing of the personnel creating the new, improved MHI-MHARR, while forming a new joint operating philosophy, all in the face of industry disarray. Challenging.

Meanwhile, consensus seemingly so important at MHI, the new Image Campaign will get the input of dozens of people who know precious little on the subject, outside consultants will be hired, innumerable follow-ups held, a funding scheme established, and finally, at the very least a year later, the first ad hits, maybe.

This is all a very long way to say that based on the old association model of doing things, the association merger, the image campaign, and new MHI President are extremely unlikely to add one more home shipment to the 2007 shipments pace. The initial pace for '07, by the way, is under 100,000 homes as things stand right now. That is what the trends portend.

The '06 Pace

And the 2006 shipments pace? The "all homes" category, which includes the 3,500+ FEMA homes from last winter, is running at **117,000** homes. The normal, non-FEMA pace, is running at **113,500** homes. No misprint, **113,500** homes, a reduction of about 17,000 homes from the ending 2005 non-FEMA volume.

But hell, don't worry. This industry worked well for 50 years and will again. In fact, I again read an MH stock analyst's pronouncements that as conventional and sub-prime mortgages go into the tank, those lenders, being the unsophisticated dunces they are, will transition their funds from normal sub-prime, already troubled, to deep sub-prime, in fact the Undisputed Sub-Prime Champion, manufactured housing lending, especially on a chattel basis. That way they can increase lender losses, albeit on a different product. Hey, you never know.

The Leader

This contest has settled into the all **Chuck Ladd** Show. **Chuck**, with **Roadmaster Transport, LLC**, had a non-FEMA prediction of **113,760** homes, almost spot-on the present pace of **113,500**. And in the "all-homes" category, Chuck was at **123,760** homes, higher than the present pace of **117,000** homes, but no one was closer. I'm designing his two trophies now.

Memo

Interested in Chris Stinebert's complete column in "The Journal", November '06 issue? Go download it on my website.

Call Today!

802-862-1313

Martin V. Lavin
350 Main Street
Burlington, VT 05401
Mhlmvl@aol.com
802-862-1313

"We cannot direct the wind, but we can adjust the sails." - Bertha Calloway