Volume 6, Issue 9

"END OF AN ERA?"

SEPTEMBER 2006

Marty's News & Notes

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

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Inside this issue:

Chris Departs

I think I am usually fairly well plugged in to what is happening in HUDCodeville, but when the email message came at 4:50 P.M., October 2, 2006 that Chris Stinebert had announced his resignation at MHI, I was caught flat-footed. I did not know, and was not expecting it.

During the 8 years Chris served as President of the association I wondered whether he wasn't occasionally "looking around", but no rumors to that effect ever circulated. But then few, if any, knew of his negotiations with his new association either. I simply wondered how much job satisfaction Chris was getting from an industry in retreat, and often in disarray, with two industry-representing associations at work, and often at odds.

In addition, MHI is a very diverse association with many different business platforms, with the fact they all deal in factory-built housing being the loose tie between the many factions. In larger industries there would be several different associations representing the many disparate interests contained within MHI.

Consensus Elusive

Because of the many different segments and interests it is very hard to meld a common set of goals and during the last 8 year downturn, there has been a notable lack of consensus within MHI. Rent control in land-lease communities might well be favorable to retail lenders, but is an anathema to the community owners. The home retailers and the builders often have very contradictory interests. Contrary aims abound within the association.

Under these circumstances getting any sort of consensus has been virtually impossible. And it shows, even as we approach a **70% shipments pullback** from the last industry top of 1998, precious little consensus has evolved, although flashes are beginning to show. The Roper Report to identify the problems, the Consumer Satisfaction Index to quantify it, and recent industry/GSE meetings are all steps in important directions. Far more is needed as the MHI Shipments Contest results herein indicate, and it can't come too soon.

Having fun yet?

Chris had come under fire recently by some association members, but I'm not sure the criticism should have been directed at Chris personally instead of the association. Chris had lots of bosses to please and couldn't do too much without the proper releases, which didn't always seem forthcoming. Thus, I was somewhat surprised by his recent editorial in The Journal, taking a very strong stand in favor of an Image Campaign for the industry. While I heartily approve, there are some powerful people in the industry who still do not seem convinced.

Yet, as Chris went to work every day, constantly cutting association personnel and reducing budgets, as the industry imploded around him, with no seeming ability by anyone to do much about it, I can only assume it must have weighed on his mind. How can it not be disheartening watching every year under your direction at the association, being worse than the former, for such a long period?

I spoke with some industry powers coincident with Chris' announcement and I am certain Chris moved along to a better opportunity rather than being fired or pressured. His bosses all regretted Chris' resignation and felt replacing him would be a challenge. Even as he presided over a protracted industry funk, he was not blamed for the massive industry drain which took factory-built housing from about 20-22% of new housing starts to about 6-8%, as we fell into the dreaded "niche".

Strange, but when the position offer came, Chris reportedly had been solicited for the job by Tom Hallman, a senior executive at The CIT Group, CIT formerly being a long-time MH lender and member of MHI. CIT exited about 3-4 years ago from industry lending as Hallman reputedly had his fill of MH lending. Rumors persist Hallman was never wild about lending on MH, finding it too much work and too risky. Mr. Hallman has not been alone in that assessment in the last 8 years. The web site for Chris' new association quotes association Chairman Hallman as announcing Chris' acceptance of the new position. (American Financial Services Association, **www.dfsaonline.org**)

Reportedly the members of that association are consumer and commercial lenders of an aggressive stripe and having been in the trenches at HUDCodeville for 8 years was viewed as a big plus for Stinebert by his new charges. For those members of the new association concerned about charges of faulty lending and possibly predatory lending, MH is a product well versed in those concerns. Chris seems extremely well suited to his new association. I personally wish him every success there.

Set me free

The irony is that not only did the new job set Chris free from a challenging industry in trying times, but he reportedly got a substantial raise as well. As one elected industry leader said to me, "Stinebert got an offer he couldn't refuse." There was no question of taking the position once offered. It was only a scant two-three months ago that Danny Ghorbani of MHARR, and others orchestrated the "Chicago Meeting", which could have effectively ended MHI had it gone to the end the instigators sought. I confirmed this thought with Chris myself so know of the angst it caused all MHI employees, including Chris. What a turn of events!

What I do not know yet is whether Chris had already entered into job discussions at the time of the Chicago Meeting. The Chicago move seems quiet for now, but the betting is that far more aggressive government relations will result in the future at MHI. I keep hearing that membership thinks it would be good if a Danny Ghorbani "bomb-throwing-clone" could be found and hired. MHI has had gentlemanly tendencies. I question whether a "Ghorbani" type is any sort of an answer for MHI. I fear it is the wrong strategy. How an industry with the baggage MH suffers can be feisty and combative is puzzling.

The future?

What does the future hold for MHI, the industry and for replacing Stinebert? In my opinion the industry direction has been well known for several years now. Only an unthinking sort would believe the maladies affecting MH lending would correct themselves and of course they haven't. Worse, when lenders made a bona fide effort to bring some order to MH lending working through the association and industry, their efforts were rebuffed and worse. Opportunities have been squandered to set up a long-term industry model correction, which was dramatic in terms of change. It probably would also have been slow to cut to the upside. Not good for an industry seeking the quick growth of the past, and the double-digit shipments "rebound years" of yore.

But these previous rebounds came only and always at the expense of the retail lenders. Difficult as it is to believe, actual MH loan performance figures are still being compiled today and studied for a better understanding of what they mean. In a nutshell, there are virtually no lenders other than the two at Berkshire-Hathaway presently who have successfully prevailed lending on MH over many years. Clayton Homes and its two lenders were sold to Berkshire 3-4 years ago as even their long-term model of lending success was torpedoed by the failure of other lenders and the company was sold.

New lenders coming into the industry to start a new shipments growth last occurred in 1991-1998. Industry participants who have any length of service remember the ever- turning cycle of new lenders coming, as the old failed and retreated, to be replaced by the others as they came a few years later. And always they came. The lure of "high rates" and "high returns" the driver, often coupled with Community Reinvestment Act needs. Repeatedly, none had a real understanding of the reality of MH lending, and many who may have had at one point (GreenTree comes to mind) ultimately got into situations that destroyed their enterprise. It was always the same. The industry was awash in lending failure, and lender failure subsidized the industry at levels not otherwise achievable.

Lending now

The best industry lending I've seen done in my 35 years has occurred since 2003, but it is still a lot of work, a great deal of risk, and not really the comfortable province of regulated institutions like banks. Further, the present lending model only allows a small industry. For most banks, its simply too much work and doesn't fit comfortably into their "first mortgage" culture. One of the ongoing challenges for the industry is to put together a conforming mortgage program which can fit comfortably into a first mortgage mentality, with safeguards, to open the money spigot. This would attract a great many lenders and bring fresh money. It will, however, take discipline and controls.

This all plays into the belief by significant numbers of industry participants that once again the industry will rise as new money enters, and it will not be frightened money like that from existing lenders. The industry attitude in the past has been, why make changes of the type lenders proposed if it would not create a big shipments increase and would take a long time to show any positive results? Why, indeed? There is no question in my mind that as lenders proposed these industry changes, that was really what was on peoples' minds. In the past, the industry wanted retail-lending money, but wanted it uneducated, wanted it fast, and wanted it loose. They have seemed prepared to bet the industry's very existence waiting for its return instead of changing the industry model as needed to attract new lenders. We may be seeing the very early stages of significant changes in this attitude. That is a **mega-step** in the right direction.

Affordable Housing

In addition, industry participants have never concerned themselves that lenders might lose money lending on HUDs. Being affordable housing and there being a great need for that type of housing, lenders should "subsidize" this industry for that reason. That feeling is an industry staple and widespread. Couple this with the thought that it is a social commitment for the GSE's to lend on HUDs, with the previous concept that new lenders always come again, and you can see why the industry was playing its poker hand to the end. Only since recent meetings with MHI and lenders have I seen real evidence that the industry may finally have come about to reality. Still, it needs far more action on our part to seal the bargain to assure a retail lender any sort of an even break. Without government subsidy for the borrowers (not happening), or far-reaching industry enhancements in the value proposition for consumers or both, lenders simply take the loses the borrower would bear if they had the resources to stand up to them, which they generally do not. That dynamic can and must be changed.

Replacement process

As the process to replace Stinebert starts rolling, I'm not sure what the timing will be or the goals. Going outside to bring in an outsider would bring new ideas perhaps, but be hampered by losing several years as the new man struggles to learn the industry. Staying with an insider has the benefit of continuity, but the weakness of potentially carrying on in the same vein as previously for the association. The association's results give little hope that continued trekking of the same course is a wise move. Many in the association are still invested in its present course, but I must admit that recent events give reason for hope. The far reaching changes recently begun are a positive, if brought to fruition.

MHI is like most associations, with many constituencies to please, and in my opinion, little record of making good business decisions. Presumably this weakness could again frustrate a sound decision in replacing Stinebert. My chain of emails on replacing Stinebert reflect lots of different opinions. Others have called me for advice and offered to work as President of MHI in a temporary capacity as needed, to give plenty of time for the right replacement. I have referred them to the search committee.

At this point the only candidate I know who has applied for the job is Michael O'Brien, Chris' right hand man at MHI. Michael has been at the association for a very long time and there can be no question of the man's ability to operate efficiently. He delivers what he promises. I have notified industry leaders that personally I hope Michael will be given every opportunity to qualify for the position. His personal and work habits are tested and he would be an adequate candidate.

If others have applied for the position, I am unaware of their identities. I do know that a search committee will be formed in Tucson at the Executive Committee and that a direction and the goals of the committee will be discussed. Meanwhile O'Brien charts the daily course of the association and it is in capable hands until the position is filled.

Personal thoughts

Stinebert departs after Tucson. Personally, I like Chris, have found him intelligent and engaged, respect him, and if I thought he could have urged greater industry correction, I am throttled back by seeing even our highest elected leaders unable to create consensus with the very wide-ranging interests clamoring at the MHI table.

As so often happens, things have had to get worse before they got better, but the ability to take punishment without capitulating by HUD-Code housing is nothing short of amazing. With this ability to hold out against pain without flinching, I can only assume the depredation of Abu Garib would have been a laugher for HUDCode housing. The industry is that resistant to pain.

Good time to regenerate?

As the incoming MHI chairman, **Barry McCabe of Hometown America**, assumes a two-year term in October, and a new president replacing Stinebert arrives soon, it would seem a good time to chart meaningful choices at MHI. Still, I do not see that as the most likely outcome, the membership still is not entirely comfortable with capitulation of the old industry model, to be succeeded by a far more rational, consumer friendly approach.

The industry has habitually and historically primarily catered to consumers who have not appreciated the consequences of rapid home value depreciation coupled with very long term purchase-money repayment terms. This is especially so with chattel loans in landlease communities. This placement formerly created the largest shipments volume for the industry and has resulted in the greatest lending losses, 25-50% default rates on this type of loan being fairly common with even relatively high (650-680) FICO scores.

If we study the 68% decrease in home volume annually for the industry since 1998, it is this segment, placements into rental communities and chattel financed, which has been almost extinguished, reducing 125-150,000 homes annually, and perhaps more, in shipments. There simply does not seem to be any way to replace this lost chattel volume in a profitable way, with even the Berkshire-Hathaway Group, the best of the lot, very cautious with this loan type. Therefore, we are probably deemed to continue this lost volume, unable at present to finding a way to replace it. If at one time modulars were thought to be the easy hope as a replacement, reality has since set in.

Trends emerge

There are three trends which have arisen and beginning to be tested. It may be these trends break new ground for an industry which has followed the same business model long after parts of it ceased to make any sense.

The three trends are:

1. Building upscale HUDs and modular homes for subdivisions to compete with site-built developers, where ***the factory building the home is also the developer***. This has not generally been done in the past on a consistent basis and the industry has been unprepared to take this risk. Instead, the factories have attempted to find "pick-up truck" builders to do the land development and erection of the homes. These builders have generally been small, poorly capitalized, unsophisticated and located in rural locations. Their success has never been very great, thus the low volume of real estate subdivision sales for factory-built housing.

While using small builders for development has reduced the risk for the factories, the great hope of creating significant, new upscale home sales volume from this channel has been very muted, increasing to only 43,000 homes last year, up from 25,000 homes 10 years ago. No big deal, obviously, and hardly enough to even remotely replace the homes lost to landlease placements that are no longer happening.

Palm Harbor Homes and **Patriot Homes** have led the way, with both having some success. **Champion Homes** has made a major commitment through their Genesis Division. Recently, in a published story, the **Clayton Homes** effort to create real estate residential subdivisions with the houses they produce shows a significant change at that builder. Previously they did not engage in this type of activity, but are touting their 12 subdivisions, with a seeming desire to do even more. Clayton claims a 20% price advantage over a comparable site-built home, delivering real value to the consumer, and greater amenities.

There has been an understanding that factory-built homes do not compete well with site-built homes at the same price point for similar homes. It is believed that in order to succeed factory-built housing must be 20-25% less expensive than comparable site-built housing. Generally, this goal has not been achieved to the extent the industry has desired. Again, in spite of much hullabaloo from industry builders that they in fact can deliver a better product at a cheaper price. This is not always true, with our builders telling me that sales into rural markets away from the metro markets and from the rugged competition of the large site-builders is the most inviting opportunity.

Long-term leases

2. The second trend is the attempt by rental community owners to assure their leasehold residents of capped rent increases by use of written long-term leases to create a better value proposition for the resident, reducing or eliminating home value depreciation, sharing some of the real estate homesite value with the resident and thereby reducing lender exposure of loss severity upon borrower default and repossession of the home.

Let me be plain in saying that I **very much** favor this new trend. It is a lender-desired change, previously resisted by many community owners, but now being accepted by most large community owners as necessary for far better in-park retail lending.

Nonetheless, I have reservations about the success of the initiative. First, many community owners' view of capping the annual rent increases still puts far too great a burden on the resident, with little if any relief to stem home value depreciation. Community owners must understand that lenders cannot successfully engage in chattel lending in communities where the probable rent increases strongly outpace the residents' actual earnings increases. Many community owners continue to try to gain the same return from their homesites as the increase in value annually for site-built, single-family residences. This is highly unlikely to be achievable for leasehold community owners without significant reductions of home value depreciation for the resident.

Secondarily, most persons who have sound credit generally make good life choices and tend to educate themselves about their purchases. Many in this industry have spent years creating home value depreciation through the imposition of annual rent increases reducing the value of the residents' homes. I know I did in my communities. The use of long-term leases to correct this well-known industry proclivity simply through the offer of a long-term lease, especially with rent increases of the type many landlords desire, will not be an easy sell.

So even if long-term leases do have a value, and under certain conditions they do, their acceptability with consumers, especially those with sound credit and especially retirees, will take some time to gain market acceptance. And so long as the annual rent increases pass on rents well above annual resident income increases, acceptance will come hard. While some community owners comprehend this, many still do not.

3. The third and final trend is in its infancy and far from being completed. But I hear strong rumors of a real estate conforming mortgage program geared to approach site-built housing in pricing and underwriting, meant to be generally available to industry lenders, mortgage companies and banks. This is said to be Chris Stinebert's swan-song and if achieved could lead to his canonization in the MH Hall of Fame. We'll follow MHI reports on this one as they evolve, as it could transform industry lending, and ultimately the entire industry.

The Two Big Ones

At the most basic level, two questions remain unanswered that have always plagued the industry, although frequently masked by deficient retail lending which has bolstered an industry far beyond its true potential as the industry model has been constituted to the present day.

The two questions which constantly arise are:

1. Is it in fact true that you can build a home in a factory which results in better construction, with comparable or better materials at a purchase price to the consumer materially lower than a comparable site-built home, once finish-erected?

2. Is it possible to have retail financing programs in factory-built housing which will result in profitable lending with average personnel doing an average job, on a long-term and sustainable basis?

In my mind the two above concepts incorporate almost all of the industry's weaknesses, and at present the answer is a qualified "yes" for 1, and an outright "no" for 2, except as a niche industry. Until the industry can answer, both of the above questions with an unqualified "yes", I'm not sure whether Michael O'Brien, Chris Stinebert, Danny Ghorbani or any other industry leader can create a climate of growth and success in the factory-built housing industry. And in order to answer those questions with a "yes", many changes must take place. So as Chris Stinebert leaves in two weeks, and Michael O'Brien takes charge of MHI on a temporary basis, the industry continues its most difficult chapter since the modern MH era began 30 years ago and as it now seeks a much better future.

The MHL Annual Shipments Contest

Trend Line

It's easy to follow the continuing trend line of the HUDCode Shipments after the two last reports of July and August, both being double digit declines from the shipment levels of last year. I think it fair to say that most observers were not surprised, but still, the mood was not enhanced by the news. Is there no respite? Apparently, not yet.

With the decline in July of 13.9% and August of 11.4%, any hope of stronger activity spurting upwards for a strong '06 finish almost disappeared. Few were contending that these two reversals were anything but another bludgeon to the HUDCode head.

And as analysts released their earning reports for the industry's publicly-held companies, that performance was less than stellar. Both **Palm Harbor Homes** and **Fleetwood Homes** reported lackluster results, although **Cavco** was better, but under expectations. I've noticed there has habitually been a story told by the analysts to explain the acrid results, putting a best light on the earnings results, but consistent success in this industry environment is challenging to say the least. And so the results have shown, as the companies trimmed costs, jettisoned losing entities, and continuously remade themselves to conquer the threats. But the threats, like viruses, adapted quicker than the companies. I do not envy the people in charge of these enterprises, as overwhelming challenges abound.

Population Growth

What can you say of an industry which shipped 120,000 of their products (homes) in 1959, with about

190 million of population and will ship about 120,000 homes in 2006, with a population of 300 million? The answer is that at this point there has been a product shipments decrease of about 50% for our housing type since the shipment levels of 1959. Not only have we not grown, but have actually shrunk. I've covered these trends endlessly in this letter and a trip to my web site will make them all available for your reading if you have the next week off and are a glutton for sledgehammer blows. If the trendy French term "niche" serves your purposes, we are there.

Transition?

We've discussed it some above, but it almost seems certain at this point that an industry transition is in the process of being made. The 1959 industry, (ah for the good ole days) is rapidly diminishing in the rearview mirror and a new industry is being formed. I'm not smart enough to fathom whether the new industry being crafted will succeed in a new round of growth, but I do think the old model, almost entirely dependant on non-profitable chattel retail lending, is almost buried and dead, except as a "niche", under present conditions. The survivable lending there requires too much credit capability by the borrower and there simply are not enough of those to fuel a 250,000 homes or more sized industry. You almost have to think that sticking to the old model will yield about one-half that number, about 125,000 homes

Again, the loser in this product mix of precarious lending is the below average (680) FICO's in landlease communities, especially in working-class types where home value depreciation has been a continuous problem in many, though not all markets. And for this reason lenders do what they can to identify factors other than credit capability to uncover and identify loan elements that might create more survivable lending. But there are few magic arrows available so far.

Real Estate Subdivisions

The continued search for far more competitive real estate subdivision placements of HUDs and mods continues its search for a more aggressive and competitive offering against site-builts. The search for the model to battle the big site-builders with their housing types in their markets continues. In spite of announcements by factory-built housing of conquest pricing and quality, the total of modulars and upscale HUDs in conforming mortgage status barely dents 4% of new housing starts, even after 30 years of practice and assault against the site-builders. If we are to prevail here, the answers are not yet ours. We are still relegated primarily to rural markets, with limited housing demand to compete against smaller site-builders. It's OK, but not the next coming of the Messiah.

Shipments Pace

These are the factors driving our product, as it continues to seek its final bottom, again dipping to scary depths. After consultation with my shipments experts and my own analysis of the present pace, it seems like the "all homes" category, which includes the homes built for our friends at FEMA, is running (walking) at **123,500 homes** for the 2006 final figure, and the pace for homes, excluding FEMA, is totaling about **120,000 homes**. Again, a drop from the previous pace I reported when we last spoke, and one giving little comfort to observers and industry participants.

The Contest leader in the "all homes" category was **Chuck Ladd of Roadmasters Transport, LLC**, with a prediction of **123,760 shipments**, a mere 260 homes more than the actual pace of 123,500. First of all, Chuck hoped in his entry to me that he would be wrong at year-end, and his guess of 123,760 homes was the lowest contest entry in the "all homes" category. No one had a prediction lower than that. Unless shipments take a turn upward, I can order Chuck's trophy now. Chuck also had the lowest non-FEMA home shipments prediction of **113,760** homes**.** Only time will tell if Chuck will be a dual winner. I guess Chuck is not happy with the results, but not surprised by them.

The non-FEMA category is running at a pace of **120,000 homes** and **Joanne Stevens, the Iowa Realty broker** specializing in the sale of land lease communities was the closest at **122,350 homes.** Joanne writes an informative monthly newsletter which I get and enjoy, about LLC's. The runner-up was **Don Fuqua of GreenTree Servicing**, the Sr. VP of Sales, at **122,555 homes**. Both of these predictions were above the actual pace of **120,000 homes**, and only Chuck Ladd was below, with that frightening **113,760 homes**.

Say it ain't so, Chuck.

You say it worked?

Little pleasure can be derived from watching an industry in the process of destroying itself. All too often, since the last industry top of 1998, I keep hearing that the industry worked well for 40 or 50 years and various conditions recently, especially overcautious retail lending and tightening by the money people, have led to an unreasonable hamstringing of the industry. I still get those messages, some with particular vehemence, at times implying that certain lenders or I have become too cautious, have abandoned the industry, and even go so far as to imply a conspiracy amongst lenders has caused this result. Presumably it has been done as blood sport, perhaps the culprits being in the thrall of site-built housing interests, mere Trojan horses bent on scuttling factory-built housing as a threat to the site-builders. Riiiggght....

I would suggest that if instead of waiting around for the last 8 years for the next round of "stupid" retail lending to start again, the industry had used the many summits and meetings to empower a small group of men and women to fashion a comprehensive series of best practices, recommended industry model changes, convened a lender summit, a CSI, and an image campaign, instead of still looking for the bottom, we might well be on our way to a better tomorrow. Ah, 20/20 hindsight you say? Read my last 6 years of newsletters.

Lender Summit

If instead of decrying and roundly obstructing every lender-requested enhancement, perhaps we should have asked for a lender summit and invited them to give us their wish list for actions and acted on it. Perhaps we could again enjoy better financing and a growing number of retail lenders interested in the industry. Instead, precious little recognition was given the grievous losses suffered by our lenders, the attitude being that lenders should expect to lose money to support affordable housing. While that may be a popular industry theme, it bears far less resonance with lenders. Difficult as it is to believe for some industry participants, I am not aware of any lenders who enjoy losing money lending on any product. In fact, those who do, commonly exit that industry and the people involved in the venture **lose their jobs**.

And so it was with The CIT Group, Chase Manhattan Bank, The Associates, Conseco Finance, National City Bank, and a raft of others. They and others are gone and unlikely to return. And still the industry fails to do much of anything to stem this enormous weakness, frequently confronting lenders with demands instead of accommodations.

Eight years has passed. Reading the future seems relatively easy, the trends are fairly clear. Without better retail lending, what will be the catalyst for increased industry activity? Without a more survivable lending environment, how can lending be easier and more profitable without industry changes to encourage these better lending trends? Who can we expect to lose money lending on our product? The answers to these questions should be obvious to all and have needed attention not for 8 years, but for 50 years. It really is past the time when we need to make an effort, as an industry, to address these shortcomings. Otherwise, in spite of the rhetoric, Marty's **First Rule** still controls:

Rule #1: Never mind what people are saying, watch what is happening.

What has been happening for a long period of time is that lending on our product is too difficult and insufficiently profitable for most, over the long haul. In a world where I wait for the pretty lady in front of me to pay for her Starbucks $3.00 purchase with a credit card, I can only assume financing is the key to our sales. And as an industry, we haven't encouraged survivable financing and are now paying the price. **Time for change, anyone?**

Call Today!

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